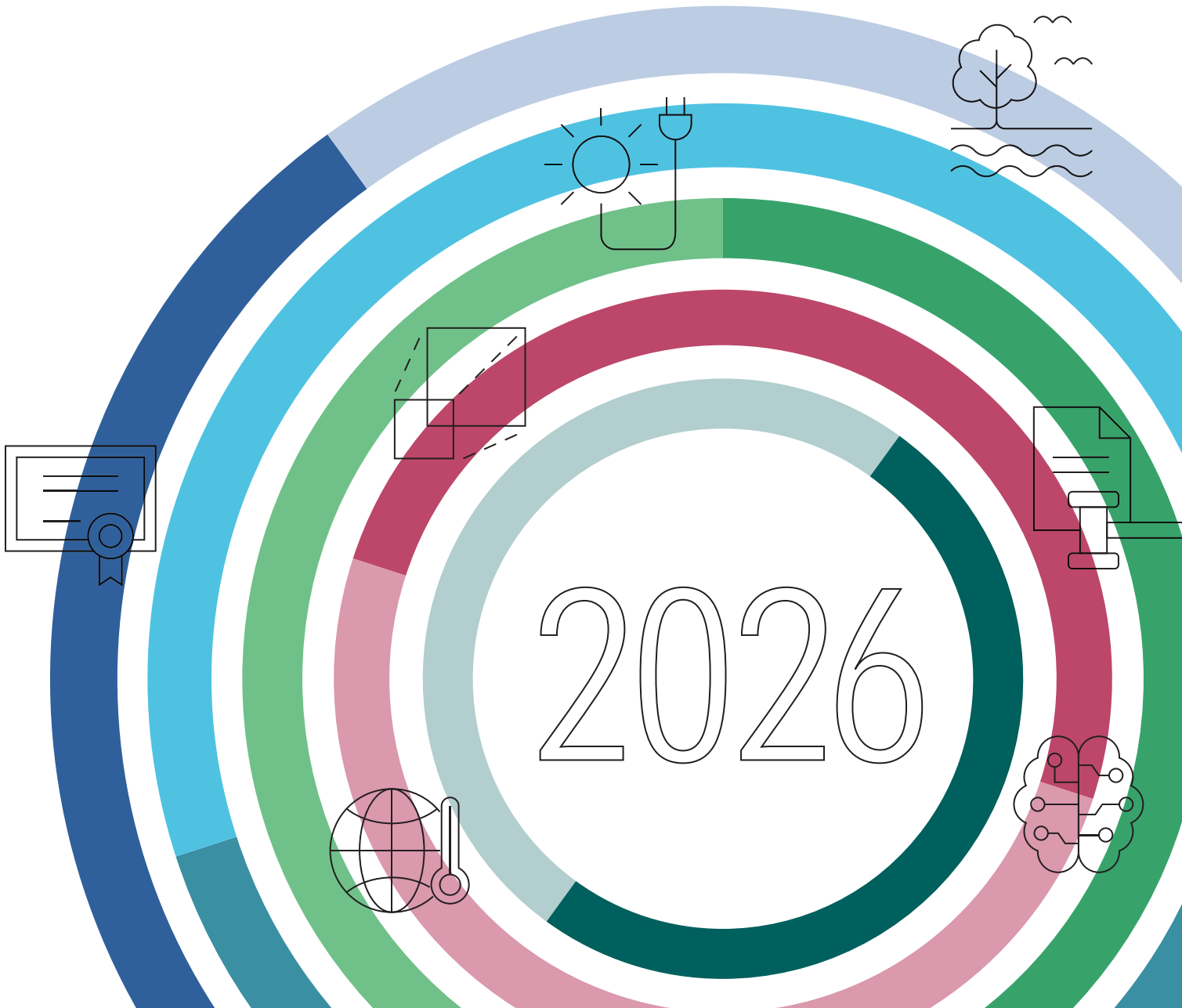


Sustainable Investing Trends to Watch in 2026



Contents

Introduction	3
Sustainable Investing Recalibrated	4
<ul style="list-style-type: none">• 2025 brought new standards and a reframing of sustainable investing narratives• The priority in 2026 will be to demonstrate tangible value and drive innovation	
ESG Regulations: An Ongoing Test to Delivering Value	6
<ul style="list-style-type: none">• ESG regulatory backlash resets the rules for long-term sustainable finance• The global focus will remain on mandating ESG disclosure, less so on taxonomies	
Climate Risks Evolve: From Transition to Adaptation	9
<ul style="list-style-type: none">• Assessing the credibility of transition plans is a key challenge• Physical risks and adaptation will rise on investors' agenda	
Climate Investing in Private Markets: A Mixed Picture	12
<ul style="list-style-type: none">• Energy transition infrastructure will continue to drive growth• Venture capital will have selective appetite amid headwinds	
A Maturing Sustainable Bond Market	16
<ul style="list-style-type: none">• With the sustainable bond market reaching maturity, the focus turns to innovation, supported by stronger standards	
Investors at the Frontline of Biodiversity Action	19
<ul style="list-style-type: none">• Mixed regulatory signals have slowed progress on biodiversity• Growing investor concern will drive deeper integration of biodiversity risks	
AI: Key ESG Risks to Monitor	21
<ul style="list-style-type: none">• ESG risks related to AI are set to accelerate• Areas to watch include energy and water consumption, cybersecurity, and workforce dynamics	

Introduction

Sustainable investing enters 2026 at a critical juncture. The past year brought political headwinds and regulatory setbacks, prompting some investors to question the importance of sustainability. In this context, we outline seven key trends likely to shape sustainable investing conversations in 2026.

First, we discuss how sustainable investing is evolving in response to changing market conditions, regulatory shifts, and new government priorities focused on growth, competitiveness, and security. In 2026, the priority will be to demonstrate the tangible value of sustainability considerations.

Despite the negative headlines and some pullbacks, climate change is set to rise higher on investors' agenda. We expect the focus to remain on climate transition, while increased attention will be paid to physical climate risks and adaptation.

The opportunities created by the energy transition will become even clearer, with private markets playing a larger role in scaling infrastructure and driving innovation. The strategic role of clean energy—both in meeting growing energy demand and ensuring energy security—will keep momentum strong.

This report also examines the outlook for the green, social, sustainable, and sustainability-linked bonds (GSS+) market, which is maturing. Thematic bonds have become a key financing tool for the transition, and stronger standards, combined with continued innovation, will support their growth.

Meanwhile, investors will remain at the forefront of biodiversity action, as regulatory momentum stalls. Despite a lack of quality data, investors are increasingly eager to integrate biodiversity considerations into their decision-making.

Finally, we expect artificial intelligence (AI), a major investment theme in 2025, to come under greater scrutiny from investors in 2026, as its rapid adoption is accelerating ESG risks. Beyond the environmental impacts, governance issues and broader societal concerns are gaining prominence.

Together, these themes reflect a more complex, fast-evolving sustainable investing landscape, where financial materiality, innovation, and measurable impact are essential for long-term success.

Hortense Bioy, CFA, Head of Sustainable Investing Research



Sustainable Investing Recalibrated

In 2026, the priority will be to demonstrate value and drive innovation

Geopolitical tensions, the ESG backlash, and uneven policy progress have led to a recalibration of sustainable investing, with a shift towards realism and pragmatism. In 2025, new standards emerged, strategies were redefined, scopes broadened, and narratives reframed around growth opportunities, security, and resilience. In 2026, the priority will be to demonstrate the tangible value of sustainability considerations and drive innovation.

A Challenging Year

2025 was undeniably a challenging year for ESG and sustainable investing. The incoming US administration marked a turning point with its explicit anti-ESG stance and shift toward deregulation. This in turn sparked concerns in Europe that the continent's own regulatory agenda could undermine its growth and competitiveness.

Against this volatile backdrop, investors have struggled to navigate the sustainable investing landscape, many questioning whether companies have scaled back their sustainability commitments or simply adjusted their public messaging. We anticipated¹ that “greenhushing”—the deliberate downplaying of

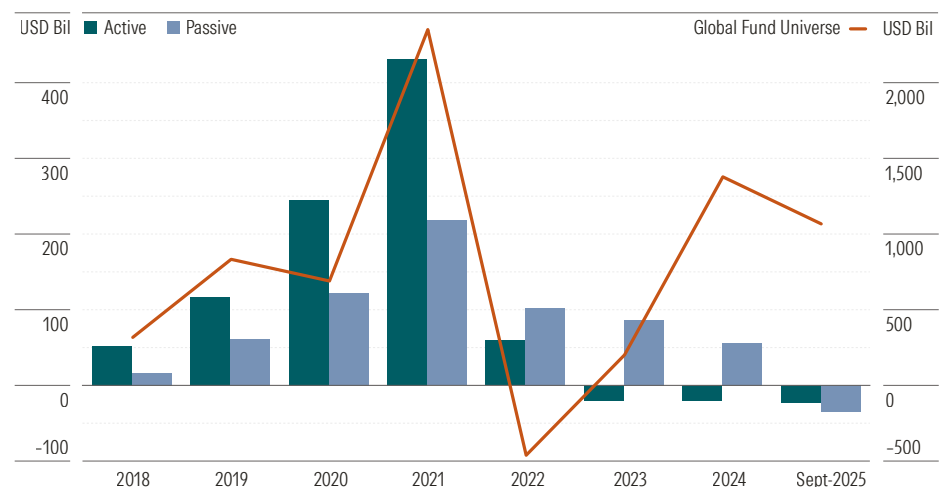
sustainability goals—would become pervasive. That expectation has largely materialized, most visibly in the diversity, equity and inclusion (DEI) space.²

At the same time, 2025 also brought anti-greenwashing measures that clarified language and introduced minimum standards for ESG funds. In Europe, this shift manifested in the

implementation of the European Securities and Markets Authority fund naming guidelines,³ which saw at least 1,400 funds (31% of EU ESG funds) change their names.⁴ In many cases, contentious terms such as ESG and sustainability were dropped and replaced by alternatives such as climate, transition, and screened, reflecting a growing priority for climate considerations, alongside continued promotion of ESG attributes.

