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Allianz Trade

Eight lessons learned from 20 years of ESG investing

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Allianz Research

Content

Executive Summary

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- **ESG investing is the answer to a double tragedy.** Global systemic risks such as climate change are particularly challenging to address because they embody two intertwined dilemmas: a tragedy of the commons and a tragedy of the horizon. ESG investing has emerged as a mechanism for bridging the gap between short-term pressures and these long-term sustainability imperatives.

- **A bet on change.** ESG metrics as a risk and analytical tool provide an essential lens through which to navigate the investment landscape, focusing on avoiding idiosyncratic risks today while anticipating long-term systemic risks and opportunities tomorrow. Rather than assuming a continuation of the status quo, they enable investors and institutions to manage change and drive innovation.

- **Moving from hype to mainstream.** Investor attitudes towards sustainable investing have evolved from early hype to more sober resilience, reflecting the classic Gartner Hype Cycle framework. Indeed, the performance of ESG investments has been quite volatile over the past 15 years, mostly for the same reasons as non-ESG portfolios. But overall, ESG funds have proven resilient, continuing to see inflows and sustained growth. This shift towards more stable assets shows that sustainable investing has matured, not disappeared.

- **Europe dominates ESG investing.** The extent to which ESG investing is prominent in portfolios varies widely by region. Europe is by far the leader – supportive regulations and strong investor demand have driven sustainable investing into the mainstream. European funds have a much higher proportion of ESG assets as a percentage of total assets under management than any other region – around a fifth, compared with low single-digit percentages in the US or emerging markets.

- **ESG investing is intelligent risk management.** Beyond regional differences, a growing number of investors share a common motivation: they continue to view ESG considerations as a form of prudent risk management that offers strategic foresight. ESG does not guarantee success. But it does provide investors with a structural toolkit to seek, identify and analyze risks and opportunities beyond what can be deduced strictly from quarterly reports.

- **A complement to traditional financial analysis.** Analysis that incorporates ESG considerations works best as a complement – not a substitute – for traditional financial analysis. The metrics are designed to complement, not replace, fundamentals such as earnings and cash flow. They can highlight risks or opportunities that a pure numbers view might miss. Used properly, they can lead to smarter strategic decisions while preserving core financial fundamentals.

- **A fiduciary duty.** Investors' fiduciary duty is increasingly intertwined with prudent ESG-based risk management. By incorporating ESG factors, asset owners and managers are constantly rethinking how they can continue to thrive in an era that looks increasingly different from the past. This refines their pursuit of long-term returns and forces them to balance client demand for ESG with their fiduciary duty, recognizing that ignoring material ESG factors may itself mean failing their clients.

- **ESG investing matters for insurance.** The insurance sector offers a powerful case study of why ESG cannot be ignored. As climate disasters intensify, insurers face rising claims: 2024 was the fifth consecutive year that insured costs from natural catastrophes worldwide exceeded USD100bn. Major insurers, particularly in Europe, have responded by committing to net-zero targets for both their underwriting and investment portfolios to reduce long-term risks. Such forward-looking moves are not just about keeping losses manageable; they also build valuable intangibles such as brand reputation, intellectual property and stakeholder trust.

Lesson 1: A double tragedy requires a new lens

Global systemic risks like climate change are exceptionally challenging to address because they embody two intertwined dilemmas: a tragedy of the commons (each actor benefits from collective climate action but has an incentive to free-ride) and a tragedy of the horizon (the worst impacts lie beyond current planning cycles). Tackling this problem requires unprecedented global coordination over timelines much longer than markets or governments usually consider. ESG investing has emerged as a mechanism to bridge the gap between short-term pressures and these long-term sustainability imperatives. It means integrating broad systemic risks (like climate change or a global financial crisis) and company-specific idiosyncratic risks (like governance failures or product defects) into decision-making. It encourages extended time horizons, "big picture" thinking and adaptation to societal and environmental shifts.

In this context, asset owners, who are particularly susceptible to systemic risks in their business models – as opposed to asset managers that can outcompete even in a falling market – have more vocally signaled the long-term risks that they experience and forecast. Businesses that benefit from perpetuating the status quo have an easier time justifying and obstructing the process of addressing systemic risks, and those that need these risks addressed are faced with the problem – continually – of what is the best way to do so. This splitting of interests on how to address these risks leaves a fragmentation of voice and action.

