

# Thought leadership Sustainability and ESG 2026 – evolving trends



# Sustainability and ESG 2026 – evolving trends

## Key takeaways

- 1 Sustainability and ESG risk is intensifying. Geopolitical instability and rising litigation make it a boardroom issue.
- 2 Regulatory uncertainty defined 2025. 2026 will bring a degree of much-needed clarity, although full regulatory certainty remains out of reach.
- 3 Policy signals stimulate capital flows to priority sectors and natural capital investment through outcome-based funding show signs of scaling-up.

The sustainability and ESG landscape is shifting rapidly, driven by geopolitics, macroeconomic pressures and technological advances. Over the past year, businesses have had to navigate a minefield of emerging standards, political volatility, increased public scrutiny and litigation activity across multiple jurisdictions. Yet this is also a moment of strategic opportunity. Policy signals are stimulating capital flows towards priority sectors, outcome-based financing is expanding and new frameworks for climate, nature and development solutions are taking shape.

This briefing examines 12 key trends influencing sustainability and ESG and what businesses should anticipate in the year ahead.

# 1

## Diverging views of ESG. Still ‘between a rock and a hard place’?

Political polarisation over ESG deepened in 2025, most visibly in the United States, where climate and energy policy and DEI measures remained flashpoints. Policy volatility is unlikely to subside in the short term. As the US is in an election year, the partisan framing of ESG will persist. Indeed, we expect “blue states” to intensify ESG-related action as a counterpoint to the federal rollback. Yet stakeholder expectations – including those of customers, shareholders and employees – tend to be more stable and less reactive to short-term political cycles. Businesses that shift their policies too easily with the political winds risk reputational harm, whereas those whose approaches are anchored in core strategy, mission and material risk management tend to be more resilient. Strategically, there is likely to be a further decline in explicit communication about ESG/DEI topics, while businesses will continue monitoring developments across the sustainability and ESG landscape.

That landscape is complex. Jurisdictional approaches are not harmonised, but rather are characterised by a patchwork of regulatory requirements that businesses must navigate carefully. While some regulatory initiatives relating to due diligence and disclosures have been scaled back due to political or economic pressures, obligations remain firmly in place in many jurisdictions. At the same time, regulatory retrenchment is heightening litigation exposure, with NGOs, investors and other stakeholders increasingly stepping in where regulators pull back.

So, contrary to suggestions that sustainability and ESG issues are diminishing in importance, the reality is quite the opposite. Businesses continue to integrate sustainability into both near- and long-term risk strategies. Moreover, the underlying risks are intensifying, driven by a rise in armed conflicts, shifting geopolitical and geoeconomic dynamics and rapid technological advancement. The World Economic Forum’s 2026 Global Risks [Report](#) ranks extreme weather and pollution among the ten most acute global risks, alongside these geopolitical tensions. Over the decade ahead, half of all identified global risks are environmental in nature – including the top three: extreme weather events, biodiversity loss and ecosystem disruption and critical shifts in the Earth’s systems.

**What to look out for:**

sustainability and ESG risks are rising. Jurisdiction-specific, strategically anchored approaches will be essential, especially for multinationals. Given the current political climate, for many businesses 2026 may indeed feel like another year ‘between a rock and a hard place’.

# 2

## Sustainability regulation – is the picture clearer?

Regulatory uncertainty defined 2025. Global sustainability rules remained fragmented, with regulatory frameworks developing at uneven speeds and at markedly different levels of maturity. While some jurisdictions have advanced new binding requirements, others – including the EU, historically at the forefront of sustainability regulation – have revisited key elements of their frameworks, delaying, scaling back or reversing earlier proposals. The result is an increasingly fragmented and, at times, confusing regulatory picture.

In 2026, the view is becoming clearer in some jurisdictions. In the EU for instance, after a series of delays and revisions, the bloc's first Sustainability Omnibus Package has now been agreed. It introduces simplifications to both the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD) and clarifies aspects of the Taxonomy Regulation. However, the outcome was politically contested, and debate continues over whether large companies will still pass obligations through their value chains despite lighter-touch rules. Clarifications have also been published regarding the Carbon Border Adjustment Mechanism, which was another key component of the Omnibus I simplification package.

