

The backlash is backfiring: The institutionalization of ESG

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Executive summary

Interviews with thirty-six Canadian institutional investors representing \$10.3 trillion in AUM reveal a market that has not retreated from ESG, but one that has recalibrated and institutionalized how sustainability-related risks and opportunities are addressed. Despite political pushback, particularly in the United States, and heightened scrutiny following Canada's Anti-Greenwashing Act (Bill C-59), ESG considerations are reported as being more deeply embedded within mainstream investment, risk, stewardship, and governance functions.

Nearly all respondents confirmed continued integration of ESG considerations, with **97% indicating a high level of ongoing commitment**. Rather than diluting focus, external pressure has accelerated a shift away from broad narratives toward financial materiality, risk management, and fiduciary accountability. Climate change remains the dominant priority, with growing emphasis on execution, physical and transition risk management, and portfolio-level integration. Biodiversity, Indigenous reconciliation, governance, namely AI governance, and disclosures have also emerged as key areas of focus, shaped increasingly by client expectations.

Of these, governance has emerged as the most acute concern. As ESG becomes institutionalized, governance is increasingly viewed as the primary mechanism through which fiduciary duty is executed. Heightened concern was expressed around shareholder rights, stewardship effectiveness, and the evolving nature of engagement, which is marked by more targeted, board-level, and policy-focused approaches rather than broad collaborative initiatives.

Artificial intelligence is a rapidly accelerating force. **While 94% of investors already use AI for issuer analysis**, adoption for formal risk assessment and risk management lags, creating a growing gap between analytical capability and governance oversight. This gap is expected to narrow quickly, with 2026 anticipated as a year of deeper implementation. AI is widely viewed as a material source of disruption for companies across sectors, with implications for competitiveness, labour, and long-term risk.

Against this backdrop, disclosure has become a critical pressure point. Heightened greenwashing risk has contributed to more cautious disclosure and, in some cases, silence. In an AI-enabled information environment, silence itself is increasingly a material risk, undermining comparability, confidence, and access to capital. Clarity from policymakers on disclosure requirements, particularly what constitutes defensible, good-faith disclosure, was identified as urgent and essential to restoring momentum.

Taken together, the findings point to a Canadian market at an inflection point. ESG is no longer a parallel agenda, but part of the core infrastructure of capital allocation. The challenge ahead is execution: sustaining credible governance, decision-useful disclosure, and disciplined stewardship so that Canada's capital markets can remain competitive, resilient, and secure in a period of heightened geopolitical and economic uncertainty.

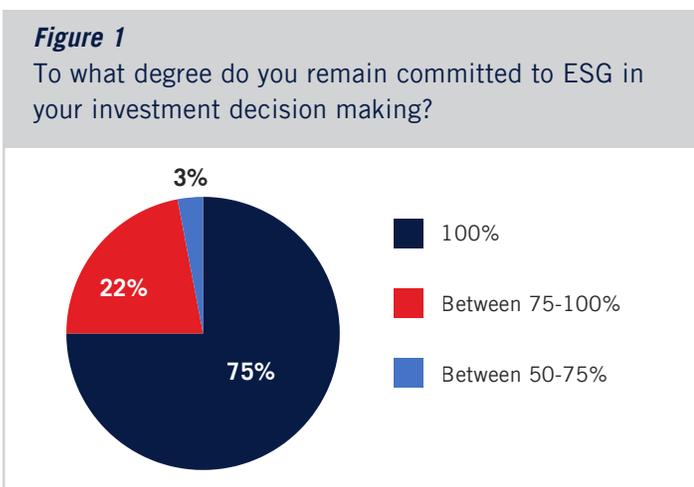
Introduction

Across global capital markets, the past several years have been marked by heightened uncertainty. Political polarization, geopolitical instability, regulatory changes, and rapid technological advancement have reshaped how risks are assessed and how capital is allocated. In this environment, narratives suggesting a retreat from environmental, social, and governance (ESG) considerations have gained prominence.

Insights from interviews with thirty-six Canadian institutional investors representing \$10.3 trillion in AUM investors present a more nuanced picture. Rather than retreating, ESG considerations are being recalibrated and increasingly institutionalized as they become embedded into core investment decision-making, governance structures, and fiduciary practice. This report examines how investors are responding to this shift, how policy and disclosure dynamics are influencing behaviour, and what leadership looks like as markets adjust.

