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Interdisciplinary Research in Law and for Sustainable Value Creation

Department of Private Law - Research Group Sustainability Law Faculty of Law

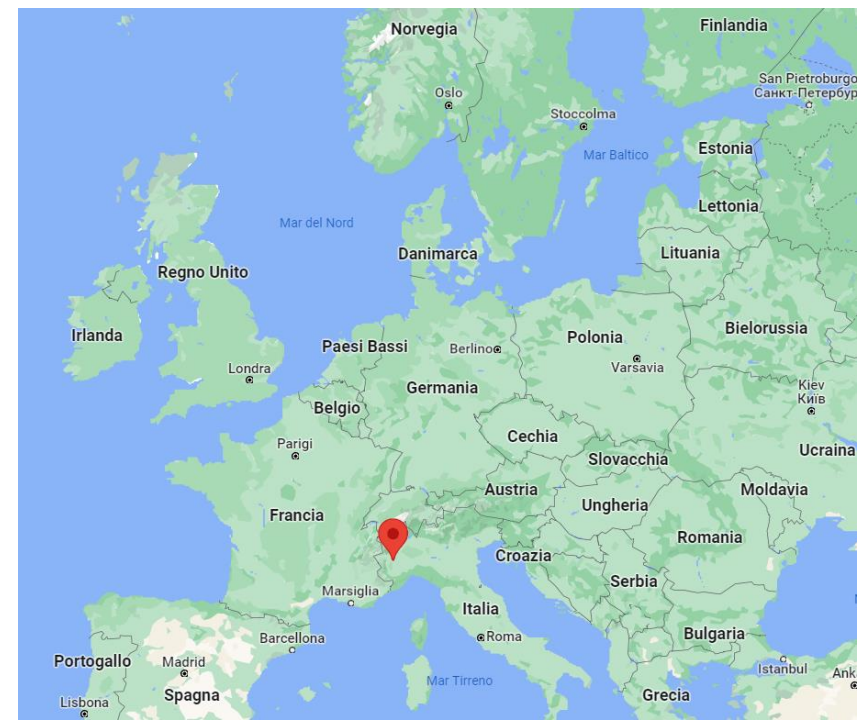
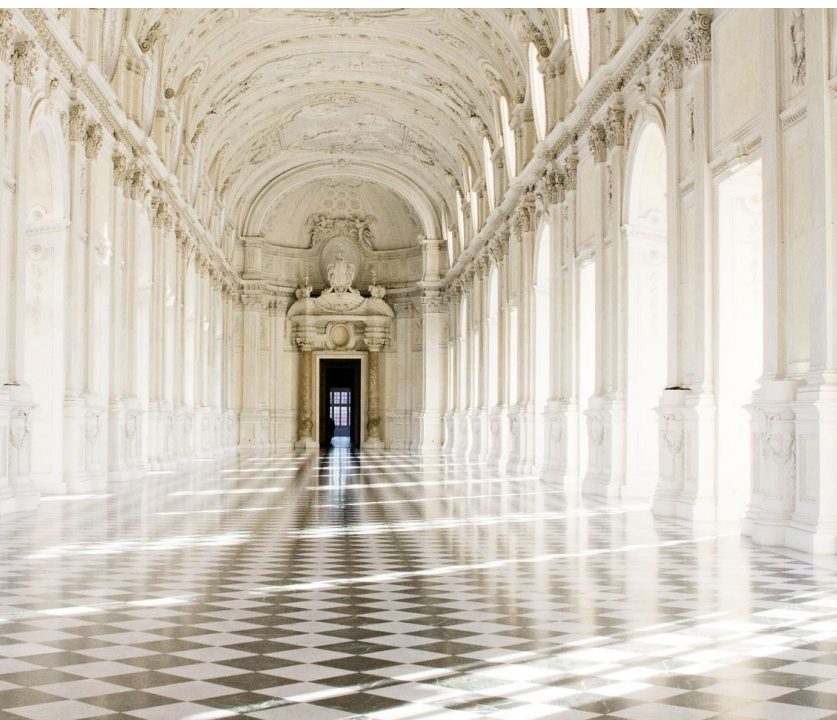
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Towards an EU Social Market Economy

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Towards an EU Social Market Economy

Policy-oriented research: Why is it so important nowadays?

In recent times, conditions for a significant change of society according to sustainability criteria have been manifesting.

