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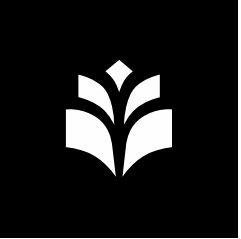
Climate mitigation and biodiversity trade-offs in sustainable investments - how the 'Do No Significant Harm' principle fails to protect biodiversity

Saga Eriksson, SYS Autumn days, 3 September 2025



Objectives and key findings

- Article gives view of sustainable finance regulation and its ability to account for trade offs between climate change and biodiversity
- Article analyses the environmental characteristics of ESG funds offered in Finland, classified under the Sustainable Finance Disclosure Regulation (SFDR)
- Under SFDR, there are two main types of sustainable funds:
 - Article 8 – promotion of environmental and social characteristics
 - Article 9 – intentional sustainability objective
- Empirical examination of SFDR funds indicates that:
 - In Article 8 funds, which have a larger market share (EUR 9.14 trillion), biodiversity aspects are poorly accounted for and DNSH is not fundamentally considered
 - In stricter Article 9 funds (2 % of European fund market at EUR 353 billion), where consideration of significant harm is required, it is often done in a way that leaves obvious harms unaddressed e.g. the case of hydropower and river biodiversity



EU regulatory landscape

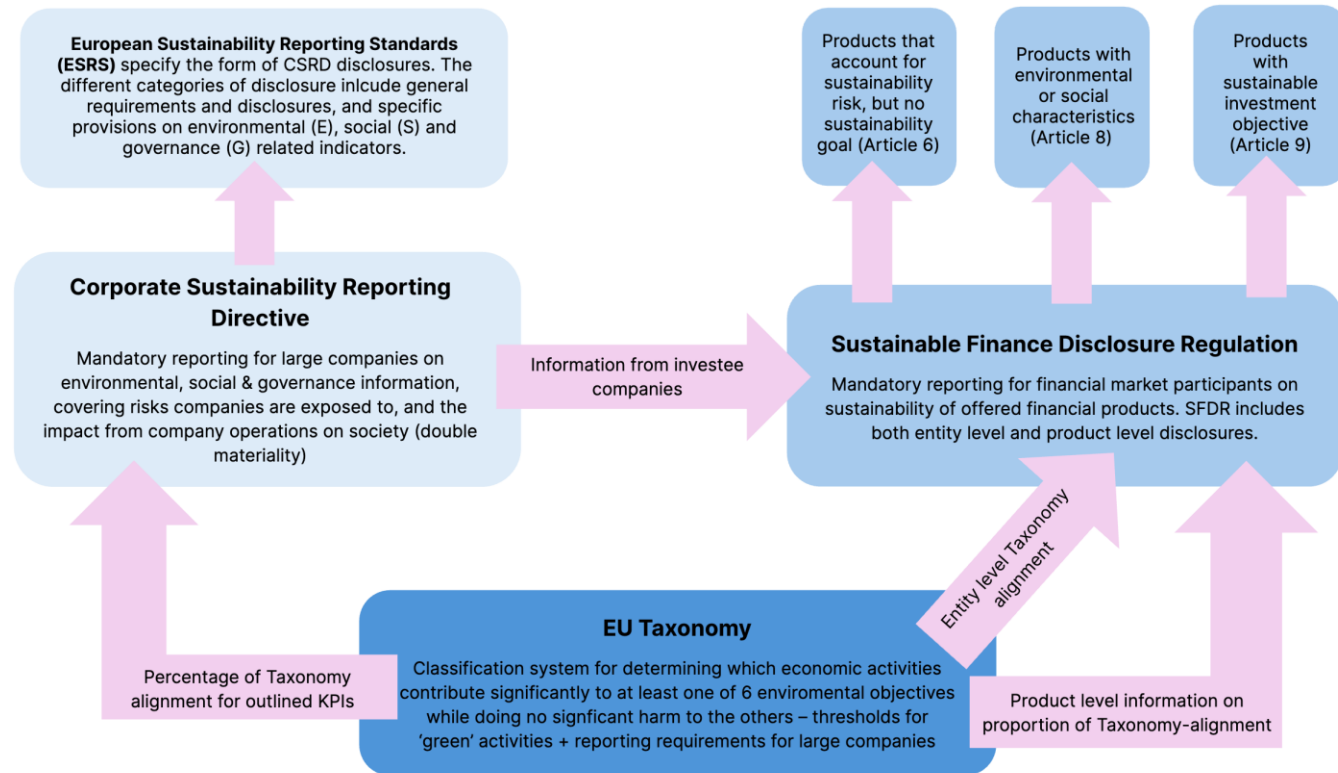


Figure 1. Interrelationship of Taxonomy, CSRD and SFDR and resulting reporting requirements



SFDR disclosure types

	Article 6	Article 8	Article 9
Main feature	Absence of sustainability goals (accounting for risk)	Promotion of environmental and social characteristics	Intentional sustainability objective