From pushback to practice: The institutionalization of ESG

Over the past year, ESG has been increasingly framed through a political lens, particularly in the United States (U.S.). Headlines have focused on backlash, retrenchment, and a perceived retreat from sustainability commitments. Yet investor data and qualitative insights point to a markedly different reality.



When asked directly about their organization's commitment to ESG related considerations being integrated in investment decision-making, 97% of respondents confirmed a very high level of continued commitment.

Specifically, 75% of respondents indicated that their commitment to ESG is 100%, with a further 22% indicating continuing at a level of 75-100%. Those selecting the latter emphasized that this reflected mandate, or asset class-specific constraints in certain asset classes or investment strategies, rather than any reduction in overall commitment to ESG integration.

Rather than weakening ESG integration, political pressure and regulatory scrutiny have accelerated its institutionalization across investment organizations. What was once concentrated within specialized teams is now being embedded across mainstream investment functions, including portfolio management, risk, compliance, stewardship, and communications. As one investor noted:

"I don't think you can carve out the sustainability part of the investment process."

Investors consistently described the current environment as one that has forced greater discipline. The combination of U.S. political pushback, litigation risk, and Canada's Competition Act amendments (Bill C-59) has shifted ESG decisively away from broad narratives toward financial materiality, risk identification, and fiduciary accountability. One participant summarized this shift succinctly:

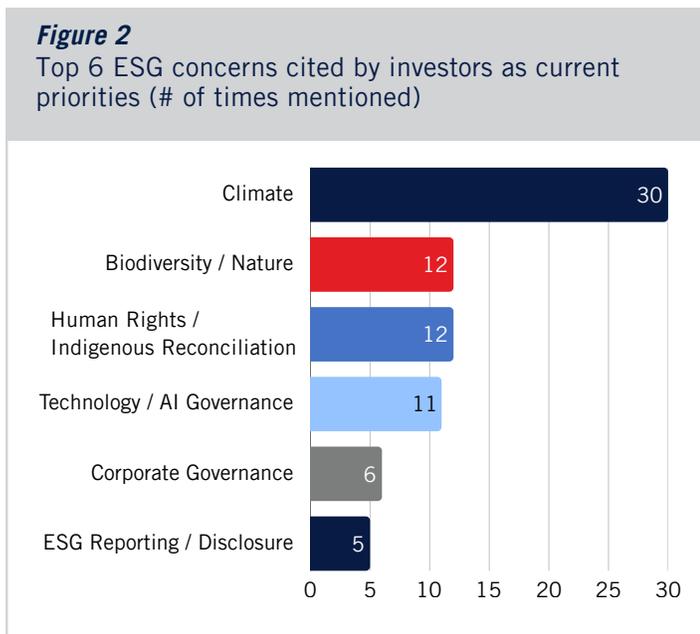
"In stepping back, we have an obligation to re-formalize our processes. Internally, the commitment is still there at the board level and at the investment committee level. This return to financial materiality makes things much easier [...] when we moved from pure exclusion to ESG inclusion [...] we lost our way somewhat in the following years; this is the normalization phase that is coming."

Importantly, this recalibration is not translating into wholesale geographic reallocation of capital. While political and regulatory developments in the United States were frequently cited as sources of risk, the majority of investors indicated that they continue to maintain significant exposure to U.S. markets. Most respondents reported no material shift away from U.S. allocations, while a smaller subset described incremental adjustments, including selective increases in Canada or emerging markets where policy signals, incentives, or climate transition pathways were viewed as more stable or investable.

These decisions were consistently framed through a fiduciary lens, emphasizing diversification, liquidity, scale, and opportunity set rather than reactions to headlines. Several investors also pointed to the scale and concentration of exposure to U.S. technology companies as a structural factor shaping allocations, underscoring the difficulty of rapid geographic shifts given liquidity, market depth, and index composition. Taken together, the findings reinforce that institutionalization is constraining abrupt shifts: capital is being calibrated, not redirected, even amid heightened geopolitical and policy uncertainty.

The result is not a retreat, but a maturation of practice. ESG has moved into the mainstream of investment decision-making, with a sharper focus on what is material, measurable, and defensible.

Across interviews, investors described a concentration of ESG priorities, with some themes clearly dominating attention and others emerging as important areas of focus depending on mandate, geography, and client demand.