Meanwhile, 2025 is on track to record the first—albeit modest—annual outflows for global

Global Flows into ESG Open-End Funds and ETFs Compared to the Overall Universe



Source: Morningstar Direct. Data as of September 2025. Excluding money market funds, feeder funds, and funds of funds.

ESG-focused open-end funds and ETFs since Morningstar began tracking this universe in 2018. Political, regulatory, performance, and greenwashing concerns have all contributed to this underwhelming outcome, coupled with an institutional shift toward customized separate accounts over traditional pooled vehicles for ESG allocations. Fixed income, meanwhile, has consistently demonstrated resilience.

Importantly, total ESG fund assets remain high, totaling USD 3.7 trillion globally at the end of September.⁵ In Europe, ESG funds still account for 20% of the overall fund universe, compared with just 1% in the US, with varying shares across other regions.

Investor Surveys Point to a Bright Future

Recent investor surveys point to a bright future for sustainable investing as we move into 2026. According to one conducted by the Morgan Stanley Sustainability Institute,⁶ 88% of global individual investors are interested in sustainable investing. The younger generation shows the greatest interest, signalling that sustainability will become an even stronger focus as their

financial influence grows. Similarly, 86% of asset owners expect to increase allocations to sustainable investments in the next two years.⁷

Sustainability Reframed as a Strategic Imperative

Achieving this will hinge on investment managers' ability to show the relevance of sustainability and that ESG considerations contribute meaningfully to risk-adjusted returns.

This emphasis on demonstrating financial materiality and value creation echoes a shift seen in 2025, where sustainability was reframed as a strategic imperative and a driver of growth and innovation, rather than a niche or ideological choice.

Today, decarbonization and renewable energy are no longer viewed solely as solutions to climate change; they are increasingly seen as critical for meeting surging energy demand and ensuring long-term energy security. The boom in AI and data center infrastructure have heightened demand for renewables, now often the cheapest and fastest energy source to deploy. In Europe, the imperative to cut reliance

on foreign fossil fuels has reinforced the need to transition faster, accelerating investment in clean energy.

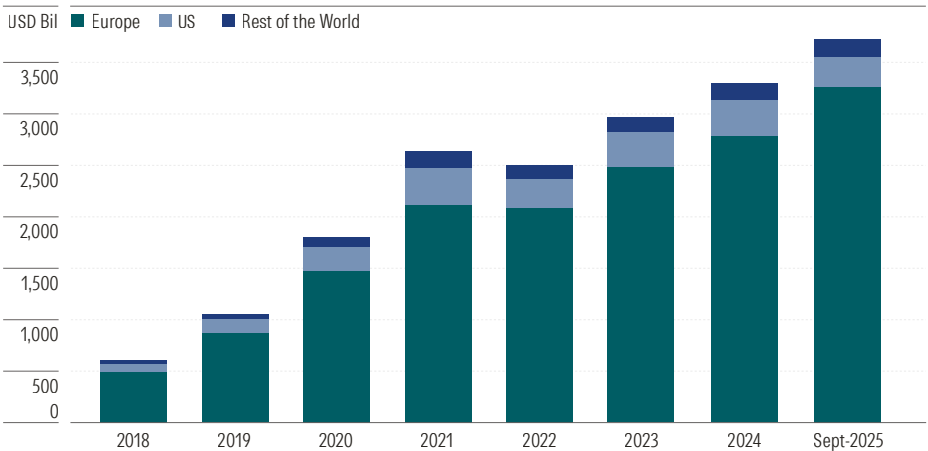
Similarly, as physical climate risks intensify, climate adaptation and resilience are emerging as new investment priorities, while circular economy and resource efficiency are moving from niche to essential solutions for addressing supply chain risks and cost pressures.

The Scope of Sustainable Investing Continues to Evolve

At the same time, the scope of sustainable investing continues to evolve. Heightened geopolitical tensions and new investment opportunities in the defense sector have prompted many responsible investors to adopt more flexible weapon exclusions policies⁸ and allocate more capital to an area once deemed incompatible with ESG principles.⁹ This shift reflects a reframing of the concept of social responsibility—recognizing the role of defense in protecting peace and freedom, while driving innovation and building resilience.

In 2026, we expect new sustainability-related themes and narratives to gain prominence as they create more opportunities for both sustainability-oriented and traditional investors.

Global Assets in ESG-Focused Open-End Funds and ETFs



Source: Morningstar Direct. Data as of September 2025. Excluding money market funds, feeder funds, and funds of funds.

This trend underscores the continuous expansion and evolution of sustainable investing as the industry strives to meet various preferences and objectives. Some investors will want to continue to avoid certain controversial activities and sectors such as fossil fuels. Others will prioritize positive impact and measurable ESG outcomes. The majority, meanwhile, will remain focused on integrating financially material ESG factors to better manage risks and opportunities. ○

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ESG Regulations: An Ongoing Test to Delivering Value

ESG regulatory backlash resets the rules for long-term sustainable finance

In 2026, sustainability disclosure regulations are likely to continue the direction taken in 2025, with a focus on demonstrating their value as governments aim to support growth.

In 2025, political shifts and evolving geopolitics prompted many regions to revisit, and in some cases, scale back their sustainability reporting rules—a sharp contrast to the early 2020s, when global policymakers explored and eventually coalesced on frameworks such as the International Sustainability Standards Board (ISSB) standards globally and the Corporate Sustainability Reporting Directive (CSRD) in the EU.

These revisions will frustrate ESG-focused investors, as the quality and availability of ESG information could weaken. Investment product providers and distributors will need to adapt so they can continue to offer clear and decision-useful information to investors.

Clarifying the Sustainable Policy Agenda in Europe

In the EU, 2026 should start with a final agreement on the [Omnibus I package](#) and could end with a final agreement on the [Sustainable](#)

[Finance Reporting Directive \(SFDR\) Review](#).

These two pieces of legislation should provide clarity for all market participants on the future of the EU sustainable finance agenda.

Investment product providers and distributors will need to adapt so they can continue to offer clear and decision-useful information to investors

The Omnibus I package will finalize changes to CSRD and the Corporate Sustainability Due Diligence Directive (CSDDD), redefining which companies must comply and what they must report or implement. Scope adjustments, for example, may exempt some companies previously expected to report under CSRD. Similarly, many companies may now fall outside of CSDDD, while those still covered might face less stringent requirements for adopting and implementing transition plans. An agreement is expected before the end of 2025, with the impact likely to begin

in early 2026 as companies adjust their plans accordingly.

Under its proposed new SFDR regime, the European Commission is introducing simplified disclosure requirements and three product categories (transition, ESG basics, and sustainable) to replace the current Articles 8 and 9 framework. [Our preliminary analysis](#) indicates that the universe of EU sustainability-related funds is likely to shrink—a deliberate move by the regulator to tackle greenwashing. The extent of this reduction will depend on the final details. In the meantime, we expect fund providers to gradually reposition products over the next 12 months to align with some of the new category requirements.

In the UK, the [Sustainability Disclosure Requirements \(SDR\)](#) came into effect in 2025. Despite [fewer funds than expected](#) having adopted the [SDR labels](#), the FCA has indicated that it will allow the market to develop rather than altering the policy in the short term, having [consulted on only minor clarifications](#) in Q3 2025. Signaling a stable regulatory environment like this could foster the development of more sustainable products that better serve investors' needs.

Although the government opted not to pursue a [UK Green Taxonomy](#) in 2025, it did consult

on a proposed set of [UK Sustainability Reporting Standards \(UK SRS\)](#), which would be closely based on the ISSB's International Financial Reporting Standards. In 2026, the FCA is expected to publish finalized versions of the UK SRS for voluntary use, then consult on introducing requirements for entities to report under these standards.

On the disclosure front, 36 jurisdictions have adopted or have plans to introduce the ISSB standards into their regulatory frameworks

US Withdrawal from Paris Agreement Contrasts with State-Level Regulation

The US will formally exit the [Paris Agreement](#), for a second time, in January 2026. This aligns with the federal approach to sustainability-related regulation but does not match what transpires at the state level.

In 2025, the Securities and Exchange Commission (SEC) [dropped](#) its climate disclosure rules for US companies and [announced](#) it will not review shareholder proposals for the upcoming proxy season. This is a decision that empowers companies to block them at their own discretion and, in turn, could result in fewer ESG-related proposals. Meanwhile, through its [One Big Beautiful Bill Act \(OBBBA\)](#), the US government will gradually phase out the tax incentives for clean energy introduced in 2022 by the Inflation Reduction Act (IRA).

At the same time, state-level disclosure policies continue to advance. Companies subject to California's [climate disclosure laws](#) are set to report their greenhouse gas and climate-related financial risks for the first time in 2026, although an [ongoing legal challenge](#) could still delay their rollout. In [New York](#), [New Jersey](#), [Illinois](#), and [Colorado](#) similar bills are in different parts of the legislative process. Clarity on the legal standing of state-level regulations could either kill them all or open the doors for additional states to introduce similar requirements.