On the other hand, if clarity is emerging in some respects in Europe, the picture is less clear in the US, where the regulatory regimes are in flux, shaped by federal recalibration and increasingly assertive – though often contested – state action. Ultimately, this underscores a broader US trend of delayed implementation, regulatory uncertainty and heightened litigation risk.

Regulators elsewhere have not stepped away from sustainability regulation. Across major jurisdictions, including the UK, the EU and APAC, authorities continue to focus on anti-greenwashing measures, sustainability and climate risk reporting, corporate transition plans and promoting transition finance.

These jurisdictions are progressing at different speeds and sometimes, in different directions. For instance, while the UK has abandoned its plans for a Green Taxonomy, Singapore, Australia and China (including Hong Kong SAR) are developing their taxonomies. Sustainability remains at the fore in many parts of the world, including the UK, where the FCA is currently consulting on changes to its Listing Rules to replace the current TCFD-based rules, and in many parts of APAC.

### **What to look out for:**

2026 will bring a degree of much needed clarity, but full regulatory certainty is likely to remain out of reach. Multinational businesses will still be required to navigate an evolving and complex patchwork of requirements – a challenging task that demands significant compliance resources.

# 3

## Higher and broader – litigation risks shape-up

Litigation risks continue to evolve. Claimants are becoming ever more creative in the targets they pursue, the fora they choose and the legal theories they use.

There has been an expansion of claims against asset managers, corporates, governments and private capital firms across a range of issues, including climate-related claims, toxic tort and environmental claims and 'greenwashing'-themed consumer deception and advertising challenges.

In the US, plaintiffs are pressing climate-related cases beyond oil and gas to target other carbon-intensive sectors, with theories including state tort-law and statutory claims such as greenwashing and consumer deception. Toxic tort actions continue to focus on PFAS, microplastics and chemical exposure. The centre of gravity for these cases will be the state courts.

Government-initiated litigation continues to grow as well. Red state Attorneys General (AGs) have scored successes in using antitrust law against ESG-related collaborations regarding net-zero targets and other climate-related goals. In 2025, the AGs persuaded a Texas-based federal court to allow an antitrust case against asset managers for allegedly collaborating to reduce output in the coal sector to proceed. Red-state AGs and the federal authorities have had roles in ongoing litigation involving California's efforts to encourage the increased production of zero-emissions electric heavy-duty truck engines. Building on these successes, red-state AGs have announced the opening of investigations and potentially, litigation against standard-setters across industries. At the same time, the blue-state AGs are mobilising their own playbook. With the mid-term elections approaching in late 2026, we expect the blue states to attempt to show that they have teeth – and indeed, January 2026 saw a new case by the Michigan AG against several oil and gas majors alleging an antitrust conspiracy to suppress competition from clean energy technologies. We expect further movement as numerous cases are filed and percolate through the US courts – as well as increased activity by private plaintiffs and NGOs seeking to leverage off information disclosed through discovery in these cases.

In Europe, we expect an increase in climate change-related lawsuits following the ruling by the Higher Regional Court of Hamm/Germany in the lawsuit of a Peruvian farmer, supported by an environmental NGO, against a German energy giant which affirmed liability for climate change-related damages in an obiter dictum. Although the court merely conducted a so-called conclusiveness test (Schlüssigkeitsprüfung) and did not take the defendants' arguments into account, the plaintiffs are attempting to use the ruling for further lawsuits and have already lodged multiple court actions. As part of their strategic litigation, the plaintiffs could file further lawsuits in other courts and against other companies to increase overall pressure on the industry.

The EU has also maintained its focus on greenwashing. The so-called Empowering Consumers Directive (EmpCo), which applies to all companies, must be implemented by the member states by 27 March 2026 and applied by 27 September 2026. National transposition is ongoing. We expect that this will further intensify scrutiny, including at the member state level, where we see courts taking different approaches. In France, for instance, issues relating to greenwashing have attracted significant regulatory and judicial attention. French courts have adopted a rigorous approach to consumer-facing communications referring to carbon neutrality when published next to commercial offers, although not at communications directed purely to institutional investors. They have held that assertions regarding carbon-neutrality objectives must correspond to the trajectory and targets of the Paris Agreement, as established by the IPCC and the broader scientific community, unless expressly indicated otherwise. French courts have also demonstrated a willingness to disregard nuanced or qualified language in attaching liability. Notably, they have found that the use of the term “ambition” may be construed as equivalent to a binding “commitment.”