Climate change remains the dominant ESG priority, cited by the vast majority of investors. However, the emphasis has shifted decisively from target-setting toward development and communication of climate transition planning. Investors highlighted a stronger focus on managing physical and transition risks, integrating climate considerations at the portfolio level, and embedding climate analysis into core investment and risk processes. As one investor noted, **“Climate risk – transition and physical – [is front and centre]. We do a lot of climate scenario analysis and continue revisiting it.”**

Biodiversity and nature also feature prominently, often discussed alongside climate. Investors acknowledged growing awareness of nature-related risks and dependencies, but consistently flagged challenges around data quality, measurement, and the availability of investment-ready metrics. As one participant observed, **“Clearly nature and biodiversity present concerns, but it is not framed well yet for the investor community.”**

On the social dimension, human rights and Indigenous reconciliation remain core priorities, with Indigenous reconciliation standing out as a Canadian focus. These issues are increasingly viewed as material across portfolios rather than confined to responsible investing strategies, driven by regulatory expectations and supply-chain considerations. One investor emphasized, **“As a Canadian investor, Indigenous reconciliation is not just for responsible investing. For us, it is something material that all investors must have on their radar.”**

Alongside these established priorities, governance and technology, particularly artificial intelligence (AI) governance, are gaining prominence. Investors pointed to rising complexity around oversight, executive incentives, and technology-related risks as AI adoption accelerates.

Finally, client demand is increasingly shaping ESG priorities, particularly around data, reporting, and disclosures. As firms scale ESG practices across funds and asset classes, investors noted that expectations from asset owners and clients are driving greater consistency and transparency.

Taken together, these priorities provide important context for the sections that follow, particularly the heightened concern around governance, AI, shareholder rights, and the evolving role of engagement as a core component of stewardship.

Canada’s federal policy signals: Beyond the headlines

Investor reactions to Canada’s recent federal policy signals, particularly the federal budget and proposed revisions to the Competition Act, highlight a growing gap between public discourse and institutional interpretation.

While public debate has often framed the budget as lacking ambition on climate, many investors expressed a more nuanced assessment. Those who examined the budget in detail emphasized that it contained more decarbonization-related incentives and enabling measures than headline narratives suggested, particularly for industrial transition, clean technology, carbon pricing continuity, and methane regulation. Divergence in views often depended less on ideology and more on the depth of engagement with the policy details.

Investors broadly characterized the budget as incremental and politically constrained, rather than transformational. For long-term capital allocators, this pragmatism was not viewed as a weakness, but as an acknowledgement of governing realities in a polarized environment.

A more dominant theme was the reaction to Canada's Anti-Greenwashing Act (Bill C-59). Investors expressed strong support for the intent of the legislation, which is to combat greenwashing and preserve market integrity, while noting that its initial formulation introduced legal uncertainty and contributed to a chilling effect on disclosure. Many welcomed the federal government's willingness to revisit the legislation and offered consistent suggestions, including safe harbour provisions for good-faith disclosure, clearer definitions of greenwashing, and more pragmatic treatment of methodological requirements. Respondents suggested that explicitly recognizing disclosures prepared in line with internationally recognized standards (such as the International Sustainability Standards Board's (ISSB) and the suggested Canadian Sustainability Standards Boards (CSSB)), as meeting the Act's reference to "international methodologies" would provide much-needed clarity and allow issuers to move forward with greater confidence.

Taken together, investor confidence appears less dependent on any single policy decision and more influenced by clarity, consistency, and guidance over time. **Until that clarity is achieved, investors cautioned that issuers are likely to remain conservative in their disclosures and communications, underscoring the urgency for government action if capital markets are to move forward with confidence.**

The institutionalization of governance: Shareholder rights, stewardship, and engagement

Governance has emerged as the most acute area of concern for investors in the current environment.

As ESG considerations have become more deeply embedded, governance has re-emerged as the primary mechanism through which investors execute fiduciary duty, and increasingly as the area where investors feel that their ability to do so is under pressure. Governance is no longer viewed as one ESG pillar among others, but as the operating system that enables accountability, effective stewardship, and long-term value creation.