The opposing directions of travel for federal and state legislation on ESG disclosures in the US creates a challenging environment for companies. This is unlikely to change in 2026, unless a court ruling in the California case significantly undercuts state-level requirements.

Global Focus on Frameworks, Less So on Taxonomies

Across the rest of the world, much of the focus of sustainable finance policy in 2026 is likely to remain focused on rolling out disclosure and investment frameworks, incorporating lessons learned from markets that have moved earlier on these issues.

On the disclosure front, [36 jurisdictions](#) have adopted or have plans to introduce the ISSB standards into their regulatory frameworks. For example, [Singaporean-listed companies](#) will start reporting in alignment with ISSB standards from 2026 (for the 2025 fiscal year). [Brazilian](#) and [Chilean](#) listed companies will follow suit with interoperable standards from 2027 for fiscal year 2026. The adoption of global standards such as ISSB in legal or regulatory frameworks provides consistency for companies operating in multiple jurisdictions and for investors across the world.

Meanwhile, [Australia](#), [Brazil](#), [Canada](#), [New Zealand](#), and [South Korea](#) have all held consultations, launched, and even expanded voluntary taxonomies in recent years. However, a growing trend points to these taxonomies remaining voluntary, with governments responding to concerns around increased reporting burden. This concern is often exacerbated by region-specific characteristics that hinder scalability across asset classes and jurisdictions, limiting their utility for investors.

Just as the EU and UK have done, Australia is one market that seems to have shifted its focus instead to fund labelling as a framework for aiding investors. The Australian Treasury [consulted](#) on this in 2025, and is expected to continue the development process through 2026, ahead of implementation in 2027. 

Author:

Lia Mitchell, Senior Analyst, Policy Research, Morningstar



Climate Risks Evolve: From Transition to Adaptation

While the transition remains the focus, physical risks and adaptation will rise on investors' agenda

Climate change has long dominated sustainable investing conversations and is set to gain even greater significance in 2026, despite the negative headlines and scaling back of certain initiatives such as the Glasgow Financial Alliance for Net Zero (GFANZ). While 2025 will be remembered by some as a year of policy reversals in the US and Europe, it is important to recognize that elsewhere, supportive measures continued to gain momentum. The Oxford Climate Policy Monitor reports progress in 35 out of the 37 jurisdictions tracked.¹⁰

In 2026, we expect the focus to remain on climate transition, reflecting the urgency to reduce absolute carbon emissions. But investors will simultaneously be paying greater attention to physical climate risks and adaptation. Record high temperatures and more extreme weather events are already materially impacting economies. Total global economic losses from natural catastrophes rose to USD 162 billion in the first half of 2025, up from USD 156 billion the previous year, according to the World Economic Forum¹¹. The United States alone accounted for a staggering USD 126 billion of that total—marking the costliest first half for the US on record.

Asset Owners Remain Committed to Net Zero

Asset owners, cognizant of the risks, remain committed to transitioning their investment portfolios to net zero GHG emissions by 2050. Unlike other net zero initiatives affected by departures, the Net Zero Asset Owner Alliance

Despite political uncertainty, regulators and standards setters are still seeking to facilitate the flow of capital toward the transition

remains resilient; as of mid-2025, it had 86 members with assets totaling USD 9.4 trillion. Pension funds in particular (as universal owners), view it as their fiduciary duty to manage system-level risks, such as climate change, which cannot be mitigated through diversification. Climate transition readiness was cited as the top environmental concern in Morningstar's 2025 Voice of the Asset Owner Survey.¹² Beyond risks, investors also increasingly see the transition as an

opportunity to enhance returns by allocating capital to solutions, such as clean energy infrastructure and low carbon technologies.

Despite political uncertainty, regulators and standards setters are still seeking to facilitate the flow of capital toward the transition. In Europe, under the revised Sustainable Finance Disclosure Regulation (SFDR 2.0), a dedicated transition product category will be created. National fund labels have evolved (and some have been introduced) to include transition-related criteria. In other regions, such as in Asia-Pacific, transition-focused frameworks and taxonomies have been introduced to accelerate the financing of transitioning companies, especially in hard-to-abate sectors.

At the same time, the International Sustainability Standards Board (ISSB) standards, which have already been or will be adopted by 36 jurisdictions, require companies to disclose material information about climate-related risks and opportunities, including transition plans. The EU Corporate Sustainability Reporting Directive (CSRD) still requires companies to disclose transition plans, although the CSDDD has stopped short of mandating the implementation of these plans.

In 2026, we expect investors to monitor these developments closely as they seek to distinguish transition leaders¹³ from laggards. Increasingly, investors are moving away from what is often described as paper decarbonization—reducing financed emissions on paper—towards supporting real-world emissions reductions.

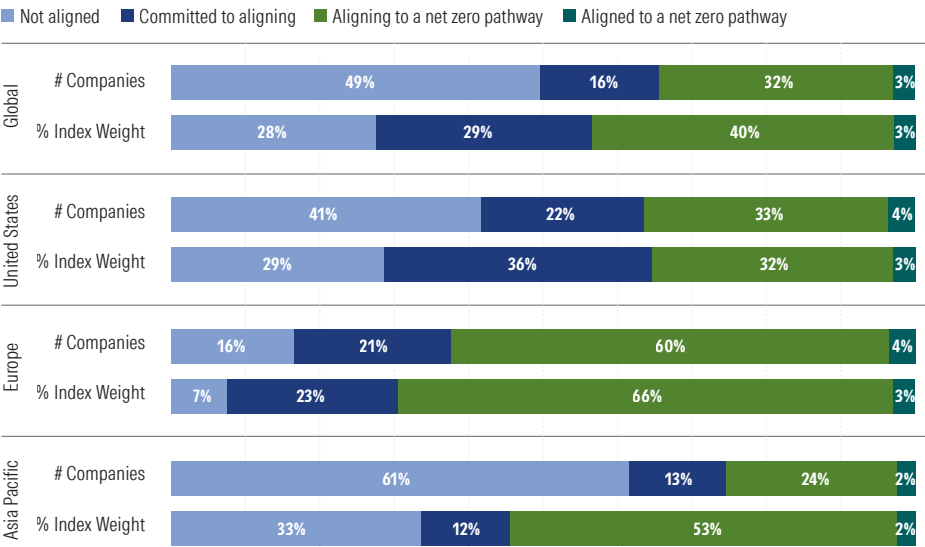
Assessing the Credibility of Transition Plans

The key challenge for investors will remain assessing the credibility of companies' emissions reduction targets and transition plans. Many frameworks¹⁴ have been developed to support this process, including the Transition Plan Taskforce¹⁵ and Net Zero Investment Framework 2.0 (NZIF).¹⁶ The latter enables investors to track companies' progress along their net zero journey—from target setting to capital allocation towards decarbonization.

Using this framework, we found that less than 3% of companies in the Morningstar Global Index are currently aligned to a net zero pathway, and almost half (49%) are not aligned, meaning that they have no publicly stated ambition yet to decarbonize on a pathway to achieving net zero. This finding highlights the critical role of sustained investor action through corporate engagement and policy advocacy.

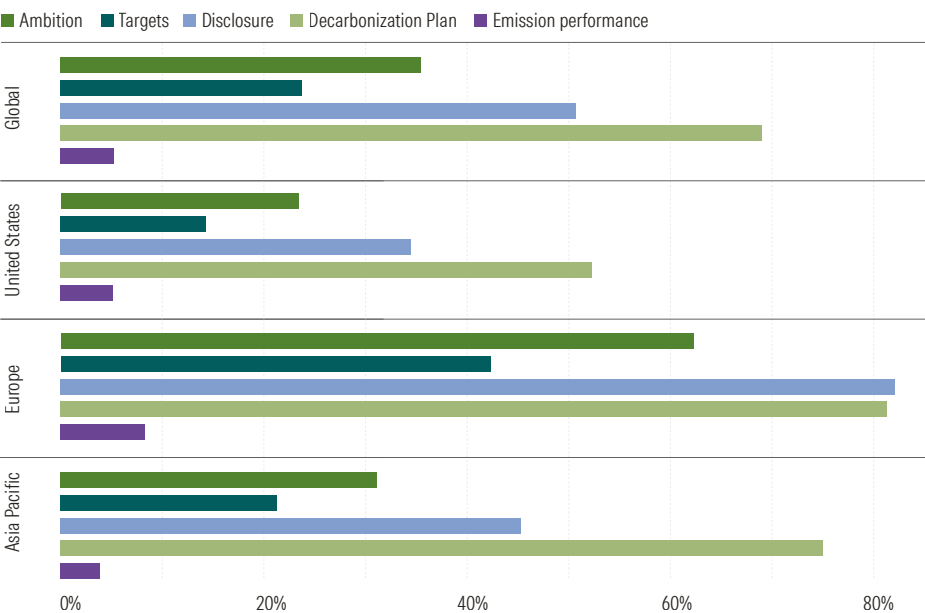
Europe shows stronger results, with only 16% of companies not aligned, and 64% either already aligning or committed to aligning to a net zero pathway. This reflects the fact that more European companies have ambition, targets, disclosures, and decarbonization plans¹⁷ as seen in the second exhibit.

Geographic Comparison of NZIF Alignment



Source: Morningstar Sustainability. Data as of November 2025, using Low Carbon Transition Rating data applied to the Morningstar TME Global Index, Morningstar TME US Index, Morningstar TME Europe Index, and Morningstar TME APAC Index.