In the APAC region, Australia, Japan and New Zealand are also seeing rising climate and ESG-related legal activity, from greenwashing enforcement to activist shareholder strategies. In Australia, a judgment from the Federal Court has shed light on what is required to substantiate net zero statements in corporate reporting, with the reporting entity having the onus to establish that it has a reasonable basis to make statements as to future matters relating to climate or net zero commitments. With mandatory sustainability reporting commencing for large companies in 2026, the focus will be from regulators during an initial transition period, but we expect that this will broaden out to other stakeholders and customers. Greenwashing continues to be a focus in Australia, and we anticipate regulators and claimants will continue to frame claims related to greenwashing or climate under the Australian Consumer Law. While claims in tort related to climate change have been unsuccessful so far, there remain active cases which rely on these causes of action which are underway in common law countries and may, in the future, reveal available causes of action. In an M&A context, ESG diligence has been part of transactions for several years now, with Courts yet to consider the extent to which W&I or warranty claims respond to ESG issues that arise post completion.

**What to look out for:**

across the globe we expect claimants to continue to be inventive in the targets they select, the fora they pursue and the legal theories they advance, especially in light of perceived regulatory enforcement rollback in some jurisdictions. This will make for new and potentially surprising litigation risk.

# 4

## Building resilience to ESG risks amidst increasing conflicts and a fragile international order

The world has become much more unstable, with an increasing number of armed conflicts (both international and civil), geopolitical shifts and economic pressures, the effects of climate change, and disruptions to trade and competition for natural resources. Instability and conflict create uncertainty and risk. In particular, companies operating or investing in conflict zones and other high-risk contexts have come under intense scrutiny for their business activities, including their relationships with parties to the conflict. This affects not just businesses on the ground, but also those along the up- and downstream value chains, including suppliers of arms and technologies used in conflicts, financiers and investors.

There is an increased focus on the impacts businesses may have on conflicts themselves and whether they can be held accountable for the acts of others. These scenarios call for heightened forms of due diligence to address security, human rights, environmental, corruption, sanctions and similar ESG-related risks. This development reinforces a trend of expanding due diligence obligations to downstream activities of companies (i.e. the marketing, distribution, use and end-of-life of products) in addition to their supply/upstream activities.

### Global uncertainty requires agility to mitigate risks.

Yet this heightened attention to risk coincides with efforts by many governments and regional blocs – including the UK, the EU and other NATO members – to increase both public and private sector investment in defence to account for strategic realignments and an intense focus on threats to peace and security. Regulatory concessions, cutting red tape and other incentives to invest are deemed necessary to prepare to resist future aggressions through urgent investment in national security capacity and enhanced defence capabilities. Even though conflicts and the deployment of munitions in them can have devastating environmental, social and human rights consequences, policy makers focused on defence capabilities have been quick to emphasise that investment in the defence sector is not inherently disqualified from being “sustainable”, as it can contribute to the security and resilience of societies.

With an urgent need for private sector investment being a key component of government strategies, many financial institutions are realigning their defence sector policies to anticipate and meet the challenges. Navigating the parameters of the legal, ESG, reputational and commercial risks is compounded by the shifting contours of armed conflict and particularly the impacts of new technologies and their incorporation into autonomous weaponry and sophisticated surveillance capabilities. Managing risks associated with dual-use technologies and businesses producing them is ever more challenging and complex. Businesses across the real economy and those financing it need to be agile yet cognisant of these moving contours and aim to incorporate appropriate risk management into their calculus and their cementing of business relationships that could entangle them in risks in the years to come.

**What to look out for:**

increasingly intense scrutiny on businesses involved or investing in conflict-affected areas, including those that will transition from conflict into peace that may be fragile and may have reconstruction phases that will be challenging. Shifting international alliances and geopolitical reconfigurations will elevate decision-making to boards and will require operational agility and resilience.