Requirements	Pre-contractual disclosures should have descriptions of manner in which sustainability risks are integrated into investment decisions and results of the assessment of the likely impacts of sustainability risks on returns of financial products. Where sustainability risks not deemed relevant, need to explain why.	Product managers required to <u>declare how these characteristics are achieved and what methodology</u> is used to measure them. Information on how characteristics are met and if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics.	Need to indicate <u>how investment contributes to achieving sustainability objective and to explain how this differs from traditional market objective</u> . Need to either provide info on how used index is aligned with objective and if no index is used then need to explain how objective is attained – e.g. where reduction of carbon emissions is objective, disclosed info should include objective with view to remaining consistent with Paris Agreement.



Disclosure as a regulatory mechanism

- Aim of EU regulatory interventions is to incentivise more private funding towards sustainably operating entities
- In the absence of a broad consensus on carbon tax, finance-led initiatives emerge as next best option – relies on presence of climate-conscious investors willing to exercise their influence, and who have a preference towards sustainability
- Better quality disclosures are thought to impact the cost of capital through two main routes:
 1. There is a clear label for sustainably operating entities, and investors prefer risk-return profile of investments that perform better on ESG criteria → better sustainability information allows for investors to fulfil their preference, and this in turn creates more demand for sustainability
 2. Better information leads to better management of climate risks → the cost of capital for entities with better managed risks is lowered