Proportion of Covered Companies Meeting NZIF Criteria by Region



Source: Morningstar Sustainability. Data as of November 2025, using the Low Carbon Transition Rating data applied to the Morningstar TME Global Index, Morningstar TME US Index, Morningstar TME Europe Index, and Morningstar TME APAC Index.

Accelerating Investments in the Energy Transition

2025 was a test year for the energy transition. At the start of the year, uncertainty loomed over how the change in the US administration might affect the pace of clean energy investments domestically and beyond. While US investments in renewables have indeed slowed, momentum has accelerated in other regions, particularly in China, Europe, and emerging markets.¹⁸ Global clean energy spending is projected to reach a record USD 2.2 trillion in 2025.¹⁹ This figure, which includes renewables, grids, storage, and electrification, will be twice the amount invested in fossil fuels (USD 1.1 trillion). The growth in clean energy investments is being driven by the surging demand for energy—led partly by data centers, AI applications, electric vehicles, space cooling, and global industrial growth. Some of this demand can be met by cost-competitive renewables, [accelerating electrification](#).

2025 also delivered strong returns for stock investors after four years of underperformance: the Morningstar Global Markets Renewable Energy Index gained 24%, outpacing the Morningstar Global Energy Index, which rose by just 13%.²⁰

Looking ahead to 2026, global investment in renewables is set to continue to soar. In the US, growth will remain fueled by data centers, despite political headwinds, while in Europe, alongside the rapid expansion of data centers by hyper-scalers such as Microsoft, Google, and Amazon,²¹ the strategic role of clean energy—central to energy security and independence²²—should keep momentum strong.

However, the renewable energy sector is far from uniform, as the outlook for each technology is shaped by its own drivers. Investors are likely to remain discerning,

while also considering the state of the electrical grid, which is essential to support rising energy demand. In many places, investments in grid infrastructure have not kept pace with investments in renewable energy. In the EU, it is estimated that over USD 600 billion will be needed to modernize grids by 2030 for renewable integration, which represents significant opportunities for investors.²³

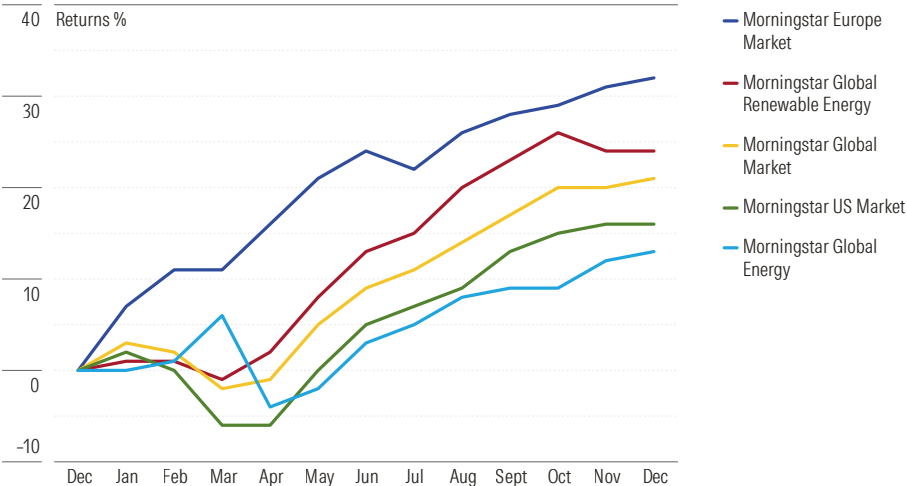
Another key consideration in 2026 will be the supply of critical minerals—such as lithium, cobalt, nickel, and rare earth elements—which currently lags the rising demand.²⁴ This supply-demand imbalance poses a significant constraint on the energy transition. At the same time, it creates opportunities for investors to support capacity building, recycling technologies, and supply chain diversification. National security concerns, particularly around dependence on China, will continue to shape investment flows into mining, processing, and alternative sourcing strategies.

Adaptation, Adaptation, Adaptation

Meanwhile, climate adaptation and resilience—long overshadowed by climate mitigation—are rapidly gaining prominence, culminating at COP30 with a call to triple adaptation finance over the next decade.²⁵ As mitigation fails to accelerate at the pace required to limit global warming to safe levels, businesses and investors increasingly recognize the urgency of adapting to a warmer world and more extreme weather events. This requires not only better assessment of physical climate risks, but also the ability to identify the investment opportunities that adaptation presents.

On the risk side, we expect investors and lenders to increasingly demand that companies disclose adaptation and resilience plans. These plans will need to be supported by scenario testing to assess potential disruptions and financial losses from physical climate impacts, along with measures to mitigate risks. Few companies globally disclose such data. For example,


2025 Renewable Energy Index Return Compared to Other Market Indexes



Source: Morningstar Direct. Data as of 5 December 2025.

according to our research,²⁶ less than 8% of companies reporting EU taxonomy-alignment data on mitigation reported on adaptation for the 2024 financial year.

On the opportunity side, the potential is significant. The World Economic Forum [estimates](#) that the investment opportunity across public and private debt and equity for adaptation could increase from USD 2 trillion in 2025 to USD 9 trillion by 2050. Investors, business groups and non-profits²⁷ have started developing frameworks to identify opportunities across a broad range of sectors, including infrastructure, water management, healthcare, agriculture, and insurance. In 2026, we expect to see more research in this area.

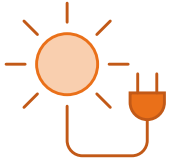
While opportunities linked to adaptation and resilience are substantial, investors' options in the form of dedicated funds or strategies remain limited. Adaptation faces multiple challenges, including uncertain cash flows, long time horizons, fragmented markets, lack of standardized disclosures, and dependence on public or regulatory action. These challenges should be addressed gradually, starting with more and better estimates of potential financial losses. 

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Climate Investing in Private Markets: A Mixed Picture

Energy transition infrastructure will continue to drive private climate investing, while venture capital will have selective appetite

Private capital markets are expanding. We expect assets under management to [eclipse](#) USD 24 trillion by the end of the decade, up from USD 18.7 trillion in 2024. In turn, private capital's influence on sustainable investment, particularly climate funds, is also growing.

Private climate funds invest in companies across various stages of development and in many different areas. We highlight where capital is likely to flow in 2026, both at the private capital strategy level, and in key segments of climate technology, focusing on likely outcomes for clean energy, electric vehicles, and the sustainable foods sector. The movement of private investment in 2026 will affect not only near-term decarbonization outcomes, but also the technologies available to tackle the climate crisis for decades to come.

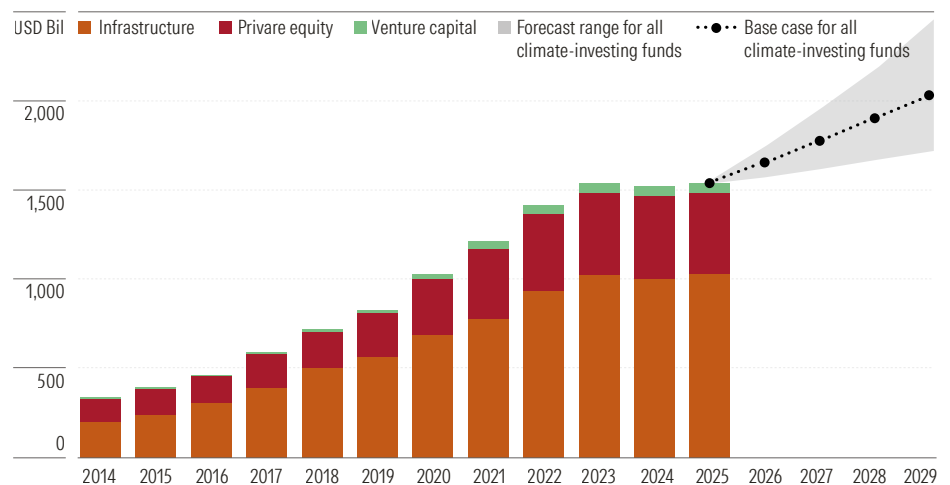
In recent years, macro headwinds (high interest rates, inflation, and recession fears) have put pressure on dealmaking activity and fundraising across much of the private capital markets, particularly in venture capital (VC). In 2025, investor sentiment was cautious amid trade tensions

and unpredictable US policy shifts. These dynamics will remain broadly influential overall. However, because private capital funds are far from monolithic, the outlook for climate investors in 2026 will vary substantially by asset class.

Energy Transition Infrastructure Will Continue to Drive Overall Growth

We expect energy transition infrastructure to remain a key driver of growth in private climate investing in 2026. This segment, within private infrastructure funds, includes funds investing in renewable and low carbon energy generation, electric vehicle (EV) charging infrastructure, carbon capture, utilization and storage, and battery storage assets, and have collectively attracted significant capital: USD 604 billion since 2021 (often alongside other sectors).

Global Private Capital Climate-Investing AUM Forecast



Source: PitchBook. Data includes only private equity, venture capital, and infrastructure drawdown funds. Climate-investing funds are defined as both generalist funds investing in climate alongside other themes and specialists investing exclusively in the space, so not all capital will be directed to climate investments. Forecasts were generated August 7, 2025.

This is due in large part to robust performance relative to non-energy transition infrastructure funds²⁸ and an expectation of continued strong returns even in the face of continued macroeconomic challenges.