According to political philosophy, the forces that can drive changes in society are a **proper context**, a **committed leadership** and **support**.

The **context** is given by dramatic environmental and climate changes along with increasing inequality, which require policymakers to act.

The EU is trying to assume the **leadership**, with its policies and regulations, in retooling society according to sustainability criteria.

Finally, **support can be offered by academia research providing inputs for informed policymaking**.

New opportunity spaces for socially engaged research!

Policy-oriented research: What can the contribution of economists be?

In this study, we investigate which corporate governance mechanisms are effective in improving the likelihood that banks do green lending, thus supporting the transition, and which are, instead, more symbolic → Corporate governance law, CSDDD

To green or not to green? How CSR mechanisms at the governance level affect the likelihood of banks pursuing green product strategies

Giuliana Birindelli and Vera Palea

Abstract

Purpose – This study aims to investigate the relationship between banks' corporate social responsibility (CSR) mechanisms at the governance level and their likelihood of pursuing green product strategies. It also examines how CSR characteristics and green product strategies have evolved across regions and time.

Design/methodology/approach – Using a sample of listed banks from different economic areas over the period 2010–2019, the authors examine how CSR mechanisms at the governance level and green product strategies, which they categorize through principal component analysis, have changed over time and across regions. The authors then conducted panel regression to identify which CSR characteristics affect the likelihood that banks implement green product strategies.

Findings – Results show that CSR mechanisms related to bank transparency and commitment to the community, such as sustainability reporting and United Nations Global Compact adherence, are substantive in affecting the likelihood of banks pursuing green product strategies. In contrast, mechanisms related to internal organization, such as the presence of a CSR Committee and an environmental management team, tend to play more a symbolic role. Findings also support a reconsideration of environmental, social and governance-related compensation schemes, which appear to decrease the likelihood that banks engage in some forms of green financing. The likelihood of banks pursuing green product strategies varies across regions and has increased after the Paris Agreement.

Research limitations/implications – The findings are useful in guiding regulators, supervisory authorities and policymakers in defining policies that can create conditions for banks to develop green products and, hence, encourage the sustainability behaviors of their clients. Empirical evidence reveals that some corporate governance mechanisms and green product strategies correlate positively, institutional factors matter and public policies can play a role in strengthening such a correlation. However, results are limited to specific geographical areas and listed banks.

Originality/value – This study contributes to the institutional literature by showing that some corporate governance mechanisms are substantive in increasing the likelihood of banks pursuing green product strategies, while others are more symbolic. It also extends the literature by analyzing how banks belonging to different geographical areas have responded, over time, to sustainability objectives.

Keywords Sustainable finance, Corporate governance, Corporate social responsibility, Green loans, Green assets under management

Paper type Research paper

1. Introduction

The transition toward a sustainable economic development model has been a steadily growing focus since the sustainable development goals were issued and the Paris Agreement was signed in the second half of 2015. In the past few years, supervisory

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Abstract

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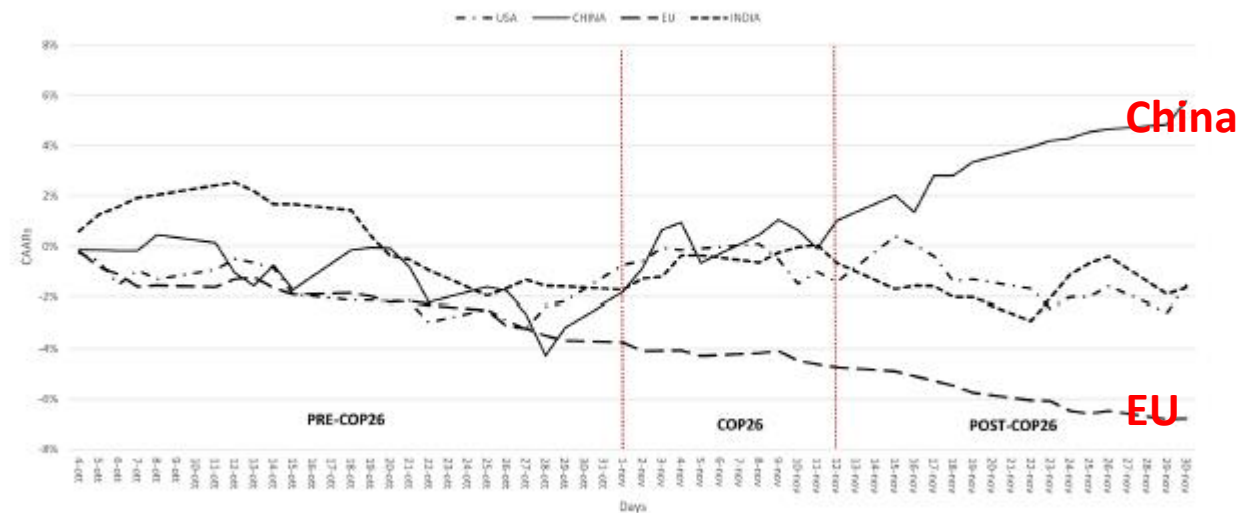
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Policy-oriented legal research: What can the contribution of economists be?