This recalibration is occurring amid mounting concern about the erosion of shareholder rights, particularly in the United States. Investors described this not as a theoretical risk, but as a direct challenge to their fiduciary responsibilities. Investors cited political polarization,

regulatory uncertainty, and increased scrutiny of proxy advisory firms as sources of risk to established stewardship norms. As one investor put it, **"Stewardship is core to the work that we do. There are headwinds out there, in the US and from the SEC... What do we do from a strategic point of view?"** Another noted that recent developments require adapted approaches, **"Other than in the US where we need to be careful, we continue... we ask questions differently."**

In response to these concerns, engagement practices are evolving. Investors described a shift toward more direct, deliberate, and board-focused engagement, alongside a reduced emphasis on broad, collaborative engagement initiatives. At the same time, there is growing focus on policy-level and system-wide engagement, as investors seek to influence the structural conditions shaping markets, ranging from regulatory frameworks and market rules to stewardship norms and shareholder rights. Greater formalization of escalation frameworks and more disciplined documentation reflect adaptation rather than disengagement.

Importantly, this investor-side recalibration mirrors trends across the Canadian corporate landscape, but with important nuance. Millani's [2025 ESG disclosure study of S&P/TSX Composite Index](#) found that while sustainability-related reporting has remained broadly present, issuers appear to be consolidating practices and moderating tone in response to heightened greenwashing risk, legal uncertainty, and evolving regulatory expectations. Rather than signaling retreat, this reflects a defensive recalibration: disclosure processes are increasingly institutionalized, but caution around forward-looking detail and narrative ambition has become more pronounced as companies seek to manage legal and reputational exposure while preparing for alignment with global standards such as IFRS S1 and S2.

Artificial intelligence: Accelerating disruption and rising urgency

Artificial intelligence (AI) has emerged as a rapidly rising and increasingly urgent focus area for investors as they look toward 2026. What was recently viewed primarily as an efficiency-enhancing tool is now widely understood as a fast-moving source of disruption, with the potential to materially reshape companies, sectors, and portfolio risk profiles in a compressed timeframe.

Survey results confirm that AI adoption among institutional investors is already well underway, but with important variation in how these tools are being applied. Ninety-four percent (94%) of respondents reported at least some use of AI to analyze issuer data and extract meaningful insights, underscoring how quickly AI is becoming embedded in research and analytical workflows.

In practice, 61% indicated moderate to extensive use, and 22% already report significant or extensive implementation, signalling that advanced deployment for issuer analysis is no longer confined to early adopters.

By contrast, the use of AI for formal risk assessment and risk management remains less advanced and more uneven. While some investors are beginning to apply AI meaningfully in risk contexts, the data shows a heavier concentration at the lower end of adoption, with many firms still in exploratory or early implementation phases. This divergence highlights a growing gap between analytical use and risk integration, reinforcing investor concerns that governance, oversight, and control frameworks may not yet be keeping pace with the speed and scale of AI deployment. Many respondents noted that 2026 is expected to mark a period of accelerated and deeper implementation, particularly as firms work to more fully integrate AI into risk and control functions.

Respondents expressed that these challenges are compounded by physical and systemic constraints such as access to power, grid capacity, water availability, and data infrastructure, but also the absence of clearly articulated governance guardrails. Where investor comfort exists, it is typically grounded in fundamentals: clear policies, defined accountability, data protection, meaningful human oversight, and board-level awareness.

Together, these factors show that AI is not only a technology issue, but also a governance and disclosure challenge that increases scrutiny across multiple ESG priorities and raises the consequences of information gaps.

Disclosure, greenwashing, and the Canadian paradox in an AI-enabled market

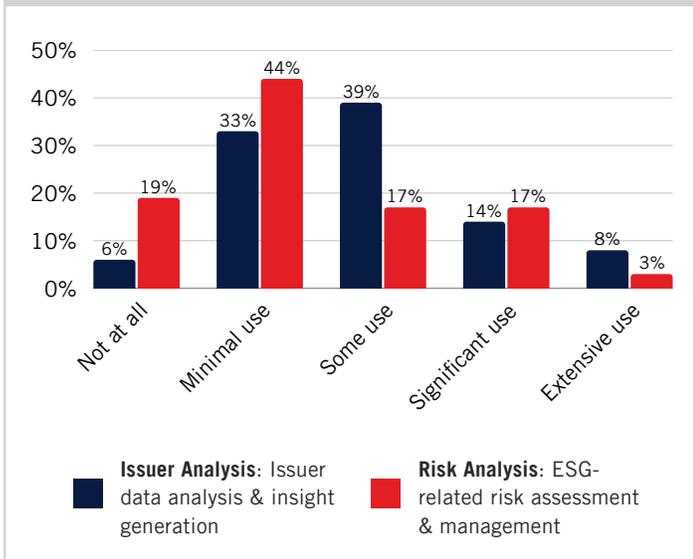
Millani’s analysis suggests that the implications for disclosure and communications are immediate. While public companies are subject to broad corporate disclosure obligations around material risks, strategy, and performance, heightened concerns about greenwashing are driving more cautious disclosure and, in some cases, silence. That silence is increasingly seen as a material risk. In an AI amplified information environment, models rely heavily on publicly available data; where information is limited, assumptions, proxies, and third-party interpretations will fill the gap.