Lesson 2: ESG is a bet on change

Rather than assuming the continuation of the status quo, integrating ESG is ultimately about preparing for the future, enabling investors and institutions to manage change and drive innovation. It does so by using current performance indicators for idiosyncratic risks, while considering systemic issues via sustainability mindsets. Investors and firms that take ESG seriously are working to avoid immediate value losses, whereby those taking a strong sustainability approach position themselves for a world inevitably shaped by the low-carbon transition and evolving social expectations.

This does not mean placing all business strategy on one outcome, like 1.5C alignment – which looks increasingly unlikely as a global goal. Instead, it means orientating ourselves to be resilient in a 1.5 scenario and any other lower-carbon scenario than the current trajectory. Efforts are focused on the 'no regret' decisions we can take today, while continuing to support the real economy in meeting the most ambitious commitments of the Paris agreement.

Already nearly half of the world's 2,000 largest companies have set formal net-zero targets (and another ~11% have pledged to) – a broad shift beyond short-term profit motives. Companies known for responsible, long-term practices tend to attract loyal customers, talented employees and patient investors, translating into durable competitive advantages over time. In a real sense, strong sustainability performance – in the form of setting durable commitments and targets and then measuring, reporting and verifying progress toward these targets – builds trust and brand value that support sustained returns. Over time, investor sentiment rewards these firms if they believe ESG leaders are more attractive long-term investments than those focused purely on short-term financials. Thus, sustainability – embodied in brand trust and stakeholder goodwill – becomes a strategic factor in investment portfolios, indirectly influencing valuations and capital flows.