In this study, we investigate whether public policies announcements can effectively change equity investors' behaviors. Our hypothesis is that stock markets behave "sustainably" only if there are well defined and oriented rules. Otherwise, they continue prioritizing returns over sustainability selection criteria in their asset allocation.

G. Birindelli et al.

International Review of Financial Analysis 88 (2023) 102699



ABSTRACT

Applying an event study methodology, this research examines whether and how the stock market incorporated the key outcomes and statements from the COP26 summit into share prices. Our study is based on a sample of 7587 firms from four economic areas (EU, USA, China and India) belonging to the most carbon-intensive sectors. The empirical evidence shows that stock market reaction depends on how country authorities respond to commitments to accelerate and scale the transition to a greener economy, confirming that the stock market reacts negatively to stringent climate policies and positively to less stringent regulations. At the same time, in sectors emitting the most pollution, investors tend to reward companies with the best/worst environmental performance according to the type of climate policies adopted, more or less strict. Since finance is expected to play a critical role in the transition to a low-carbon economy, our results have relevant policy implications by highlighting that only clearly-defined, long-term and credible climate-related policies can lead equity investors to adequately consider environmental issues.

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Just "blah blah blah"? Stock market expectations and reactions to COP26

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ABSTRACT

Applying an event study methodology, this research examines whether and how the stock market incorporated the key outcomes and statements from the COP26 summit into share prices. Our study is based on a sample of 7587 firms from four economic areas (EU, USA, China and India) belonging to the most carbon-intensive sectors. The empirical evidence shows that stock market reaction depends on how country authorities respond to commitments to accelerate and scale the transition to a greener economy, confirming that the stock market reacts negatively to stringent climate policies and positively to less stringent regulations. At the same time, in sectors emitting the most pollution, investors tend to reward companies with the best/worst environmental performance according to the type of climate policies adopted, more or less strict. Since finance is expected to play a critical role in the transition to a low-carbon economy, our results have relevant policy implications by highlighting that only clearly-defined, long-term and credible climate-related policies can lead equity investors to adequately consider environmental issues.

1. Introduction

The absence of effective mitigation and adaptation policies related to governing fossil fuel production and use in the age of climate disruption will lead to a substantial acceleration of adverse climate change effects and, thus, increased frequencies of disastrous events. The United Nations Intergovernmental Panel on Climate Change (IPCC) has drawn public attention towards building adequate regulatory actions to avoid potentially catastrophic consequences of climate change (Intergovernmental Panel on Climate Change (IPCC), 2022). The recent speech of UN Secretary-General Antonio Guterres at the World Leaders Summit COP26 (26th Conference of the Parties) carried a reminder of the urgency of regular climate-oriented actions across the globe: "If commitments fall short by the end of this COP, countries must revisit their national climate plans and policies. Not every five years. Every year. Every moment."

After the cornerstone climate change Protocol in Kyoto (1997), 2015 can be seen as the year with the most impact in terms of climate mitigation effort: the UNFCCC introduced the Addis Ababa Action Agenda – a global action agenda for financing sustainable development; the Paris

Agreement on Climate Change (adopted by COP21) set ambitious goals for greenhouse-gas emissions mitigation; the United Nations Environment Program released the report "Inquiry into the Design of a Sustainable Financial System" to discuss the best available financial systems and arrangements to fight climate change, reduce greenhouse gas emissions, and contribute to the development of renewable energies (UNEP, 2015). Various international task forces and forums have supported this line of inquiry, such as the Financial Stability Board's "Task Force on Climate-Related Financial Disclosures" and the "Network of Central Banks and Supervisors for Greening the Financial System". In 2015, the United Nations 2030 Agenda for Sustainable Development also set 17 key goals related to the protection of the planet, promotion of peace and prosperity, and decline of poverty to be achieved between 2015 and 2030.