Investors were clear: **companies that do not actively own their narrative risk being assessed on partial or misaligned information rather than context they control.** Over time, this can distort investor understanding, undermine credibility, and constrain access to capital, an increasingly critical consideration for companies operating in a volatile geopolitical and economic environment.

Taken together, these dynamics help explain why disclosure and communications have become a focal point across multiple ESG priorities, from climate and nature to Indigenous reconciliation, governance, and emerging technology risks. As investors recalibrate how ESG is embedded and governed, disclosure has become the connective tissue linking execution, oversight, and market confidence.

Investor feedback highlights a paradox in the Canadian market. As sustainability risks are increasingly recognized as material, fears of greenwashing accusations have contributed to more cautious disclosure. As noted by two investors **“Everybody is so guarded... they don't want to speak anymore,”** and **“We are being careful with what we say, more cautious with communications.”**

Figure 3
Use of AI by institutional investors: Issuer analysis vs. risk analysis



Beyond internal use, AI is viewed as a material source of disruption for companies across sectors. Risks extend beyond valuation and concentration to include rapid changes to business models, competitive positioning, labour and skills requirements, intellectual property, and barriers to entry. Investors expressed that these shifts also carry broader social implications, including workforce displacement, skills polarization, and widening inequality, which increasingly feed back into regulatory, reputational, and long-term performance risks.

Bill C-59 has played a central role in shaping this environment. While investors support its intent, many observed that legal uncertainty has contributed to greenhushing, particularly around forward-looking information. This concern was reinforced in discussions following broader debates around shareholder rights, governance pressures, and the rapid adoption of AI tools, where clarity and defensibility of disclosure have become increasingly critical.

Defence and geopolitics: Revisiting boundaries

Geopolitical instability featured prominently in investor discussions. Ongoing conflicts, shifting alliances, and increased defence spending are reshaping how risks related to national and economic security are assessed.

Within this context, defence has re-emerged as a complex and sensitive topic for institutional investors. Many responsible investing policies include long-standing exclusions related to military or defence exposure, reflecting client expectations, historical norms, and ethical considerations embedded in mandates and fund structures.

As the geopolitical landscape has shifted, these policies are increasingly being challenged. Investors described active internal discussions around where boundaries currently sit, whether they remain fit for purpose, and how, if at all, they should be adjusted. These debates are rarely straightforward. As exclusions and constraints are often client-driven, changes raise questions about mandate integrity, beneficiary expectations, and consistency across portfolios.

As a result, many organizations are navigating periods of internal debate rather than immediate policy change, weighing fiduciary duty, national and economic security considerations, governance oversight, and long-term alignment. To date, this has translated into deeper discussion rather than widespread revision of investment policies, reflecting a cautious and deliberate approach to recalibration rather than reactive change.

This contradiction is demonstrated by comments from these investors:

“We haven’t had a nuanced discussion on defence... I am not completely comfortable with the open flood gates.”

“We are going to revise our exclusions related to controversial weapons and the defence sector.”

What leadership looks like now

In this environment, we are increasingly being asked a simple but important question: If you want to lead, what does leadership actually look like? Our analysis points to a more demanding view – one grounded less in rhetoric or positioning and more in clarity, discipline, and execution.

Across both issuers and investors, leadership is increasingly defined by the ability to navigate complexity without retreating into silence, while maintaining credibility with capital providers. This includes demonstrating a clear internal logic for how risks and trade-offs are identified, governed, and communicated, and being explicit about where flexibility exists and where principles remain non-negotiable; particularly in areas such as governance, shareholder rights, and fiduciary responsibility.

While the contexts differ, investors noted that expectations of leadership are strikingly similar across both groups. In an environment defined by heightened scrutiny and rapid change, leadership is reflected not in perfection, but in coherence, internal alignment, and consistency over time.

Across both groups, governance emerged as the critical enabler linking intent to action. Strong governance, characterized by clear accountability, informed oversight, and disciplined decision-making, was viewed as essential to sustaining credibility and confidence with capital providers over the long term.