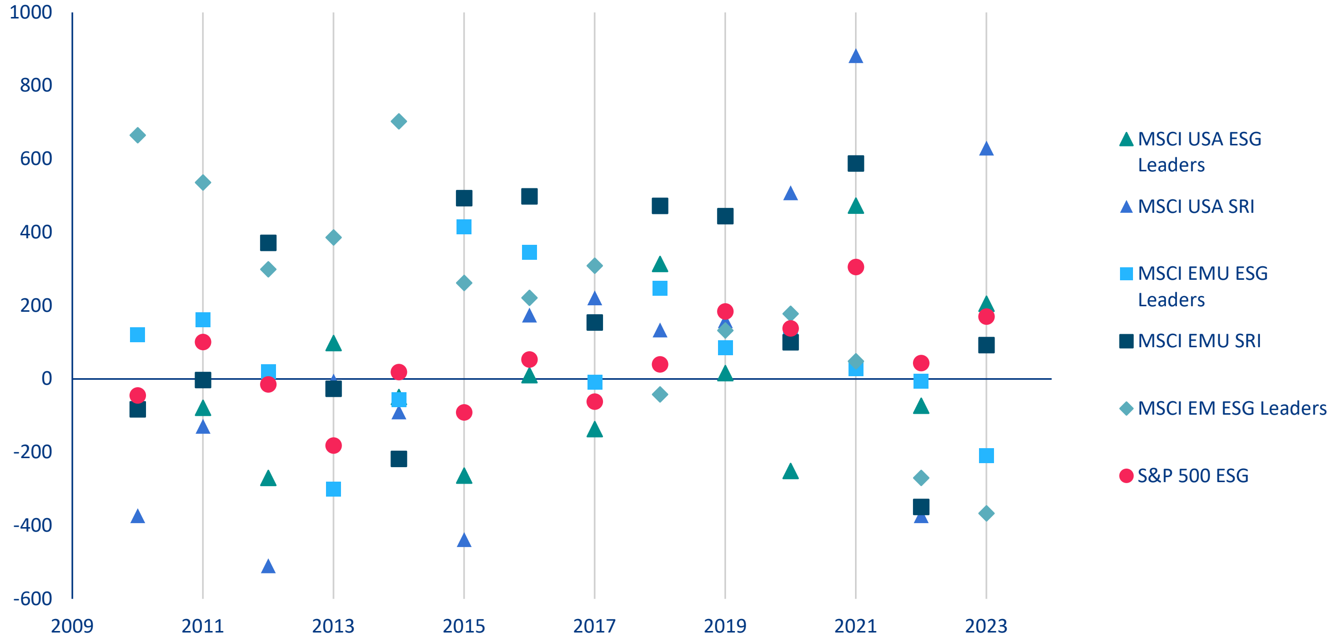
Lesson 3: From hype to resilience

Investor attitudes toward sustainable investing have evolved from early hype to a more sober resilience. In the mid-2010s, a wave of optimism drove a surge of capital into funds that took into account ESG considerations when doing fundamental analyses. These funds started naming conventions like "green" or "ESG", and capital flows into them was pushing into the trillions. Some of that enthusiasm was excessive, and it combined with actors jumping on the bandwagon by doing very little to integrate ESG-related KPIs, instead assigning an ESG label but only doing some surface-level activities like adding exclusions on earmarked industries. ESG was used as a superficial marketing tag rather than a rigorous analytical approach. Such window-dressing led to confusion and backlash, as shallow ESG claims were rightly criticized for failing to deliver real risk management or value.

As a result, by the early 2020s, the market was increasingly confused between those who address ESG risks, those who do so nested within a wider sustainability approach and those doing window-dressing activities and then just calling it ESG. This made it difficult to understand performance and to distinguish between good and lazy actors. Hence, the market started to self-correct as investors realized simply having a green symbol on a ticker or an ESG word in a title is not a guaranteed win: over time, ESG funds have sometimes outperformed and sometimes underperformed and disentangling the drivers is difficult.

In fact, the performance of ESG investing over the last 15 years has fluctuated quite widely and mostly for the same reasons as non-ESG portfolios do, driven by macroeconomic conditions, global crises and sector-specific trends. For example, ESG strategies suffered substantial losses in 2022 amid the Russia-Ukraine war and the resulting energy crisis that drove up energy prices and led to outsize returns for oil and gas companies and gas utilities. ESG investing does not guarantee outsize returns, but it is also no drag on performance for the sake of ethics. Over the last decade, sustainable investments delivered comparable returns to traditional investments. Normal rules of investment strategies still apply (Figure 1).

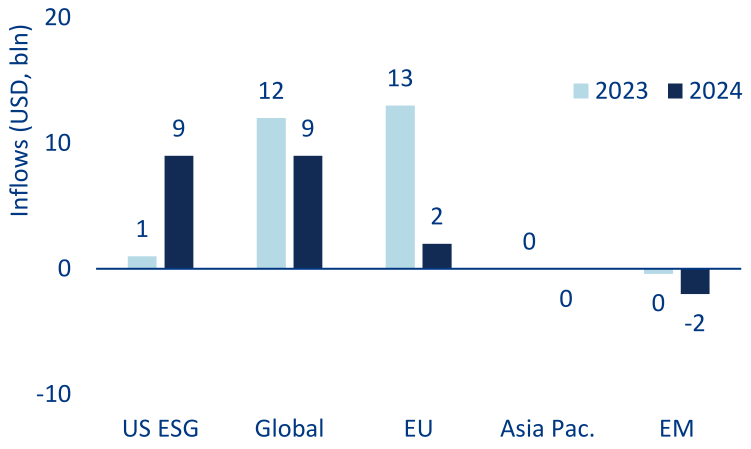
Figure 1: ESG alpha returns over time in bps



Sources: Roncalli, T. (2025), Handbook of Sustainable Finance, Allianz Research

The crucial point is that by marrying ESG data on idiosyncratic risk with systemic risk considerations, competitive returns can be achieved. As a consequence, ESG funds have proved resilient, continuing to see inflows and durable growth. This shift toward steadier assets highlights that sustainable investing has matured, not vanished. This applies in particular to ESG bond funds, which have proven resilient, maintaining modest yet steady inflows (Figure 2). This trend aligns with investors who are recalibrating their enthusiasm and reallocating ESG capital towards the relative stability of fixed-income assets. In turn, it reinforces the argument that while ESG fervor in equity markets has cooled, sustainable investing remains a core strategy; the bond market's continued ESG commitment underscores a more stable, long-term confidence in ESG principles. ESG remains a core part of many portfolios – now pursued with more realism and discipline than at the height of the hype.