Focusing on the risk that matters for our purposes – the transition risk,¹ empirical research has analyzed the effects of environmental initiatives on transitioning to a lower-carbon economy from several perspectives, including the political and legal options to control emissions and the related financial risks (see, among others, Bolton & Kacperczyk,

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¹ Climate risks fall into two main categories: physical risks and transition risks. The former are economic costs and financial losses resulting from increased weather disasters, rising sea levels, floods, extreme heat, water scarcity, and other changes in weather and climate. The latter are related to the process of moving away from dependence on fossil fuels towards a low-carbon economy. For more details see Basel Committee on Banking Supervision-BCBS (2021).

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Policy-oriented legal research: What can the contribution of economists be?

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Financial reporting for sustainable development: Critical insights into IFRS implementation in the European Union

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M20 business economics
A12 relation of economics to other disciplines

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ABSTRACT

By adopting a political economy perspective to accounting, this paper provides an overall post-implementation assessment of International Financial Reporting Standards (IFRS) adoption relative to the European Union's (EU's) fundamental goal of sustainable development. The paper questions the consistency of the International Accounting Standards Board's business view with the EU's and provides some critical insights into the potential long-run effects of IFRS on the European economy and society. Therefore, it raises several doubts about unquestioned accounting standardization at a global level and makes some suggestions for future policymaking and research.

The current issue and full text archive of this journal is available on Emerald Insight at <https://www.emerald.com/insight/2049-372X.htm>

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Accounting for sustainable finance: does fair value measurement fit for long-term equity investments?

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Abstract

Purpose – The purpose of this paper is to discuss whether fair value accounting fits for long-term equity investments, which are considered key to retool economies according to sustainability criteria. In doing so, the paper focuses on the European Union and addresses the European Commission's (2018a) concern that current accounting rules are unfit for achieving the United Nations Sustainable Development goals and the targets of the Paris Agreement on climate change.

Design/methodology/approach – The paper grounds in a wide literature review on the effects of fair value accounting on investors' asset allocation strategies. By critically integrating literature on the notion of long-term investment with theories and possible accounting approaches, the paper provides implications for a revision of the current measurement system for long-term equity investments.

Findings – The literature review supports the view that fair value accounting has played a role in discouraging equity investments over time, thus leaving economies with poorer risk-sharing and weaker long-term investments. The paper contributes to the debate on alternative measurement systems by suggesting possible solutions in relation to controversies arising from empirical evidence.

Originality/value – Reorienting economies according to sustainability criteria represents an urgent issue which requires prompt and policy-oriented responses. Accordingly, this paper offers insights and guidelines that can help policymakers revise current accounting rules for long-term equity investments in line with sustainable development objectives.

Keywords Sustainability, long-term investing, Equity, Fair value accounting, European Union

Paper type Technical paper

These studies are on the relationship between accounting regulation and sustainable development/social market economy

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The politics economy of fair value reporting and the governance of the standards-setting process: Critical issues and pitfalls from a European perspective

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ABSTRACT

Accounting is not simply a metric; it is, rather, a calculative practice that shapes the socio-economic environment. To look at the substance of accounting standards alone is therefore sometimes inadequate.

From a Continental European Union perspective, this paper provides a general framework that deals with the potential changes in society produced by financial reporting. More specifically, it discusses fair value reporting from two points of view that are closely linked. The first relates to the political economy of fair value reporting and its potential impact on the economic and social system, while the second relates to the governance of the standards-setting process.

In discussing such issues, this paper suggests that the fundamental principles set out by the Lisbon Treaty should be used as a framework to analyze financial reporting policies in the European Union.

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Whither accounting research? A European view

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ABSTRACT

"Whither Accounting Research?" is the question raised by Hopwood (2007) in an essay documenting a growing sense of unease about the state and direction of accounting research. This paper addresses this question by focusing on the European Union, discussing the cases for a narrowing of topics and methods in research and proposing some remedies. Specifically, it connects academia's understated performance in developing research relevant to European Union society with the widespread practice of assessing academic quality based on journal rankings, which tends to reward conformity to the US mainstream. The paper promotes a view of accounting research that is strongly embedded in its economic and socio-political context and deals with the fundamental objectives and constitutional setting of the European Union. Consistent with this view, it develops novel research questions and discusses possibilities for changing the European scholarly debate towards more innovative and influential research.