A message to Canadian asset owners: Closing the signal gap

A recurring theme throughout the interviews was the critical role of asset owners. Particularly in a period where oversight of asset managers is becoming more intensive, more sophisticated, and more deeply embedded in governance processes. Many investors emphasized that expectations, scrutiny, and accountability are increasingly being addressed through private dialogue, mandate design, ongoing monitoring, and bilateral engagement.

At the same time, respondents noted a growing tension between strong private governance and relative quiet in public-facing markets and communications. In a polarized environment where external narratives often move faster than private processes, this absence of visible signalling can, at times, create uncertainty or invite misinterpretation despite robust oversight occurring behind the scenes. Investors were careful to acknowledge that public communication carries real risk for asset owners, including the potential for heightened scrutiny or politicized response.

From this perspective, the message is not a call for activism or broad public positioning, but for measured, proportionate, and intentional signals that reinforce long-term expectations. Even limited public affirmation, aligned with existing mandates and fiduciary obligations, can help stabilize market understanding, support alignment across the investment value chain, and reduce uncertainty for managers operating in a highly scrutinized environment.

Several respondents also cautioned against overlooking the role of retail investors in this environment. While institutional oversight and engagement occur largely through private channels, retail investors rely almost exclusively on public disclosures, media narratives, and visible signals from market leaders. In this context, securities regulators play a critical role in ensuring that all market participants have access to consistent, decision useful information. However, investors noted that current market conditions which are characterized by heightened caution, uneven disclosure, and rapid narrative amplification, may be challenging this objective thereby increasing the risk that different audiences are operating with different levels of information and context.

Several investors cautioned that without some form of visible reinforcement, there is a risk that progress could slow. Not because of declining commitment, but because ambiguity erodes confidence. In an increasingly institutionalized market, asset owner leadership may be expressed as much through thoughtful, calibrated public signals as through the strength of private governance and oversight mechanisms.

Conclusion: From recalibration to durable practice

The findings from this study point to a clear conclusion: despite political noise and regulatory uncertainty, ESG has not receded. It has been absorbed into the core machinery of investment decision making. What is unfolding across markets is not a retreat, but a recalibration that has sharpened focus on materiality, governance, and fiduciary responsibility. For investors, issuers, and policymakers alike, the challenge now is less about direction and more about execution, clarity, and confidence.

In an environment shaped by accelerating technological change, geopolitical fragmentation, and heightened scrutiny, progress will depend on the ability of market participants to act deliberately rather than defensively. Strong governance, credible disclosure, and disciplined engagement are no longer differentiators; they are prerequisites for maintaining trust and accessing capital. As ESG becomes increasingly institutionalized, leadership will be measured by the capacity to set clear boundaries, explain trade-offs, and sustain alignment over time, even when doing so is complex or contested.

Looking ahead, the opportunity for Canada's capital markets lies in translating this recalibration into durable practice. That will require continued policy clarity, thoughtful stewardship, and signals (public and private) that reinforce long-term expectations across the investment ecosystem. The direction of travel is clear. The task now is to ensure that confidence, comparability, and accountability keep pace with ambition. This is essential for capital markets to support economic resilience, competitiveness, and security at a time of rising geopolitical risk, and to contribute meaningfully to Canada's long-term economic development.

Contributors

Thank you to our contributors who took the time to provide their insights on key ESG trends. Our contributors represent 36 of Canada's largest institutional investors, some of which are listed below.



About Millani

Millani provides sustainable investing and corporate sustainability advisory services, including ESG integration and impact, to both investors and companies.

For the past 18 years, Millani has become the partner of choice for institutional investors and corporations alike. By providing advisory services on integrating material ESG issues into investment strategies and decision-making processes, Millani helps reduce risks, increase returns and create value. Millani also regularly develops leading thought leadership on investor and disclosure trends. The firm leverages this expertise and experience to help corporations, both public and private, create strategies, engage with stakeholders and strengthen their strategies and disclosures, supporting the organizations in their access to capital and optimization of market value.

Millani's success is founded on a bespoke, client-centric approach that focuses on material issues, practical implementation, and independent advice. Our extensive capital market experience and unparalleled expertise in ESG and sustainable finance, and its connection to value creation, position Millani at the nexus between investors and companies – making us unique in the Canadian market.

For more information, contact us at info@millani.ca or visit our website www.millani.ca.