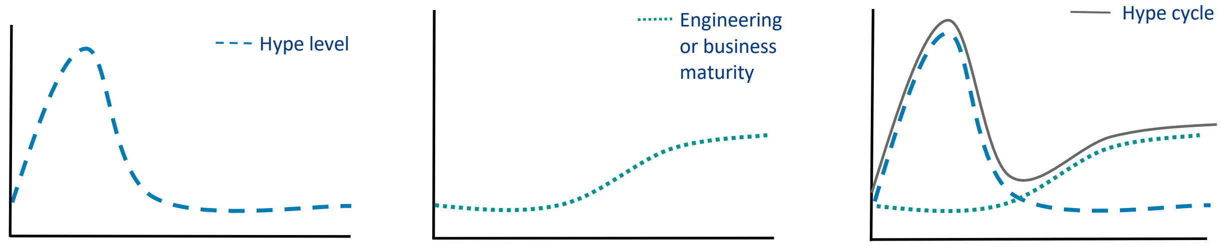
Figure 2: Bond ESG fund net inflows in USD bn



Sources: EPFR Global, Allianz Research

This evolution – from hype to disillusionment to moving to the mainstream – might have annoyed many investors but it is a rather normal pattern. In fact, it mirrors the classic Gartner Hype Cycle framework (Figure 3). During the initial boom, ESG reached a peak of inflated expectations as surging inflows and optimistic analyses fueled sky-high hopes. When real-world performance and implementation complexities failed to fully live up to those outsized expectations, enthusiasm cooled – effectively plunging ESG into a trough of disillusionment, marked by slower fund flows and rising skepticism. Interest waned and some early advocates pulled back. Yet, this correction has not invalidated ESG's core premise or long-term potential.

Figure 3: The Gartner Hype Cycle framework



Sources: Dedehayir, O. and Steinert, M. (2016), The hype cycle model: A review and future directions, Allianz Research

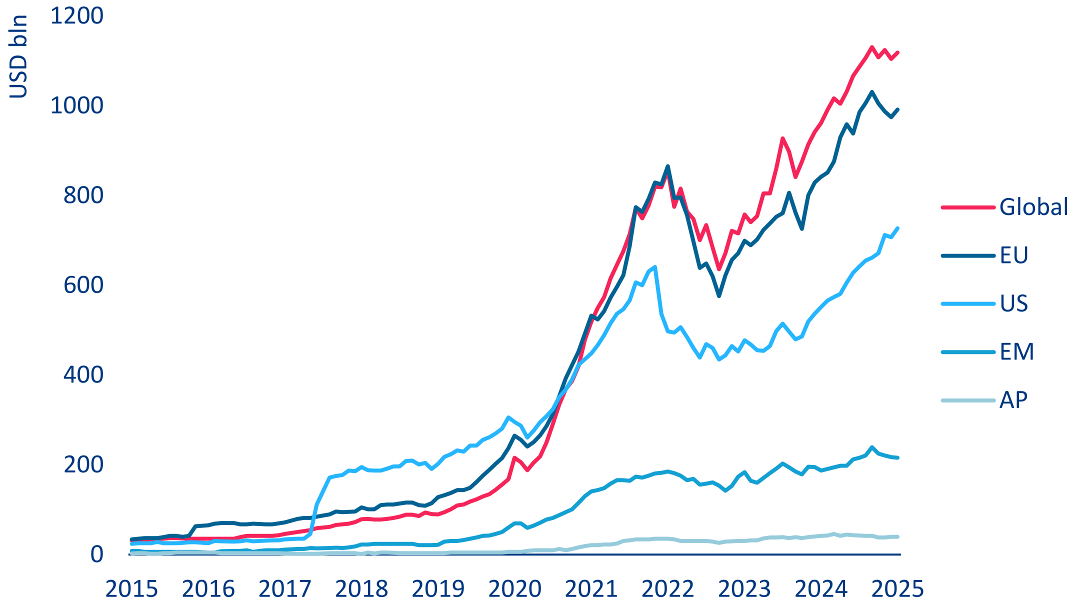
As the hype dies down, investor focus is shifting from grand promises to concrete outcomes – a transition that signals the climb up the slope of enlightenment. Market participants are learning from early missteps and refocusing on tangible value creation and risk mitigation. While a vocal minority of investors and policymakers seized on the pullback to question ESG's legitimacy (branding it a "woke" or political agenda), the forces propelling ESG remain firmly in place. Regulatory pressures, long-term risk management imperatives and stakeholder demands for corporate responsibility continue to push sustainable investing forward. According to Gartner's model, such temporary disillusionment is not a permanent defeat but rather a normal precursor to broader adoption. Accordingly, ESG investing is expected to mature and eventually attain a plateau of productivity, where sustainability integration becomes standard practice and yields consistent, measurable returns.