Effect of disclosures

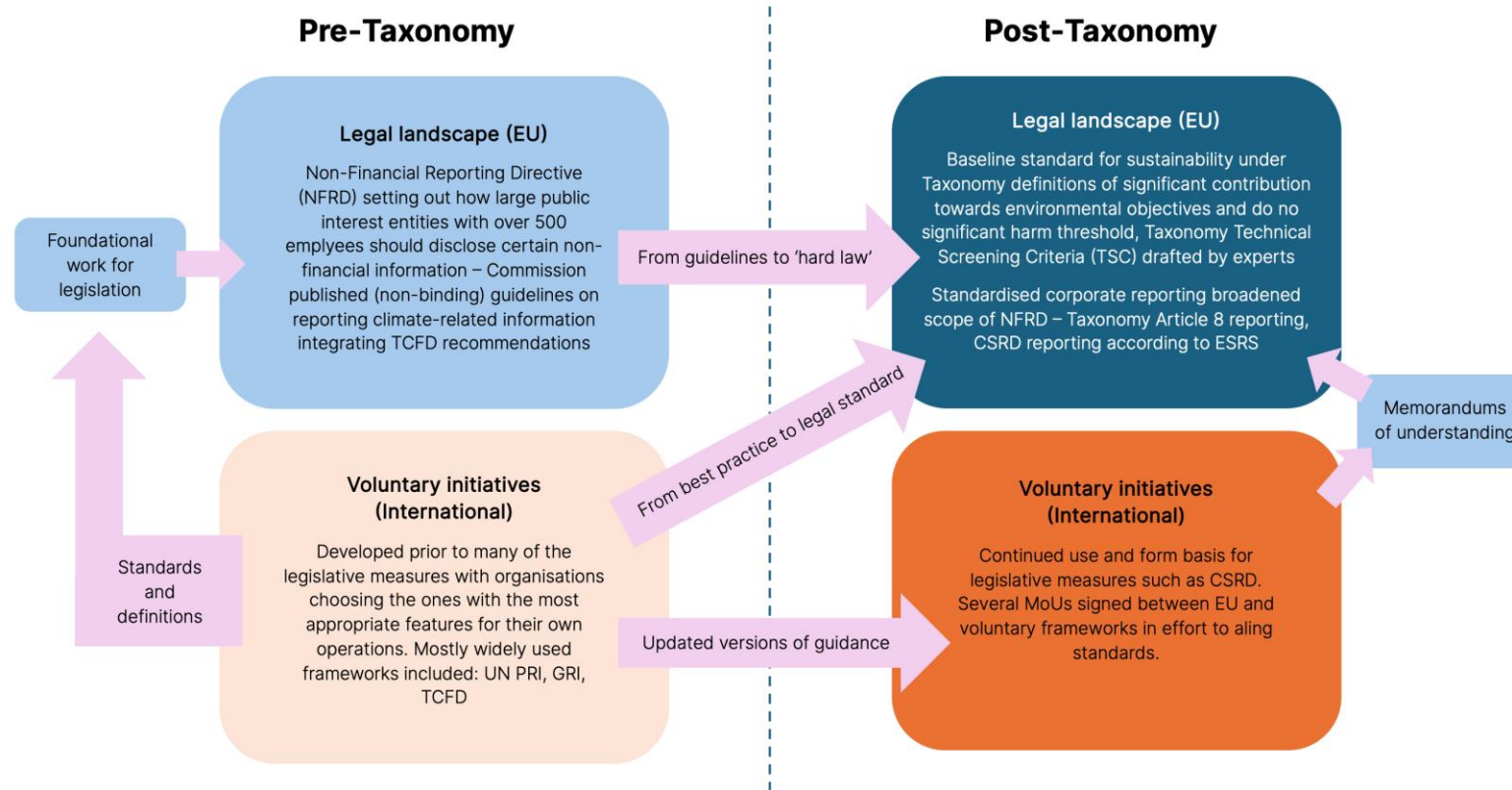


Figure 2. Effect of the Taxonomy on corporate sustainability reporting



Biodiversity provisions in the SFDR and Taxonomy

- Important to understand difference between Taxonomy-alignment and sustainability
- Definition of harm also diverges - 'Do No Significant Harm' (DNSH) principle in Taxonomy versus Principal Adverse Impacts (PAI) in SFDR
- Absence of a 'brown' taxonomy - anything not labelled sustainable remains 'undefined' rather than 'unsustainable'
- these elements within the regulations create room for biodiversity trade offs to go unnoticed
- current shortcomings could get worse - changes coming to the regulatory landscape through Omnibus Simplification Package reduce obligations on companies to report sustainability information



Methodology

- Empirical examination of ESG funds offered by financial market participants with membership in Finland's Sustainable Investment Forum
- 36 organisations (banks, asset managers, investment funds, VC funds)
- Analysis of Article 8 and Article 9 fund disclosure documents for the following aspects:
 - Exclusions used at entity level and product level
 - Taxonomy-alignment
 - Principal Adverse Impact statement – entity versus product level
 - 'Do No Significant Harm' consideration



Initial findings

1. General nature of Article 8 disclosures - do not provide much additional information beyond entity's general responsible investment policy, which means funds deemed 'sustainable' can vary in portfolio allocation significantly
2. Article 9 funds make limited usage of Taxonomy classification to indicate funds' sustainability – Taxonomy alignment is low to non-existent and DNSH is accounted for through generic entity wide disclosures

→ Disclosures do not sufficiently address problem of lack of information on which investments are sustainable – this undermines the market mechanism which relies on better information to facilitate re-orientation of funds towards more sustainable investments



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