Meanwhile, within climate-investing private equity, generalist funds will likely continue to experience moderate AUM growth as these funds selectively target climate-related opportunities with solid fundamentals, while specialist funds—still a minority—continue to popularize.

However, we do not expect VC climate tech funds, which represent only 3.5% of climate investing AUM, to gain significant ground in 2026. This is partly due to the persistent aforementioned dealmaking headwinds, which are likely to continue weighing on sectors outside of artificial intelligence and machine learning. These challenges are also compounded by a less supportive US regulatory and policy environment for climate-related investments.

While climate tech VC fundraising and dealmaking may not see much improvement in 2026, venture capital will remain a vital component of the climate-investing ecosystem, serving as an incubator for breakthrough technologies that make their way into private equity and infrastructure portfolios, and to the public markets. There will be areas of relative strength and weakness across each of the climate tech segments.

Clean Energy VC Activity Likely to be Flat in 2026

One of the most impactful segments of venture climate tech is clean energy. Global deal activity in this sector declined in early 2025, with regulatory and policy challenges from the US presenting significant downward pressure. This pressure was namely tied to tariff-related global supply chain shocks and concerns around the modification or removal of Biden-era policies supporting climate tech deployment.²⁹ North American deals can make up anywhere from 31% to 75% of clean

energy deal value in any given year, making US policy heavily influential. Investment in clean energy fell to USD 2.3 billion in Q1 2025 before partially recovering in Q2 and Q3. In 2025, the average quarterly VC deal value was about 25% lower than the same period in 2024. We anticipate global VC deal activity in clean energy technologies to be flat in 2026, with any improved clarity around US tariffs and other policies being offset by continued headwinds. These challenges include global supply chain disruptions and the difficulty of scaling up production for new energy technologies.

Bright Outlook for Nuclear Fission and Geothermal Technologies

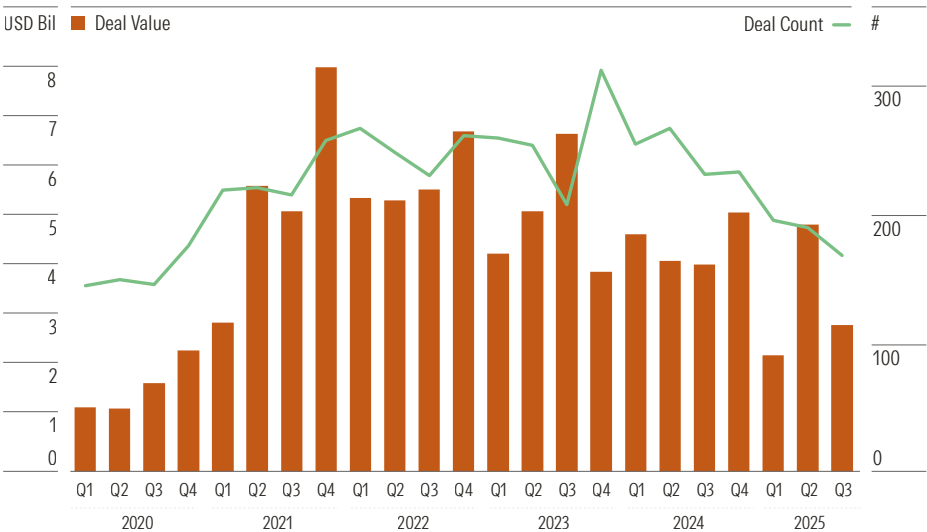
Nuclear energy has been a bright spot, with small modular reactor (SMR) developers, such as X Energy and TerraPower, securing megadeals in 2025.

We expect investor interest in low carbon stable energy sources to intensify in 2026, with a favorable outlook for nuclear fission and geothermal technologies, compared to solar and wind, which have experienced substantial pressure following the change in US administration.

Both nuclear and geothermal can be considered less disruptive to power grids and are increasingly viewed as solutions for data center expansion and industrial electrification. VC-backed geothermal and nuclear fission technologies are approaching a critical stage of maturation, with early commercialization on the horizon for advanced or enhanced geothermal projects—as evidenced by development milestones hit by Texas-based Fervo Energy³⁰ and Calgary-headquartered Eavor Technologies³¹ early in 2025—and SMRs.³²

VC Deal Activity in EVs Continues to Ebb
In recent years, VC investment in electric vehicles has steadily dried up—a trend that we expect to persist in 2026. For the first nine

Global Clean Energy Venture Capital Deal Activity by Quarter



Source: PitchBook. Data as of September 30, 2025.

months of 2025, VC investment in the EV sector totaled just over USD 3 billion across 78 deals, representing an annual run rate less than half of 2024's level. This is also a stark contrast to the 2021 peak of nearly USD 21 billion spread across 300 deals.

Competition from China, which accounts for 70% of global EV production,³³ has pushed many venture investors to the sidelines, as they typically seek to manage risk over a 10-year investment horizon. The current US administration's stripping down of the Inflation Reduction Act and curtailment of the USD 7,500 EV tax credit has further soured investor enthusiasm. As traditional automakers pull back from prior EV commitments, we expect demand will continue to wane across the various tiers of EV component supply chains, dimming the investment outlook.

Still, amid an otherwise cloudy outlook, a few bright spots remain. Slate Auto, a Jeff Bezos-backed unicorn, is reportedly looking to raise a new funding round. In April 2025, the startup unveiled a barebones, US sourced and built EV truck targeting a mid USD 20,000 price point—a niche left vacant by Tesla, Rivian, Ford, and other traditional automakers.

Meanwhile, outside the EV category, innovative transportation alternatives such as Glydways are gaining traction as many cities struggle with gridlock and debt-burdened public transit systems. Glydways raised USD 101.3 million in Q3 2025, yielding a post-valuation of USD 634 million. The startup is ramping up marketing and visibility as it moves into 2026.

Selective Investor Appetite for Sustainable Foods

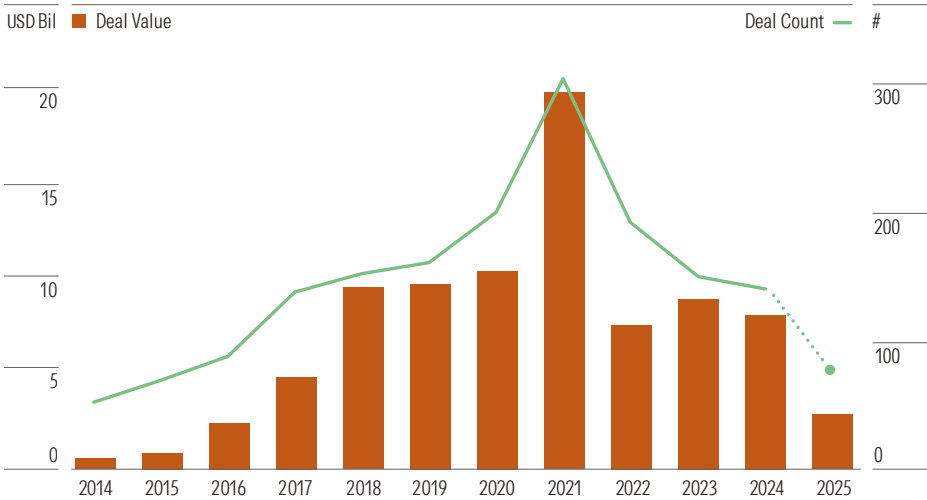
The global food system faces a significant sustainability challenge heading into 2026. Agriculture and food production account for approximately 30% of anthropogenic

greenhouse gas emissions,³⁴ while livestock production occupies 77% of global agricultural land despite providing only 18% of the world's calories.³⁵ Climate change further threatens agricultural productivity, with major crop yields expected to decline sharply.³⁶ According to the World Economic Forum, global agrifood systems require USD 1.1 trillion in annual climate finance through 2030 to achieve Paris Agreement

three quarters of 2025.³⁸ While these dynamics are likely to continue to weigh on investor interest in 2026, select opportunities may still attract capital.

In the most active segment, alternative proteins, this is especially true for companies focused on fermentation-derived protein that can demonstrate business-to-business

Global Electric Vehicle VC Deal Activity



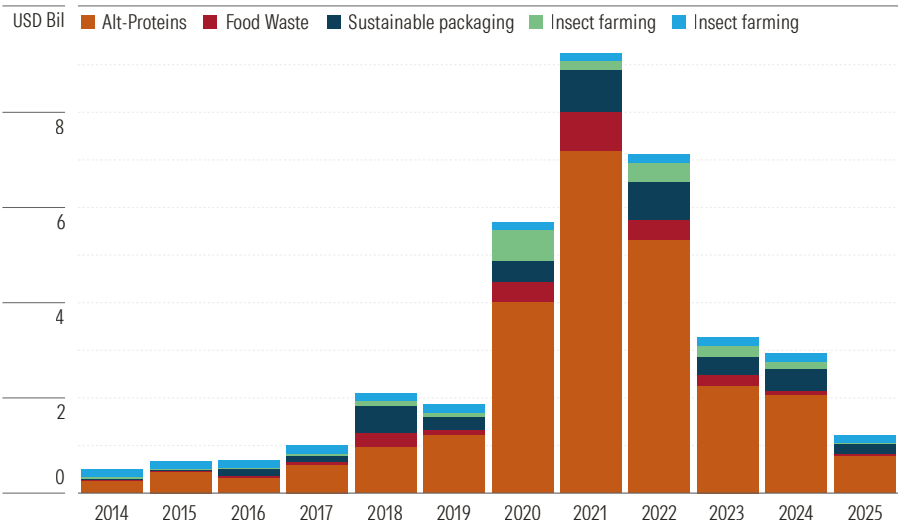
Source: PitchBook. Data as of September 30, 2025.

targets, yet only 5% of current climate finance flows to this critical sector.³⁷

VC funding in the sustainable foods sector is unlikely to contribute significantly to shrinking this financing gap in 2026, as it faces selective investor appetite. Venture capital funding in Agtech, which uses technology to improve agriculture and food production, fell by 23% to USD 6.6 billion in 2024, the lowest total since 2019. This decline reflects both macroeconomic pressures such as high interest rates and a fundamental reallocation of capital toward artificial intelligence, which captured 64% of all venture funding in the first

ingredient applications. These companies tend to offer a faster path to profitability and integration into existing manufacturing than other business models. Alternative proteins can provide comparable nutritional benefits to conventional animal products while dramatically reducing environmental impact and eliminating the inherent inefficiencies of animal agriculture. Despite these advantages, most alternative protein segments are likely to face continued funding pressure, particularly cultivated meat ventures that require extensive capital expenditure before reaching commercialization.