Lesson 4: Europe is in the lead

The extent to which ESG investing is prominent in portfolios varies widely by region, shaped by different realities of what makes local businesses (those heavily weighted in respective investor portfolios) successful or not, regulations and politics. On regulation Europe leads by far – supportive rules and strong investor demand have made sustainable investing mainstream and given Europe a bigger share in ESG assets than other regions (Figure 4).

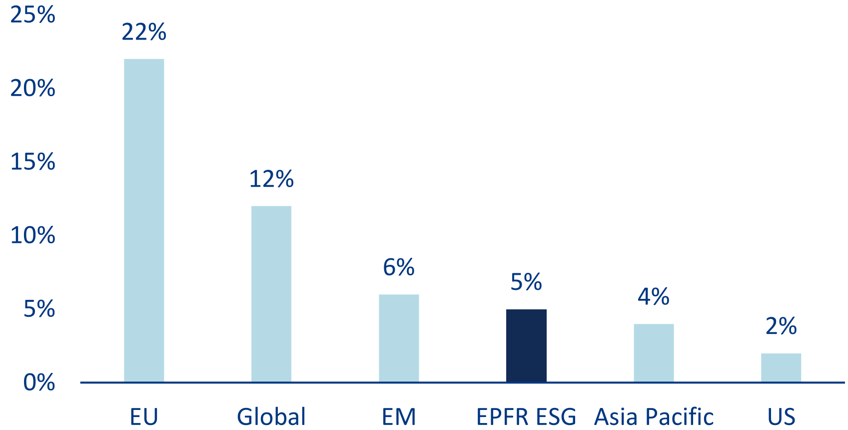
In particular, major regulatory initiatives such as the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy have been introduced to increase transparency and direct capital toward sustainable investments. These policies help drive more structured ESG practices, for example by requiring the adoption of credible net-zero transition plans as part of the EU Corporate Sustainability Due Diligence Directive effective 2028. As a result, European funds have a far higher proportion of ESG assets relative to their total assets under management (AUM) than any other region – roughly one-fifth of all European fund assets are ESG-oriented, compared to low single-digit percentages in the US or emerging markets (Figure 5).

Figure 4: ESG funds' AUM by regional focus in USD bn (end-2024)



Sources: EPFR Global, Allianz Research

Figure 5: Share of ESG funds in total AUM (%)



Sources: EPFR Global, Allianz Research

The low adoption in the US reflects in part the politicized pushback that casts ESG as part of a "woke" partisan agenda. However, it is difficult to find companies that are commercially successful, even in the US, without also having strong sustainability performance relative to their peers. This is seen in the extent to which the ESG scores are much stronger in the west and developed countries – though that is a trend that is ending. As a result, even though the majority of successful companies put a high standard on strong sustainability performance as a response to market demands of customers, shareholders, suppliers and communities, the free market nature of this attitude means adoption into regulation in the US lags. ESG metrics are seen as a means of risk mitigation and mission alignment, with less direct regulatory compulsion.

Further, given the significant size and influence of companies in the US that operate in sectors that benefit from maintaining the status quo – and given the very nature of the US's built environment and the population's consumption habits – there is strong opposition from companies that are threatened by the energy transition and their trade associations. Consequently, they challenge efforts to accelerate the transition via regulation.

Meanwhile, Asia-Pacific and other emerging markets are catching up fast. Though starting from a smaller base, these regions have logged rapid growth in investee companies as awareness that their operations must be accepted and rewarded by their stakeholders has increased, and therefore looking after sustainability performance has also increased. This has also largely been spurred by systemic issue awareness like climate change when governments roll out their own economic plans to capitalize on the need for sustainable economies, and the fact that getting there first can strongly position themselves as leaders. This is further supported by their requirements on green finance initiatives. The global gap in sustainability focus is expected to narrow, even if Europe's head start persists for now.