# 5

## The social dimension of AI: emerging risks and governance demands

Artificial intelligence will continue to have significant implications for workforces globally, although the scale and nature of this impact will vary across sectors and workforce profiles. While AI presents opportunities for upskilling, enhanced training, improved efficiency and, ultimately, strengthened productivity and profitability, the expansion of AI-driven strategies will require companies to implement robust workforce-governance safeguards. As AI adoption deepens, these matters will increasingly become the subject not only of internal governance processes, but also of external scrutiny from regulators, commercial counterparties, NGOs, unions and other stakeholders assessing both the legal and ethical dimensions of workforce impacts.

Many of the necessary safeguards already exist within established 'S-pillar' frameworks. For example, across multiple jurisdictions, collective workforce-engagement obligations – whether through works councils, unions or elected employee representatives – are triggered when certain restructuring or redundancy thresholds are met. The EU AI Act introduces further requirements for human involvement, transparency and training in the context of 'high-risk' HR-related AI systems, including safeguards aimed at preventing discrimination, although these provisions are not yet fully in force. Data-privacy laws also continue to shape the boundaries within which AI tools may be deployed in workforce management. Other regulatory regimes are still evolving. In the absence of comprehensive horizontal legislation, the UK and the US continue to develop sector-specific or regulator-specific guidance and further consultations are expected in the UK on the role of union engagement in relation to AI-enabled workplace surveillance.

Critically, these considerations cannot be 'layered on' after strategic decisions about AI deployment have been finalised. Instead, social and workforce-governance issues will need to be integrated into early-stage strategic and project planning. From a regulatory perspective, this will require companies to build in sufficient time for consultation processes associated with restructurings, engage with works councils at a formative stage of decision-making and recognise the explicit limits placed on AI systems – such as statutory prohibitions on the use of AI to infer employee emotions in the workplace. More broadly, companies may need to utilise remuneration structures, KPIs, policy frameworks and performance-management tools to mandate or incentivise responsible AI use, embedding AI governance as a core element of workforce governance more generally.

### **What to look out for:**

increasing focus from boards and investors on AI governance, including expectations that companies proactively integrate workforce-governance standards into their AI strategies, planning cycles and deployment frameworks.

# 6

## M&A ESG due diligence: touch points and mirror risks evolve

M&A ESG due diligence is evolving in response to the increasing complexity and materiality of ESG-related risks. These developments are driven by a range of factors, including geopolitical instability, significant shifts in global trade patterns, heightened investment in sectors such as defence and artificial intelligence and the adoption of mandatory sustainability reporting regimes worldwide. As a result, several meaningful 'touch points' are emerging as buyers continue to use ESG diligence to assess value protection and value creation.

First, major disruptions to global trade and investment – such as expansive US tariffs (which will continue to create uncertainty as the Administration reacts to the U.S. Supreme Court's February 2026 decision rejecting one basis for its tariff authority) sanctions, export controls and national security and industrial policies – are prompting companies to diversify or redesign their supply chains.

While such adjustments may mitigate exposure to trade-related constraints, they can simultaneously heighten ESG risks by expanding the number of suppliers, particularly in jurisdictions classified as higher risk. Supply-chain structuring and ESG risk management have therefore become inextricably linked, requiring simultaneous consideration during the diligence process. Companies that have implemented strong ESG diligence processes over recent years are well placed to navigate these supply chain shifts.

### These touch points are crucial for value protection and creation.

Secondly, buyers and investors are increasingly focused on ESG-adjacent risks and opportunities arising from: (a) defence and dual-use technologies; and (b) AI-enabled products and operations. In both areas, diligence is no longer limited to historic compliance, it also extends to product governance, end use and diversion controls and the reputational and societal impacts of downstream deployment. For EU-facing businesses, buyers are testing readiness for emerging AI governance and documentation expectations, alongside export control and sanctions risk that can directly affect market access, ability to secure customer contracts, valuation and integration post completion.