Global Sustainable Food VC Deal Value



Source: PitchBook. Data as of September 30, 2025.

Meanwhile, the food waste mitigation segment may see modest funding recovery following a 40% decline in the first three quarters of 2025 compared to the same period in 2024. Any uptick could be driven by corporate sustainability mandates and regulatory pressure in Europe (EU's Waste Framework Directive) and California's senate bill 1383, which requires waste reduction disclosure. AI-powered solutions offering immediate return-on-investment through operational efficiency are more likely to secure funding and achieve commercial scale than consumer-facing apps.

Sustainable packaging funding will likely remain constrained in 2026, after dropping by 37% in the first three quarters of 2025 (versus the first three quarters of 2024), as investors favor companies that provide cost-neutral alternatives rather than premium biodegradable materials requiring behavior change.

Meanwhile, biocontrol and biopesticides present the strongest potential, despite a 17% decline in VC funding in 2024. Unlike alternative proteins and insect farming, biocontrol (which leverages naturally derived substances and micro-organisms to manage pests and diseases in

crops) benefits from regulatory tailwinds as the EU gradually implements synthetic pesticide restrictions.³⁹ Regenerative agriculture has already secured corporate procurement commitments from major corporates such as PepsiCo,⁴⁰ ADM,⁴¹ and Nestlé.⁴² Climate adaptation imperatives and anticipated regulatory mandates in 2026, including the EU Biotech Act, create structural demand growth, positioning biocontrol as the sustainable food segment most likely to attract renewed capital. ○

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A Maturing Sustainable Bond Market

The focus will remain on innovation, supported by stronger standards

In line with 2025, we expect 2026 to reflect the continued maturation of the green, social, sustainability, and sustainability-linked (GSS+) bond market, now exceeding USD 6 trillion.

With global GSS+ bond issuance reaching USD 1.07 trillion in 2024 after three years of steady growth, issuance is set to decline by the end of 2025 amid political shifts, policy uncertainty, and the ESG backlash. Perhaps unsurprisingly, the United States has so far experienced the sharpest retreat. Europe and Asia-Pacific have contracted much less, while supranationals have held steady thanks to a 14% increase in sustainability bond issuance.

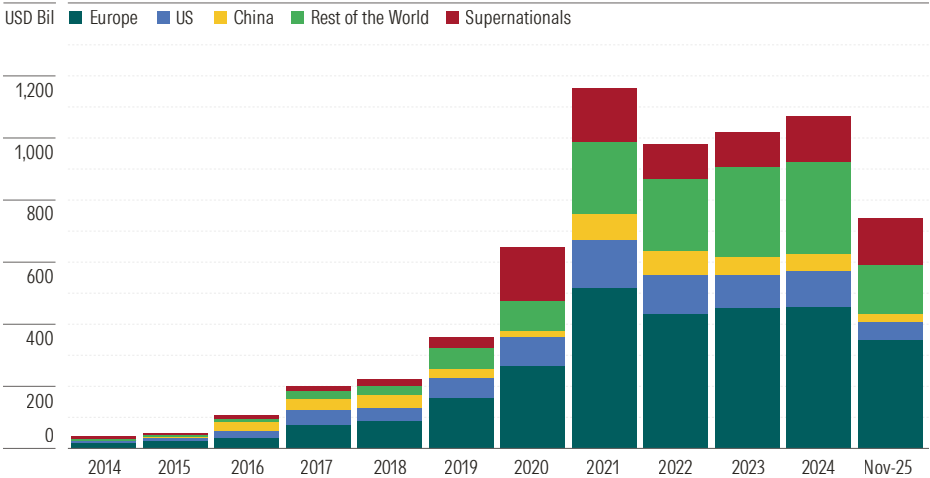
In 2026, issuance will remain supported by investor demand for sustainable investments and the ongoing—though regionally differentiated—effort by companies and governments to align financing with environmental and social objectives. Volumes will depend on geopolitical developments, interest rate trends, and financial innovation. The year will also be defined by stronger standards and a sharper focus on measurable impact.

The Breadth of EU GBS Issuers Bodes Well

After a slow start in early 2025, issuance activity under the European Green Bond Standard (EU GBS) accelerated throughout the year, reaching 29 deals totaling USD 22 billion by November. The breadth of EU GBS issuer types and sectors represented is noteworthy, signaling the potential for broader market

growth. EU GBS issuers ranged from corporates to municipal, sovereign, and supranational entities. Sector-wise, we anticipated that Utilities and Real Estate, in which capital expenditures are already well aligned with the EU Taxonomy, would be the leading issuers and first movers, but the initial wave of EU GBS issuers also included transportation and traditional banks such as ABN Amro, Société Générale, and ASN Bank. The European Investment Bank issued the largest bond at USD 3.2 billion.

Green, Social, Sustainable, and Sustainability-Linked Bonds Issuance by Region



Source: Morningstar Sustainability using Environmental Finance data, as of November 2025.

In 2026, we expect market participants to remain focused on the cost benefit trade-off of issuing under this stricter regulatory framework, as the higher compliance costs must be weighed against the potential benefits of increased investor demand and lower cost of capital for issuers.

In 2026, issuers will be testing these new labels through pilot transactions, particularly in carbon-intensive sectors such as steel, aviation, and energy. The growth ahead will likely come from the ASEAN region, where decarbonization needs are the greatest and transition is the focus of multiple taxonomies.

issuance and driving market growth. So is the development of credible projects that support climate resilience, underpinned by clear definitions such as the Climate Bonds Initiative's Resilience Criteria.⁴⁵

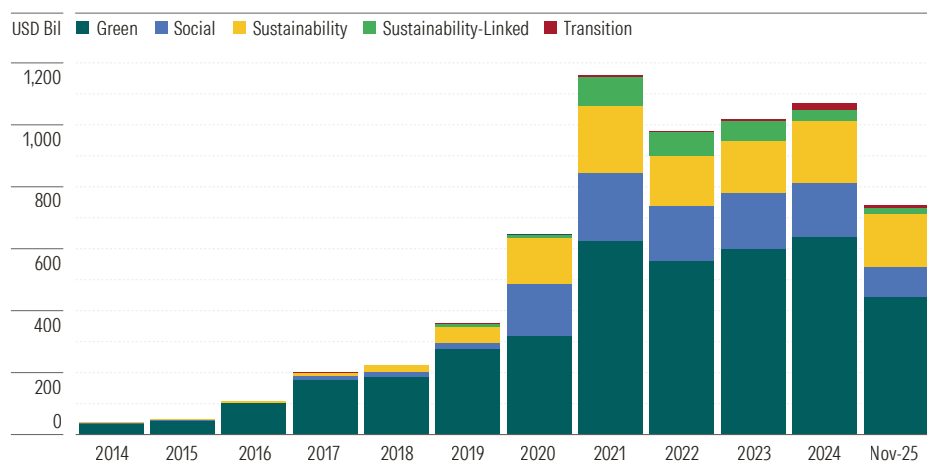
Beyond climate-related resilience, ongoing geopolitical tensions and increased defense spending will continue to raise questions about how sustainable finance can contribute to strengthening national security and societal resilience. Rather than classifying defense as sustainable, the focus has shifted to the potential development of a separate dedicated defense bond label.

Scaling Nature Finance

We also expect nature and biodiversity to gain momentum as investor demand increases. In the first 11 months of 2025, a record 29 nature-related bonds were issued, totaling USD 5 billion, compared with 12 (representing USD 1.5 billion) for the whole of 2024. Blue bonds continued to dominate, with roughly half coming from issuers in Asia-Pacific.

We expect 2026 bond issuance activity for nature and biodiversity to be supported by initiatives such as ICMA's Sustainable Bonds for Nature: A Practical Guide⁴⁶ and its optional "nature bond label" launched in 2025, which clarify what credible use-of-proceeds and KPI frameworks look like. At the same time, the IFC's updated Blue Finance guidelines broaden the range of projects eligible for ocean-and water-related use-of-proceeds and sustainability-linked structures. Coupled with corporate reporting frameworks such as the Taskforce on Nature-related Financial Disclosures and the EU's Corporate Sustainability Reporting Directive, these developments are paving the way for more innovative instruments that combine green, blue, and nature-positive objectives.

Green, Social, Sustainable, and Sustainability-Linked Bonds Issuance by Bond Type



Source: Morningstar Sustainability using Environmental Finance data, as of November 2025.