Lesson 5: ESG as smart risk management

Besides regional differences, a growing number of investors share a common motivation: they continue to view ESG considerations as a form of prudent risk management that offers strategic foresight. Applying an ESG lens via active stewardship[1] teams helps identify non-financial idiosyncratic risks – from health and safety performance standards to supply-chain diligence – that could materially undermine short-term returns and long-term viability. At the same time, sustainability focus on broader trends and systemic risks helps determine investment views and leads to investors implementing methods for aligning portfolios with structural trends and stakeholder expectations, effectively future-proofing investment strategies.

In Europe, regulators reinforce this logic through mandatory sustainability disclosures and credible transition plans. But even in less regulated environments, investors increasingly recognize that overlooking ESG risks is an incomplete picture on company evaluations and avoiding sustainability considerations is shortsighted. The objective is not virtue signaling, it is resilience: building strategies robust enough to avoid incidents and negative attention from idiosyncratic problems while using sustainability informed strategies to weather long-range disruptions rather than being blindsided by them. Regardless of political noise, the transition to low-carbon, high-efficiency technologies is not a matter of if but when – and how fast. This shift is anything but smooth or linear. It creates a dual landscape: on one side, the risk of stranded assets in high-carbon, low-efficiency sectors or among holdings most exposed to unmitigated climate risk; on the other, a spectrum of investment opportunities in low-carbon, high-efficiency technologies and assets better positioned for climate resilience. In the end, the business case for considering ESG and applying convictions on society and business trajectories by considering sustainability topics is anchored in financial materiality. ESG risks are financial risks.

[1] Stewardship is the proactive responsibility of investors to guide and oversee the companies they invest in, with the aim of safeguarding long-term value. It involves using one's influence as an owner or lender – through activities like voting, setting expectations and strategic dialogue – to ensure investee companies manage material ESG risks and sustainability issues. Effective stewardship means helping companies to mitigate risks and capitalize on opportunities for sustainable growth.

Lesson 6: Integrating ESG with traditional financial analysis

Analysis that builds in ESG considerations works best as a complement – not a substitute – to traditional financial analysis. The metrics are meant to augment fundamentals like earnings and cash flow, not replace them. They can highlight risks or advantages that a purely numbers-only view might miss. For the same reason that industrial players built in health and safety metrics into their performance scorecards, especially focusing on risky situations and near losses, investors should adopt a ESG lens: an identified risk in risky incidents precludes loss events occurring. In practice, this means neither chasing ESG scores at the expense of financial basics nor ignoring ESG data altogether. Instead, the goal is to integrate material ESG insights into the valuation process to get a holistic picture of a company's short to mid-term performance and potential idiosyncratic risks, also as a proxy to understand their sustainability performance and longer-term prospects. Otherwise, investing with ESG blind spots is like flying with one eye closed – it gives an incomplete view of potential risks and returns. It's the holistic score that drives real business outcomes.

Lesson 7: ESG is a fiduciary duty

Investors' fiduciary duty is increasingly intertwined with ESG-based prudent risk management. Major asset managers are already planning for a low-carbon future. BlackRock, for instance, "anticipates" around 75% of its portfolio holdings to have science-based climate targets by 2030 (up from 25% in 2022). This forward-looking stance reflects a recognition that focusing on near-term returns without consideration to the extent that they can succeed in a rapidly evolving business and societal landscape is no longer sufficient. As a consequence, fiduciary responsibility is being reframed: in the absence of clear guidance from asset owners and clients, it has always been assumed that pushing for the most immediate returns is the default objective. However, it is increasingly clear that when pursuing their risk/return objectives clients and asset owners value business models that do not boom and bust, lack resiliency or harm the long-term performance of economic system as a whole. Therefore, acting in clients' best interests now explicitly includes looking beyond the next quarter. Neglecting foreseeable ESG risks is a bet that the market or society will not price them. Given the history of backlash against companies performing poorly on ESG topics, ignoring such factors will increasingly be seen as negligent, since these factors will shape financial performance in the coming decades. Investors not acting on sustainability are in effect betting that the markets cannot and will not perceive the risk. That is clearly myopic. Together, net-zero pledges – with the call for other actors to meet their own commitments – and this enlightened view of fiduciary duty, act as anchors that keep capital focused on the far horizon and help overcome the short-termism plaguing markets.

