

Sustainable finance in 2026: Turning frameworks into outcomes

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Trade policy and sustainability are increasingly becoming intertwined.

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What will define sustainable finance in 2026? After years spent building rules, disclosures, and investment frameworks, sustainability is now embedded in the machinery of markets.

Green bonds have reached scale, disclosure regimes are taking hold, and environmental, social and governance (ESG) due diligence has become standard practice across asset classes.

The challenge ahead is no longer about architecture but about outcomes: can these frameworks translate into measurable results amidst higher financing costs, accelerating climate impacts and shifting geopolitical priorities?

Geopolitics enters the sustainability arena

US political backlash remains one of the sharpest risks as state-level ESG bans, Employee Retirement Income Security Act (ERISA) lawsuits and suspended Securities and Exchange Commission (SEC) rules have fractured the market.

European investors holding US renewables learned the hard way: Ørsted's shares plunged nearly 80% from their 2021 peak after offshore wind projects were cancelled, forcing a \$9.4bn rights issue at a 67% discount.

More broadly, the S&P Global Clean Energy Index has underperformed the S&P 500 massively since president Donald Trump's return, illustrating the impact of geopolitics on portfolios.

Geopolitical instability is also reshaping ESG boundaries. Wars in both Ukraine and the Middle East have revived debates about whether defence spending should qualify as sustainable.

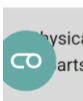
European pension funds are split, with some now calling defence a form of societal resilience, whilst others reject it outright on ethical grounds. Investors face definitions that are fragmenting less by regulation than by value perspective.

Meanwhile, the EU's Carbon Border Adjustment Mechanism, phasing in from 2026, should impose tariffs on carbon-intensive imports such as steel, cement, aluminium, and fertilisers.

Supporters see it as levelling the playing field, while critics from China, India, and Turkey call it protectionism. For investors, it is another reminder that trade policy and sustainability are increasingly becoming intertwined.

Capital under pressure: higher costs and climate risks

The cost of capital is now a central constraint. Even after ECB cuts, refinancing rates stand at 3.25%, a sharp contrast to the near-zero era. Offshore wind projects, typically financed with 70% to 80% leverage, are under strain, whilst Vattenfall and others have cancelled projects. Transition assets still offer growth but their economics must now withstand tougher discount rates.



Physical climate risk is also accelerating a repricing. Insured catastrophe losses exceed \$100bn annually, rising 5%-7% each year. Insurers have withdrawn cover from parts of Florida and California, while floods and heatwaves in Europe since 2023 have damaged crops and infrastructure.

As coverage becomes more expensive or unavailable, assets in exposed areas lose value and risk becoming uninsurable. Climate exposure is no longer a distant risk but a factor directly shaping valuations.

Sharper rules, stronger data

Trends in ESG labelling point toward fewer but more credible claims. Regulators, led by the European Securities and Markets Authority (ESMA), now require that terms like 'sustainable' or 'green' be backed by concrete allocations, exclusions, or alignment with EU climate benchmarks.

By mid-2025, nearly one in five funds had already rebranded. For asset managers, sustainability labels may be fewer and tougher to earn but that makes them more credible and valuable for investors.

Europe's disclosure regime provides a parallel tailwind. The 2025 Omnibus revision narrowed Corporate Sustainability Reporting Directive (CSRD) coverage from nearly 50,000 to about 7,000 of Europe's largest firms, trading breadth for depth.

This delivers audited, comparable, and decision-ready data that strengthens risk analysis and engagement. The drawback is reduced visibility on mid-caps and supply chains.

For long-term capital allocation, the quality of disclosure matters more than quantity and Europe is setting the benchmark.

Flows and asset class growth

Capital continues to follow policy clarity. Morningstar data shows \$8.6bn of inflows into European ESG funds in the second quarter of 2025, compared with \$5.7bn of outflows in the US.

The trend is widening. Europe's flows have stabilised for several quarters, while US funds have seen six consecutive quarters of redemptions. Investors clearly reward environments where rules are consistent.

Sustainable bonds have reached scale. With \$6trn outstanding, they now provide liquidity, duration and clearer impact alignment than equities. Sovereigns and corporates are expected to expand issuance in 2026, reinforcing fixed income as the workhorse of sustainable finance.

Private markets are also demonstrating that sustainability supports performance. A 2025 Principles for Responsible Investment (PRI), Bain and NYU Stern survey found exit multiples increased 6%-7% when sustainability initiatives were embedded in private equity, with three-quarters of investors reporting a material impact.

Impact on strategic allocation

Asset class mix must balance defence and growth whilst sustainable bonds provide the defensive backbone. Private equity and infrastructure offer growth where credible transition playbooks are in place.

Public equities demand a selective approach, with investors favouring companies whose sustainability strategies are backed by a strong business case.

Risk budgeting has become structural. Policy reversals and physical climate hazards now need to be treated alongside duration and foreign exchange (FX) in every portfolio stress test.

Investors can no longer model returns without explicitly integrating climate and policy risk – exactly the approach the European Banking Authority is embedding with the arrival of Capital Requirements Directive 6 (CRD6) in January 2026.

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