Thirdly, as sustainability disclosure regimes continue to be rolled out globally, ESG diligence is now routinely used to assess the 'reporting readiness' of the target – that is, whether the target can produce consistent, decision-useful and, increasingly, assurance-ready sustainability information (not just policies and narratives) across the jurisdictions and value chains in which it operates. In practice, buyers are asking 'can this business produce sustainability disclosures to a standard that would withstand scrutiny from a regulator, an auditor and/or assurance provider, a lender and a customer'? This includes evaluating the governance of the target, including board and management oversight and clear ownership of sustainability disclosures, the data architecture and systems adopted by the target to capture and manage ESG data and the internal controls of the target that are adopted to support external assurance of the quality of ESG data.

Alongside these emerging touch points, a corresponding 'mirror risk' has developed. In jurisdictions where political sentiment has shifted towards an 'anti-ESG' posture, ESG diligence must also assess whether the target's practices, disclosures or external messaging could create legal, contractual, reputational or stakeholder exposure by being perceived as excessively 'pro-ESG'.

Against this backdrop, M&A ESG due diligence is shifting from a predominantly historical, compliance-based assessment to a more forward-looking analysis, focused on product use, downstream impacts and future obligations. On the environmental side, this includes transition, resilience and litigation risks, including claims relating to greenwashing and climate change. Buyers are increasingly assessing the credibility and executability of climate transition plans, exposure to climate and nature-related litigation and the robustness of environmental data systems, alongside physical climate risks to assets and supply chain dependencies that could affect value over the life cycle of the investment. On the social side, key areas of focus include employee-relations risks, particularly in light of reforms affecting collective and worker rights, as well as the growing threat of activist or NGO challenge, including from a human-rights perspective.

**What to look out for:**

M&A ESG due diligence will continue to mature and become increasingly 'financial-grade' with investors applying higher evidentiary standards, auditability and clear consequence in valuation and deal terms, consistent with the discipline traditionally reserved for financial due diligence. In practice, we expect that this will result in a deeper, more prospective assessment of a target's sustainability profile, extending not only to internal operations, but also to the downstream use and impacts of its products and services.

# 7

## Sustainable finance – policy signals stimulate capital flows

Notwithstanding periodic policy reversals, governments and the voluntary sector continue to use measures aimed at stimulating the flow of sustainable finance into priority sectors with strategic importance.

One such sector is defence. There has been intense scrutiny of the role private capital may play in defence-related investment and renewed debate regarding the extent to which defence and dual-use activities can be characterised as 'sustainable'. Regulators in both the EU and the UK have recently issued guidance clarifying the application of their sustainable finance frameworks to the defence industry. In parallel, private investors are re-evaluating their investment strategies, including the structure and scope of exclusion lists and there is growing emphasis on conducting robust due diligence on potential defence and dual-use investment opportunities.

**What to look out for:**

ongoing refinement of investor policies and sustainability mandates and an increased focus on due diligence for defence-linked investments.

Carbon markets represent another area undergoing significant policy-driven evolution. Despite progress under Article 6 of the Paris Agreement and supportive statements from several governments endorsing carbon trading, natural-capital finance via carbon markets has remained largely stagnant in recent years. One contributing factor has been the 'drag effect' associated with the voluntary Science Based Targets initiative (SBTi) standard known as 'Beyond Value Chain Mitigation' (BVCM), which has been widely recognised as a key constraint on market demand.

Coinciding with COP30 in Belém, the SBTi announced proposals to replace the BVCM mechanism with a new construct – 'Ongoing Emissions Responsibility' (OER) – which would encourage companies to use high-quality carbon credits as a complement to emissions reductions within their own value chains. The proposed OER framework, expected to be adopted in 2026, together with positive policy signals from governments and the anticipated finalisation of Article 6, have the potential to reinvigorate natural-capital carbon markets.

**What to look out for:**

indications of a potential tipping point, including increased activity and renewed liquidity within the carbon markets.

# 8

## Natural capital investment through outcome-based funding shows signs of scaling-up

Investor interest in natural capital continues to grow, with private capital funds launching dedicated strategies and banks and asset managers introducing new products focused specifically on biodiversity and natural capital themes. One segment of the market that appears poised for expansion is outcome-based financing – structures in which investor returns are linked to the achievement of specific, independently verifiable social or environmental outcomes. Also included in this market segment would be instruments with payments linked to the generation of carbon credits.