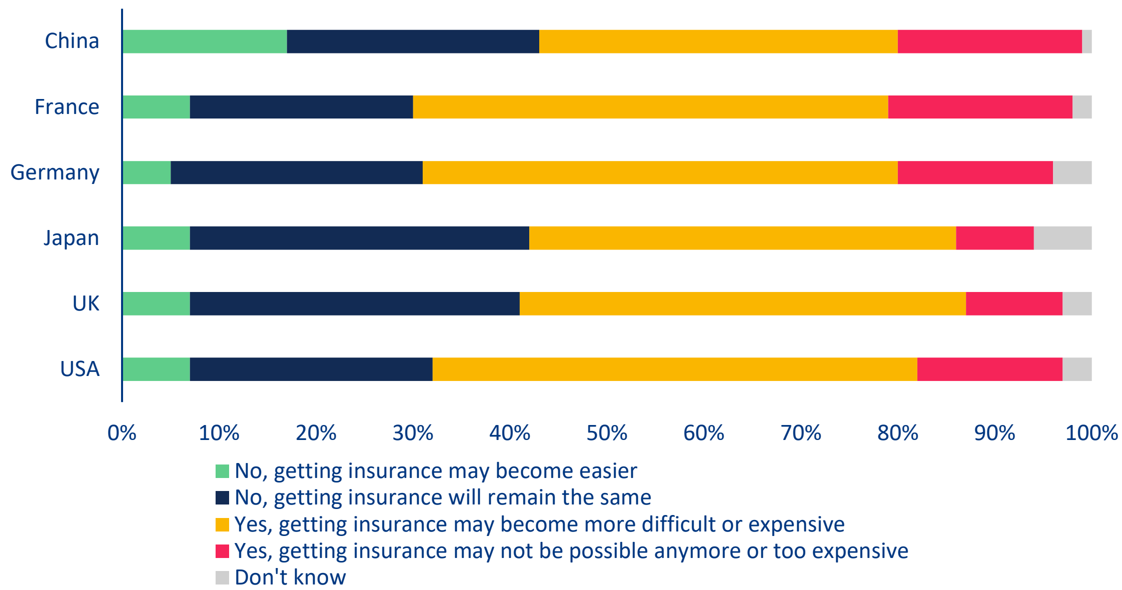
Therefore, shareholders and beneficiaries of both asset owners (e.g. pension funds, insurers) and asset managers expect robust ESG integration as the norm. This translates into demands for transparency in ESG goals and results, diligent management of long-term risks (like climate change), and strategies that enhance resilience – all while delivering prolonged financial performance. Asset owners are pressing their external managers to follow suit: a newly found, mainly UK based USD1.5trn climate stewardship coalition, for example, signals that if managers fall short on ESG criteria, they risk losing mandates. These are not empty threats: One of the UK's largest pension funds, The People's Pension, moved GBP28bn out of State Street Global Advisors to Amundi and Invesco, explicitly citing the new managers' stronger commitment to sustainability, active stewardship and long-term value creation. At the same time, asset managers are balancing client demand for ESG with fiduciary duty, recognizing that ignoring material ESG factors can itself mean failing their clients. In short, aligning investment practices with ESG principles has become key to meeting stakeholder expectations across the investment chain.

Lesson 8: The insurance industry as a powerful case study

The insurance sector offers a telling case study of why ESG factors cannot be ignored. As climate disasters intensify, insurers face rising claims: 2024 was the fifth year in a row in which insured costs from natural disasters worldwide exceed the USD100bn mark. This raises the question of adequate and affordable insurance cover. The decision of some insurers to withdraw from covering some vulnerable areas is a brutal wake-up call. According to a study by the Geneva Association, well over 50% of respondents believe that it will be more difficult to obtain insurance coverage against natural hazards in the future; almost 20% of respondents in France, Germany and the US even fear that insurance cover could become impossible or far too expensive. (Figure 6)

Major insurers, especially in Europe, have responded by committing to net-zero targets across both their underwriting and investment portfolios to reduce long-term risks. Such forward-looking moves are not just about keeping losses manageable; they also build valuable intangibles like brand reputation, intellectual property and stakeholder trust. These intangible assets comprise an increasingly large share of corporate value (over 80% of S&P 500 market capitalization). These intangibles are deeply influenced by a company's sustainability performance and even command a premium in the market.

Figure 6: Are you concerned going forward it may become more difficult or even impossible to get insurance for natural disasters? Answers in %



Sources: The Geneva Association (2023), The value of insurance in a changing landscape, Allianz Research

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