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Investigating accounting regulations against the Sustainable Development/Social Market Economy concepts:

Why

1) Sustainable Development and Social Market Economy are two core objectives and fundamental values of the European Union, set out by the Lisbon Treaty.

The **Lisbon Treaty (art. 3)** states that: «*The Union shall work for the **sustainable development of Europe** based on balanced economic growth and price stability, a highly competitive **social market economy***»

Importantly, the view of society emerging from the Treaty is quite different from the neoliberal one.

2) The Lisbon Treaty defines the EU competences. Business law is up to the EU and, therefore, regulated by directives and regulations.

3) According to the hierarchy of laws, European regulations and directives rank lower than the Lisbon Treaty.

Any EU regulation must be consistent with the Lisbon Treaty.

4) Any regulation which endangers sustainability is inconsistent with the Treaty and therefore unconstitutional.

Investigating accounting regulations against the Sustainable Development/Social Market Economy concept: Why (cont'd)

Financial Reporting as a tool for political economy

The **European Commission**, for the first time, has raised concerns about the potentially detrimental role of IFRS (fair value measurements, specifically) on long-term equity investments, **opening to adjustments to accounting standards that pose obstacles to the EU's objective of sustainable development** (EC APSF, 2018).

In the Strategy for Financing the Transition to a Sustainable Economy (2021), the European Commission strongly supports international work on **integrating sustainability considerations into financial reporting and accounting** and will seek the highest level of ambition.

Against this background, it is important to support policymakers with evidence on these two issues:

- 1) Can financial reporting rules really affect the objective of sustainable development?**
- 2) Is the current EU regulatory framework in financial reporting consistent with the EU's fundamental objectives?**

The IFRS Regulation case

IFRS were adopted in 2005, following **EU Regulation 1606/2002**, for consolidated financial statements of listed companies, with an option for member states to extend their use to private firms and individual accounts.

IFRS Regulation's purpose was to increase information transparency through the adoption of mark-to-market (or mark-to-model) measurements (fair value accounting), thus **reducing the cost of capital for companies and thereby unlocking corporate investments**.

Critical research points out that, due to equity inflation, **FVA has instead increased dividend payouts and share buybacks**, often financed by debt, leaving **little funds for investments** (Andersson et al., 2008; Haslam et al., 2015).

Underinvestment is a critical issue for targeting climate mitigation and adaptation goals, i.e. environmental sustainability, which are fundamental for transitioning to a greener and just society.

Is accounting a matter for bookkeepers only? The effects of IFRS adoption on real investments

Is accounting a matter for bookkeepers only?

The effects of IFRS adoption on the financialisation of economy

Andrew G. Haldane^a, Alessandro Mignaiacca^b, Vera Palea^c

Abstract

The process of financialisation has been extensively studied and several stylised facts identified. Short-termism is one of these. This paper analyses the role that changes in accounting rules have played in increasing short-termism in company management. Our study considers the adoption of the International Financial Reporting Standards (IFRS) in the European Union (UE), showing that the new accounting standards have altered companies' sensitivity to investment opportunities, leading to underinvestment in the real economy. In doing so, our paper highlights the public-policy profile of accounting standards-setting and possible tensions with the EU societal objectives. To the best of our knowledge, this is the first study empirically analysing the role of accounting rules in the financialisation of economy.

Keywords: Financialisation, Short-termism, Investment, IFRS, Eurozone, Real Economy

JEL classification: D22, G3, M41

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(Revised and resubmitted to
Cambridge Economic Journal)

This paper investigates whether IFRS adoption in the EU has altered investment sensitivity to investment opportunities compared to DGAAP, which we use as a counterfactual.

We use IFRS firms as the “treated” group and DGAAP firms as the “control” group. Based on critical accounting literature, we expect IFRS firms, all else being equal, to have lower sensitivity to investment opportunities than DGAAP firms.

Our research purpose is twofold:

1) To Test the adoption of IFRS regulation in the EU against its goal of reducing of reducing the cost of capital, thus unlocking investments and against the EU objective of sustainable development.

2) To demonstrate that accounting is not simply a metric for bookkeepers but a practice modelling the socio-economic environment (Miller and O’Leary, 1987).

Sample and data

Our analysis focuses on 5,301 non-financial companies operating in the Eurozone in 1990-2019.

