Policy Brief: Climate Policy, ESG, and Financial Stability in the U.S. (2010–2025)

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Date: August 2025

Executive Summary

Climate change and the rise of environmental, social, and governance (ESG) considerations have become central to U.S. financial stability debates between 2010 and 2025. Increasing frequency of climate-related shocks, heightened investor demand for ESG-aligned assets, and evolving regulatory expectations have reshaped the operating environment for banks, insurers, and capital markets. This policy brief examines the intersection of climate policy, ESG finance, and financial stability, highlighting vulnerabilities, policy gaps, and potential reforms to ensure the U.S. financial system remains resilient to environmental and transition risks.

Background

Over the past 15 years, climate risks have transitioned from being viewed as long-term externalities to near-term financial stability concerns. Wildfires, hurricanes, and flooding have resulted in billions of dollars in insured and uninsured losses. Concurrently, investors have redirected trillions of dollars into ESG funds, green bonds, and sustainable finance vehicles. Regulatory bodies such as the Federal Reserve, SEC, and CFTC have begun integrating climate considerations into supervisory frameworks, though progress has been uneven compared to the EU and UK. The U.S. financial system faces dual challenges: managing the physical risks of climate change and the transition risks associated with decarbonization policies and shifting investor sentiment.

Key Findings

- Climate-related losses are increasing in both frequency and severity, raising solvency and liquidity concerns for insurers and banks.
- ESG investment demand has surged, with U.S.-domiciled sustainable funds surpassing $400 billion AUM by 2023.
- Disclosure and taxonomy gaps hinder consistent ESG reporting, leading to risks of greenwashing and misallocation of capital.
- Climate stress testing and scenario analysis remain underdeveloped in U.S. regulatory practice compared to global peers.
- Transition risks (carbon-intensive sectors, stranded assets) pose concentrated risks to regional banks and energy-exposed states.
- Absence of a unified U.S. climate policy framework creates uncertainty for financial institutions and investors.

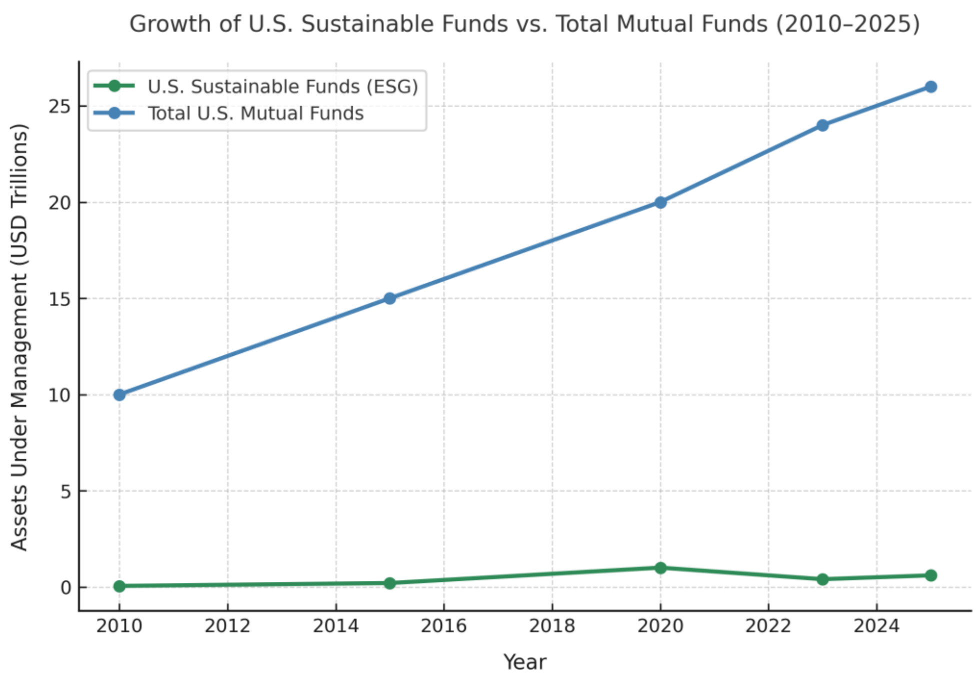

Figure 1: *Growth of U.S. sustainable (ESG) funds versus total mutual funds, 2010–2025. Source: Morningstar, Federal Reserve, SEC estimates*

Policy Recommendations

1. **Strengthen Climate Risk Supervision:** Expand Federal Reserve and OCC frameworks to include climate scenario analysis and stress testing for banks and insurers.
2. **Enhance ESG Disclosure Standards:** Support SEC initiatives for mandatory ESG and climate-related reporting, aligned with international standards (ISSB, TCFD).
3. **Foster Green Finance Innovation:** Incentivize issuance of green bonds, sustainability-linked loans, and ESG-focused capital instruments.
4. **Address Transition Risks:** Develop targeted support and monitoring for carbon-intensive sectors to mitigate abrupt dislocations in credit and equity markets.
5. **Promote Public-Private Collaboration:** Build partnerships between regulators, industry, and academia to advance data collection, modeling, and risk management tools.

Conclusion

Climate policy and ESG considerations are no longer peripheral—they are integral to U.S. financial stability. Physical risks, transition challenges, and investor expectations collectively reshape the operating landscape for financial institutions. By advancing climate risk supervision, improving ESG disclosures, and fostering innovation in sustainable finance, the U.S. can enhance the resilience of its financial system while supporting the broader transition to a low-carbon economy. Timely reforms will be critical to ensure that the financial system not only withstands climate shocks but also channels capital toward sustainable economic growth.

References

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