Transition Finance in the Spotlight

In the year ahead, we could see more transition-related issuances, supported by new industry guidance introduced in 2025, such as the International Capital Market Association's (ICMA's) climate transition bond guidelines⁴³ and the Loan Market Association's guidance on transition loans.⁴⁴

Uncertainty over what qualifies as a legitimate transition activity has long caused market hesitation. Key questions persist such as what constitutes credible labeled bonds for hard- to-abate sectors, how to distinguish real decarbonization efforts, and how to set meaningful thresholds. The new transition guidance begins to address these challenges.

Adaptation and Resilience Move Up the Agenda


Climate adaptation and resilience finance will also move up the agenda, signaling a shift from mitigation-only financing to investments that strengthen infrastructure and communities against physical climate risks. In October 2025, the Tokyo Metropolitan Government (TMG) issued the first-ever resilience bond globally using the Climate Bonds Resilience Criteria and Taxonomy. TMG will use the proceeds to enhance the city's ability to withstand risks such as flooding, storm surges, and typhoon impacts.

The challenge with resilience investment will remain in identifying reliable sources of cash flow. National governments and multilateral institutions (through blended finance structures) are essential to supporting

Sustainability-Linked Bonds Face Uncertain Path Forward

Sustainability-linked bonds, which currently make up only 3% of the overall GSS+ volume, should remain a niche segment of the sustainable bond market in 2026 due to the complex nature of these bonds and greenwashing concerns. They will continue to be primarily used by sophisticated issuers with advanced sustainability strategies and credible transition plans.

2025 was a critical year for sustainability linked bonds, as more than 200 instruments had target observation dates. Some issuers met their sustainability targets, while others fell short. Still, meaningful progress was made in defining good practice, with ICMA providing new guidance on key performance indicators and disclosure.

At the same time, sustainability linked loans financing bonds (SLLBs) made their debut with a few issuances by banks and development finance institutions, demonstrating how bond proceeds can effectively support portfolios of sustainability-linked loans. The future growth of SLLBs will depend on improved standardization, stronger verification practices, and clearer investor demand for instruments that reward genuine sustainability performance rather than aspirational targets. 

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Investors at the Frontline of Biodiversity Action

Rising investor concerns will drive deeper integration of biodiversity risks, while innovation will continue to support growth in biodiversity-focused financial products

Mixed Regulatory Signals Have Slowed Progress on Biodiversity

The [Global Biodiversity Framework](#) set the direction for strong ambition in 2022 and paved the way for regulatory progress. However, in 2025, governments' regulatory recalibration in Europe and the United States stalled momentum, resulting in uneven progress on biodiversity protection.

In the EU, the Omnibus package is likely to ease biodiversity disclosures required under the CSRD, while further delaying the implementation of the EU Deforestation Regulation by 12 months. This, in addition to a simplification review in April 2026, adds uncertainty and risks undermining the regulation's ambition.

At the same time, global negotiations on a plastics treaty have also stalled, leaving no binding measures to curb plastic production or regulate chemicals of concern.⁴⁸

In contrast, ocean governance is advancing. The UN Oceans Conference led to the ratification of the [High Seas Treaty](#), which will become

legally binding in January 2026. The treaty establishes a framework to protect marine biodiversity in areas beyond national jurisdiction, covering most of the world's ocean. It is expected to influence blue economy sectors, from shipping to seafood, as new conservation measures could translate into compliance expectations.

Investor Concern is Translating into Action

Amid this inconsistent regulatory landscape, investor concerns are growing. With wildlife populations down 73% since 1970,⁴⁹ biodiversity loss ranks among the decade's most severe risks.⁵⁰ The TNFD 2025 Status Report⁵¹ found that 63% of respondents view nature-related risks and opportunities as likely to be similar or more significant than climate-related ones.

Practical approaches to assess and address biodiversity-related risks and opportunities advanced meaningfully in 2025, laying the groundwork for further progress in 2026. For example, asset manager Robeco published its Biodiversity Traffic Light framework, which proposes a practical way to assess, sector

by sector, the negative impact that companies have on nature and the progress they are making in mitigating them.⁵² On the lending side, Barclays released a methodology to evaluate nature-related financial risks across mining and power portfolios using asset-level data and scenario analysis.⁵³

Data Quality Will Continue to Improve

Market participants are not waiting for perfect or comprehensive data. Focusing on the most material sectors and their key effects on nature already yields actionable insights.

Data quality will continue to improve, though, as regulatory and voluntary company disclosure increases and frameworks converge. More than 700 organizations have already committed to report in line with the Taskforce on Nature-related Financial Disclosures (TNFD). Meanwhile, the International Sustainability Standards Board is set to develop a nature-related standard, drawing on the TNFD framework, with an exposure draft expected in 2026.⁵⁴

Typically a driver for change, corporate engagement has reinforced this progress. Collaborative initiatives such as Nature Action 100 and PRI Spring are setting clear expectations and amplifying investors' voices, contributing to greater transparency and action on nature. Among companies engaged on

biodiversity by a large asset owner, 72% find it value-generating and 56% have adjusted their strategies in response.⁵⁵ While companies cannot always translate nature-related issues into quantifiable financial terms,⁵⁶ leaders such as Carrefour, Danone and Kering are setting strong precedents through biodiversity strategies grounded in impact and dependency assessments.

From Risk Management to Opportunity Creation

Biodiversity integration has so far largely focused on risk mitigation and engagement. In 2026, nature is set to evolve from a niche investment topic to a more mature opportunity. The World

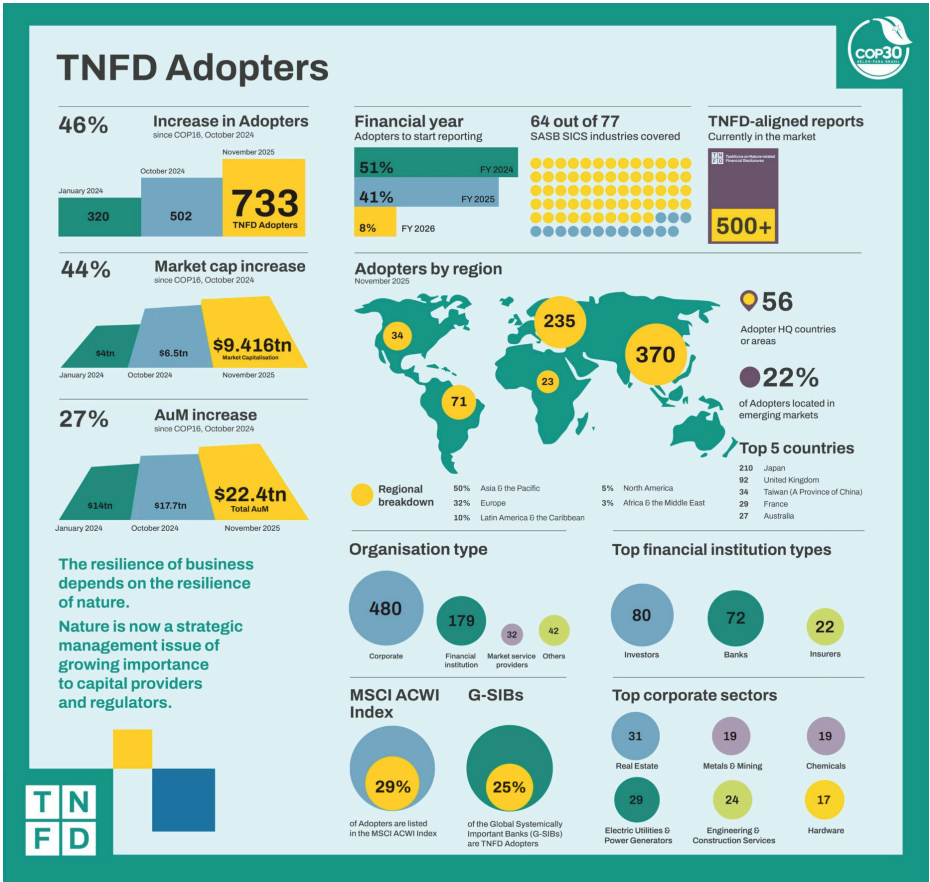
Economic Forum describes nature as a strategic investment frontier, where the 10 most scalable and impactful finance solutions feature impact funds, sustainability-linked bonds and loans, thematic bonds and loans, and debt-for-nature swaps.⁵⁷

Momentum is already visible. Biodiversity-linked bonds have grown from 5% of green issuances in 2020 to 16% in 2023.⁵⁸ More recently, Ecuador's issuance of a USD 1.6 billion debt-for-nature swap in 2024,⁵⁹ Goldman Sachs' launch of a USD 500 million biodiversity fixed income fund in 2025,⁶⁰ and Tideway's GBP 250 million blue bond⁶¹ illustrate accelerating capital flows. Financial solutions for nature are likely to further

scale up as credibility strengthens and standardized metrics and reporting support broader adoption. Frameworks such as the EU's Roadmap towards Nature Credits⁶² and ICMA's Sustainable Bonds for Nature mark important steps forward.⁶³

The Tropical Forest Forever Facility (TFFF), launched ahead of COP30, highlights how public-private collaboration can unlock nature finance at scale. Early government pledges aim to catalyze up to USD 100 billion in institutional capital, delivering performance-based funding to countries that maintain their tropical forests.⁶⁴ The TFFF provides a useful marker as the focus shifts toward implementation ahead of the next UN Biodiversity Conference (COP17) taking place in Armenia in October 2026.