All companies switched to IFRS in 2005. Total observations: 82,834 (44,952 obs. for IFRS firms, 37,882 obs. For DGAAP firms - Datastream).

Investment measures:

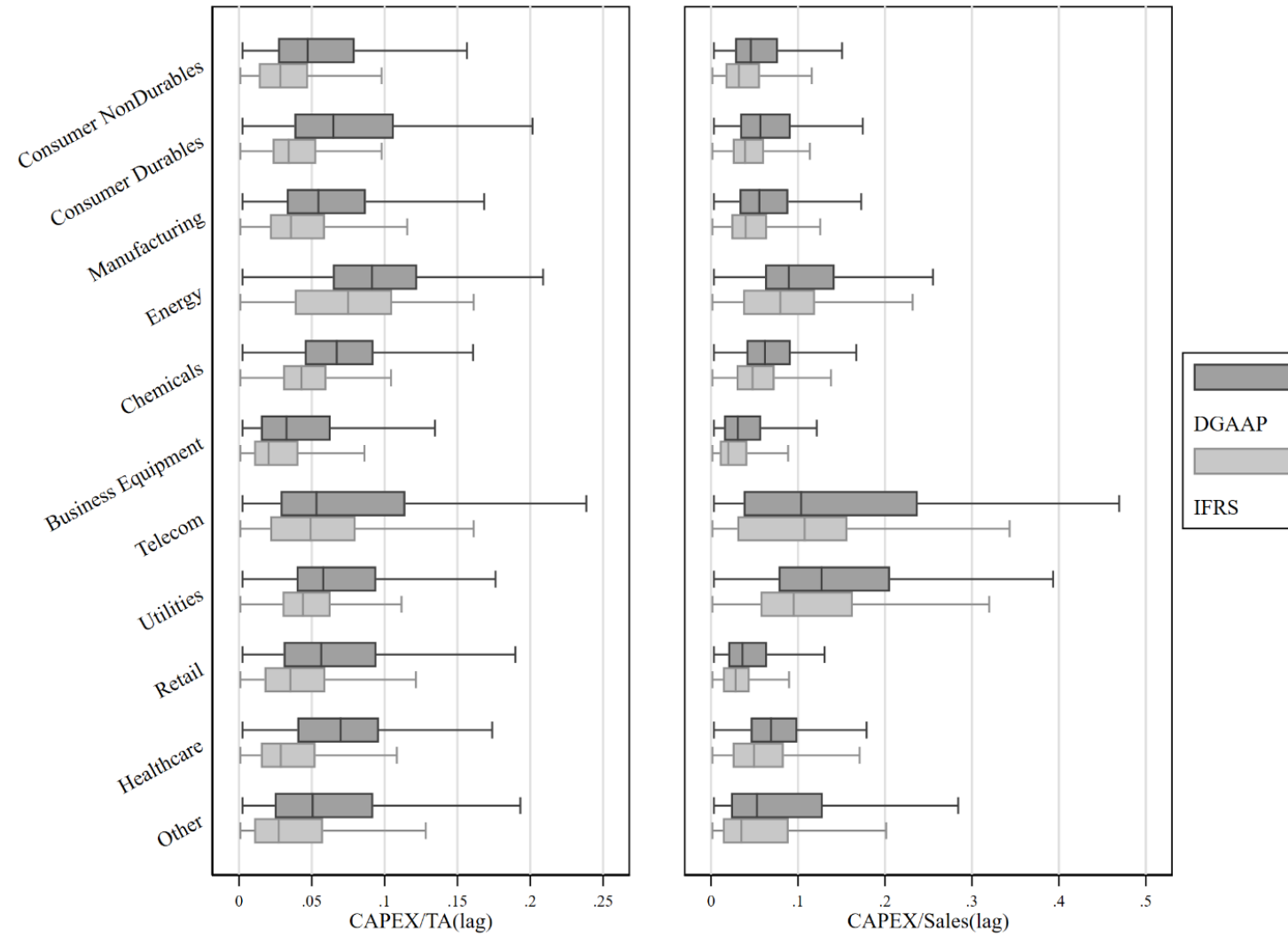
Cash-flow based: Capital Expenditures (CAPEX); CAPEX + Net Assets from Mergers and Acquisitions (M&A)

Balance-sheet based: Gross Fixed Assets (Gross investment); Gross Noncurrent Assets (Gross investment NCA); Gross NCA + R&D Expenditure (Gross investment NCA + R&D); Net Fixed Assets (Net Investment); Net Noncurrent Assets.