### Natural capital outcome bonds are becoming a more mature, investable asset class.

Although the World Bank remains the largest and most active issuer of outcome-linked bonds, the scalability of this asset class hinges on broader market participation. Encouragingly, the number of outcome bonds in issuance is increasing, with more project developers and arrangements with third-party 'off-takers' gaining further traction. These off-takers – frequently large multinational corporates – commit to purchasing the carbon credits generated by the project which the outcome bond is financing. These 'off-take agreements' are crucial, because they provide the project with a guaranteed future revenue stream and a market for the 'outcome', which significantly de-risks the investment for bondholders and helps secure up-front financing.

**What to look out for:**

evidence that outcome-based financing is scaling – such as new issuers beyond MDBs and greater corporate participation as off-takers. Growth in long-term offtake agreements and deeper private-sector engagement would signal that natural capital outcome bonds are becoming a more mature, investable asset class.

# 9

## Climate, nature and development solutions draw interest from private capital investors

Private capital investors are showing growing interest in climate and nature-based solutions, supported by a concerted effort across markets to make such investments more accessible and attractive. This trend is particularly significant for projects in emerging and developing economies, which require an estimated US\$1.3 trillion annually to meet climate and development goals. In these jurisdictions, the participation of private capital is essential to closing the substantial funding gap.

Recent use of a range of innovative financing structures incorporating blended finance, joint initiatives by MDBs and the private sector to improve transparency, monitoring and evaluation standards, alongside expert recommendations to expand credit-enhancement models for sustainability-linked sovereign financing all aim to mobilise private capital.

While challenges remain, these developments represent important building blocks that should help accelerate the flow of private capital into climate, nature and development solutions.

**What to look out for:**

increased investor participation, wider use of innovative financing structures and signs that climate, nature and development solutions are becoming a more mainstream investment category.

# 10

## Regulatory change on the horizon for funds managed or marketed in the EU

The forthcoming revisions to the EU Sustainable Finance Disclosure Regulation – commonly referred to as 'SFDR 2.0' – will introduce important changes for funds managed and marketed in the EU. Notably, current proposals for SFDR 2.0 include the introduction of three new sustainability-related product categories (Transition, ESG Basics and Sustainable) which would replace the existing disclosure regimes under articles 8 and 9 of the SFDR. The proposals would remove the prescriptive 'sustainable investment' definition that features in the current regime and would also impose restrictions on names and marketing materials in respect of non-categorised products. The SFDR 2.0 proposals for the 'level 1' text are now being negotiated through the EU legislative process and will be supplemented in due course by additional 'level 2' measures, which will add further practical details and set out revised disclosure and reporting templates.

**The final shape of SFDR 2.0 may not be known for many months.**

The SFDR 2.0 proposal includes grandfathering provisions in respect of certain existing closed-ended products. However, existing funds that are not eligible for grandfathering and new funds in the pipeline will need to assess and update fund documents, marketing materials, investor communications and internal policies and procedures for compliance with the new regime, once finalised. The final shape of SFDR 2.0 may not be known for many months, due to changes that may be made as the proposals are negotiated through the EU Parliament and Council, and the requirement for the (as yet unpublished) level 2 proposals to be subject to consultation.

**What to look out for:**

debate over the final contours of SFDR 2.0. By mid-2026, the direction of travel for the level 1 proposals should become clearer. However, the details of the level 2 measures are expected to be key to enabling fund managers to assess the viability of the new product categories and to prepare for the operational, disclosure and data governance implications of the revised framework.

# 11

## ESG risks: the insurance gap widens

Insurance continues to play a central role in the management of ESG-related risks, yet securing comprehensive protection for the full spectrum of potential exposures remains unattainable.

Companies are increasingly subject to challenges from both environmental advocates and their critics, with claims often directed at corporate environmental policies or the way such policies are articulated. Directors' and Officers' (D&O) insurance frequently responds to allegations of greenwashing; however, coverage of shareholder claims is not uniform, and separate policies may be required. Broader challenges to corporate policy are generally less likely to fall within the scope of cover, although certain general liability policies may provide limited protection.

Claims arising from employee misconduct and workplace-related issues remain prevalent. These include health and safety concerns, discrimination or harassment, diversity and inclusion failings and allegations of a toxic workplace culture or mental-health harms. Bespoke employment practices liability policies typically respond to many such claims, but individuals may not always benefit from coverage under D&O policies.