Geographical Distribution and Profile of TNFD Adopters



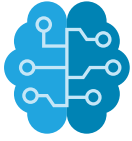
Source: TNFD Adopters. Data as of 2025.

Road to COP17: From Pledges to Capital Flows

COP17 will serve as a key checkpoint for implementing the [Global Biodiversity Framework](#), which aims to mobilize USD 200 billion annually by 2030. Yet, only about one-third of parties have updated National Biodiversity Strategies and Action Plans, leaving a substantial gap between ambition and implementation.⁶⁵ That gap makes investor leadership essential. In 2025, markets advanced despite policy inertia. Where governments hesitate, financial supervisors and standard-setters are stepping in: both the European Central Bank and the European Banking Authority now recognize nature-related risks as part of prudential oversight.⁶⁶ In 2026, momentum may increasingly come from within the financial system itself. ○

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AI: Key ESG Risks to Monitor

AI's rapid adoption is amplifying risks related to energy and water use, cybersecurity, and workforce dynamics

Artificial intelligence (AI) was a prominent investment theme in 2025 and will come under greater scrutiny by investors in 2026, as its rapid adoption is accelerating ESG risks. Companies that adopt best practices in AI governance will be better positioned to protect stakeholder trust and capture long-term value.

AI's Growing Thirst for Energy and Water Poses a Credibility Problem

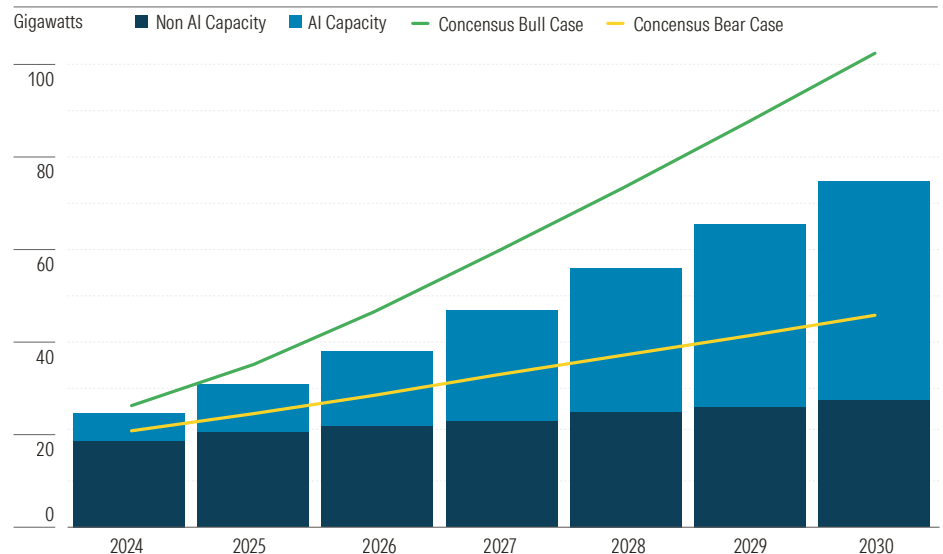
Investors increasingly recognize that AI is highly energy intensive. How companies will meet the growing power demand, though, while also reducing their carbon footprint, is uncertain. In the US—the primary AI hub—Morningstar projects that data center power demand will triple by 2030, with only 25% of the incremental load met by renewables and the remainder supplied by natural gas (60%) and nuclear energy (15%).⁶⁷

Against this backdrop, big tech companies may struggle to meet their carbon reduction targets. For instance, Microsoft and Alphabet—two popular holdings in ESG portfolios—have both pledged to halve their emissions by 2030. However, in 2024, their emissions were up 24.4% and 51%, respectively, compared

to their baselines.⁶⁸ With 2030 just four years away and energy demand continuing to rise, tech companies increasingly face a credibility problem. In the last proxy season, investors asked Amazon, Meta, and Alphabet how they planned to meet their ambitious climate commitments and whether their renewable

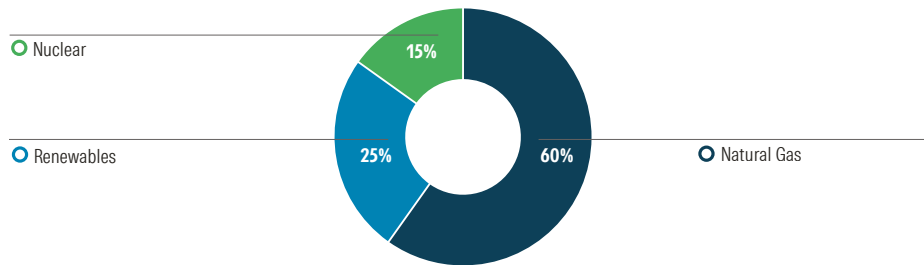
energy procurement strategies were still credible. For years, many large technology companies have maintained "100% renewable" narratives by using market-based instruments such as renewable energy certificates (RECs) and virtual power purchase agreements (VPPAs). Yet, as data centers expand at unprecedented speed, the question is whether these instruments can keep pace with actual energy consumption, or whether they mask an ongoing reliance on fossil fuels at the grid level.

Morningstar Projects a 3x Increase in US Data Center Power Demand by 2030



Source: Morningstar Equity Research, July 2025.

Natural Gas and Renewables Will Power the Bulk of Incremental Demand in the US



Source: Morningstar Equity Research, July 2025.

Some companies acknowledge their dependence on carbon removal solutions, such as direct air capture, reforestation, and ocean-based removal, to offset emissions.⁶⁹ Carbon removal can be an important tool; however, investors will want to ensure that this complements absolute emissions reduction and that the projects are credible and verified, especially projects that rely on emerging technologies. These questions are now at the center of shareholder engagement.

The proposals at Amazon, Meta, and Alphabet were among the most supported climate resolutions of the year in the US. We expect similar resolutions to appear in 2026 across the broader technology sector, as the tension between digital infrastructure growth and decarbonization intensifies.

An additional environmental concern over increased use of AI is the associated rise in water consumption. Data centers typically rely on water to cool infrastructure, which exposes companies to operational risks related to water availability. These risks should not be underestimated, particularly in water stressed regions prone to droughts and water shortages, which can lead to community opposition and rejection of new construction. Local opposition led to the blocking or delay of USD 64 billion in US projects between

May 2024 and March 2025.⁷⁰ Companies that champion initiatives and innovations to improve water efficiency and reduce their use of freshwater through initiatives such as water recycling can reduce these risks and improve resilience.

Strong AI Governance is a Defense Against AI-Related Breaches and Misinformation

Beyond environmental challenges, risks related to data breaches will likely gain prominence in 2026. IBM reported in 2025 that 13% of data breaches were AI-related, where nearly all impacted companies lacked proper AI governance.⁷¹ This percentage is likely to increase as companies further integrate AI into their enterprise systems.

Yet, the relationship between AI and cybersecurity is not one-sided. While AI introduces new vulnerabilities, it also offers powerful tools, such as faster threat detection and responses. Companies that integrate AI responsibly into their security frameworks will be better positioned to manage operational risks and avoid costly breaches.

Misinformation and disinformation will also be critical to watch, as they remain top global risks and can be further amplified by AI-generated content.⁷² Companies could be liable for the output generated by

AI tools, including chatbots, on their websites. This underscores the need to have strong human governance in place to ensure content accuracy, given the reputational and liability risks associated with incorporating inaccuracies.

Regulatory Uncertainty in the EU

In 2026, we expect navigating AI for both developers and users to remain fairly fluid, as regulation continues to evolve. In the European Union, the publication of the full high-risk AI obligations of the [EU AI Act](#) may be delayed, adding uncertainty for companies.⁷³ Meanwhile, lobbying efforts from big tech companies, the US government, leading European companies, and AI founders could ease compliance burdens, but they also raise questions about the robustness of safeguards.⁷⁴


The act is set to establish corporate accountability for both providers and users of high-risk systems across sectors such as finance, human resources, healthcare, education and critical infrastructure. Despite the proposed delay (from August 2026), companies that proactively integrate bias prevention, human oversight, and explainability into their AI systems are likely to face lower compliance costs, enjoy higher stakeholder trust, and be better positioned in regulated markets. Conversely, firms that lag behind in adopting these practices could face higher compliance risks, reputational damage, and exclusion from public procurement or sustainable investment portfolios.

Enabling Hybrid Models Through Strategic Reskilling

The use of AI has broader labor market implications and we expect investors to be paying increasing attention to this. Corporate disclosures on AI have increased, having jumped from 4% in 2020 to 43% in 2024.⁷⁵ This underscores the need for companies to

invest in closing skills gaps, as well as hybrid models that recognize the difference between human work and AI work, while leveraging their respective strengths. Automation may boost productivity and enhance job quality by shifting human labor toward more analytical, creative, or supervisory roles. In the short term, though, it could also trigger temporary job displacement and income polarization.

The pace of job displacement is expected to accelerate, with women predicted to be twice more affected than men due to women's higher representation in clerical and administrative work.⁷⁶ Industries such as Information, Financial Activities, and Professional Services have experienced the most significant changes in occupational composition since 2004, making them priority areas for strategic reskilling.⁷⁷

For many companies, the AI transition will create additional costs, including investments in reskilling programs and short-term productivity losses during restructuring. A 2024 survey by PwC found that 74% of investors expect companies to invest in both AI and upskilling. Investors will monitor how firms balance these pressures with long-term value creation.⁷⁸ 

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