Although regulatory enforcement activity in the United States has slowed, boards globally remain exposed to governance-related risks. D&O insurance continues to constitute the primary line of defence, particularly as board members are likely to be named individually in governance-related actions brought against the company. Nonetheless, deliberate fraud and criminal fines are typically excluded from cover. Professional indemnity insurance may respond to negligence-based claims, while specialist policies, such as cyber insurance, can be arranged to address data-breach liabilities arising from governance failures.

Businesses are also increasingly affected by the physical impacts of climate change, with extreme weather events occurring with greater frequency. Property insurance and business interruption policies can offer protection for physical damage or loss of income. However, organisations with elevated exposure may face significantly higher premiums or find that certain premises become effectively uninsurable. Absent state-supported alternatives, this may have material implications for the long-term viability of such assets.

### **What to look out for:**

ESG-related risks will continue to rise in both scale and complexity. Although insurance remains a key component of corporate risk management, it is unlikely to provide comprehensive cover for all potential exposures, resulting in an increasing 'insurance gap'. Companies will therefore need to adopt a broader suite of risk-mitigation strategies.

# 12

## Strengthening supervisory expectations on climate-related risks

For several years, financial regulators have required the boards of financial institutions to consider the impacts of climate change as a core financial risk – one that directly affects business strategy, governance structures and long-term resilience. Supervisory authorities appear now to be shifting to more prescriptive requirements, ensuring that climate-related risks are properly embedded in strategy, governance and decision-making.

The UK Prudential Regulation Authority (PRA) for instance was among the first regulators to require firms to assess the financial impacts of climate change on their business models. The recently updated Policy Statement 25/25 and Supervisory Statement SS5/25, effective December 2025, significantly strengthen previous expectations for all UK (re)insurers and banks, including international groups, although not UK branches of third country firms. The PRA has expressed concern that boards often receive climate-risk analysis that is insufficiently specific or decision-useful to inform strategy or capital planning. Common deficiencies include climate-risk models that do not provide adequate granularity within shorter time horizons (particularly those under five years), challenges in modelling climate tipping points and questions as to whether boards possess sufficient expertise to interrogate climate-risk modelling outputs.

In response, the PRA has required firms to complete a comprehensive gap analysis by June 2026 and to demonstrate genuine integration of climate considerations into strategic and risk-management processes. This includes clearly articulated board and senior-management responsibilities and coherent alignment between climate strategy, internal control frameworks and forward-looking scenario analysis.

These developments indicate a clear hardening of supervisory expectations, with future requirements likely to become increasingly prescriptive – potentially extending to formal competency requirements for board members or more standardised oversight and assurance processes. Boards that act now – by strengthening governance structures, ensuring that directors have access to appropriate training and expertise, enhancing the quality of climate-risk analysis and embedding climate considerations within strategic and capital-planning processes – will be better positioned to meet rising supervisory expectations and to demonstrate resilience in an environment where climate-related risks are becoming central to regulatory scrutiny.

### **What to look out for:**

tightening supervisory expectations, possible movement towards formal board-level competency requirements, and greater regulatory scrutiny of the quality and decision-usefulness of climate-risk information provided to boards.

# What's next?

As we move through 2026, the global ESG and sustainability landscape will continue to evolve, driven by geopolitical and geoeconomic upheavals, an escalation in armed conflicts and the unprecedented pace of technological change. Litigation and enforcement activity will continue to diverge, pressuring companies from multiple and often opposing directions. Throughout it all, significant shifts in investor expectations, evolving due diligence norms and expanding governance responsibilities mean that sustainability considerations are now integral to long-term operational and strategic decision-making.

At the same time, policy signals and market innovation are generating new opportunities across sustainable finance, natural capital and climate, nature and development solutions – particularly for organisations able to respond swiftly and strategically.

Ultimately, the businesses that will be best positioned to thrive in a rapidly changing environment will be those that actively engage with regulatory and market developments, embed sustainability into core governance and strategic processes and remain vigilant to both the risks and the opportunities inherent in this transition. In an era defined by uncertainty, adaptability and forward-looking perspectives will be the hallmarks of resilient and successful organisations.

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