All measures are scaled either by lagged Total Assets or lagged Sales revenues.

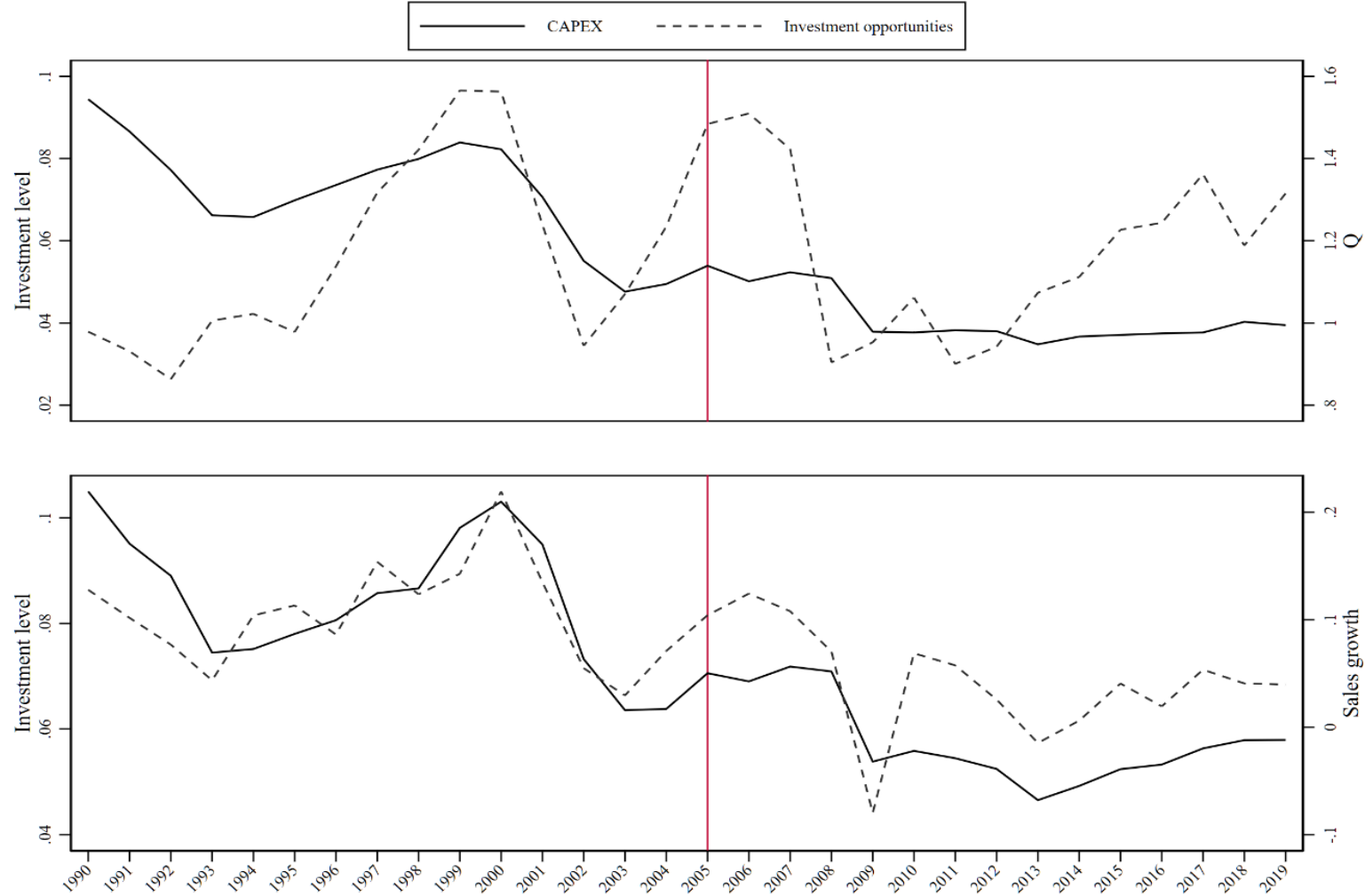
Proxies for **investment opportunities: Tobin's Q** (when using investment measures scaled by lagged Total Assets); **Sales growth** (when using investment measures scaled by lagged Sales revenues).

Investment levels by sector (CAPEX)



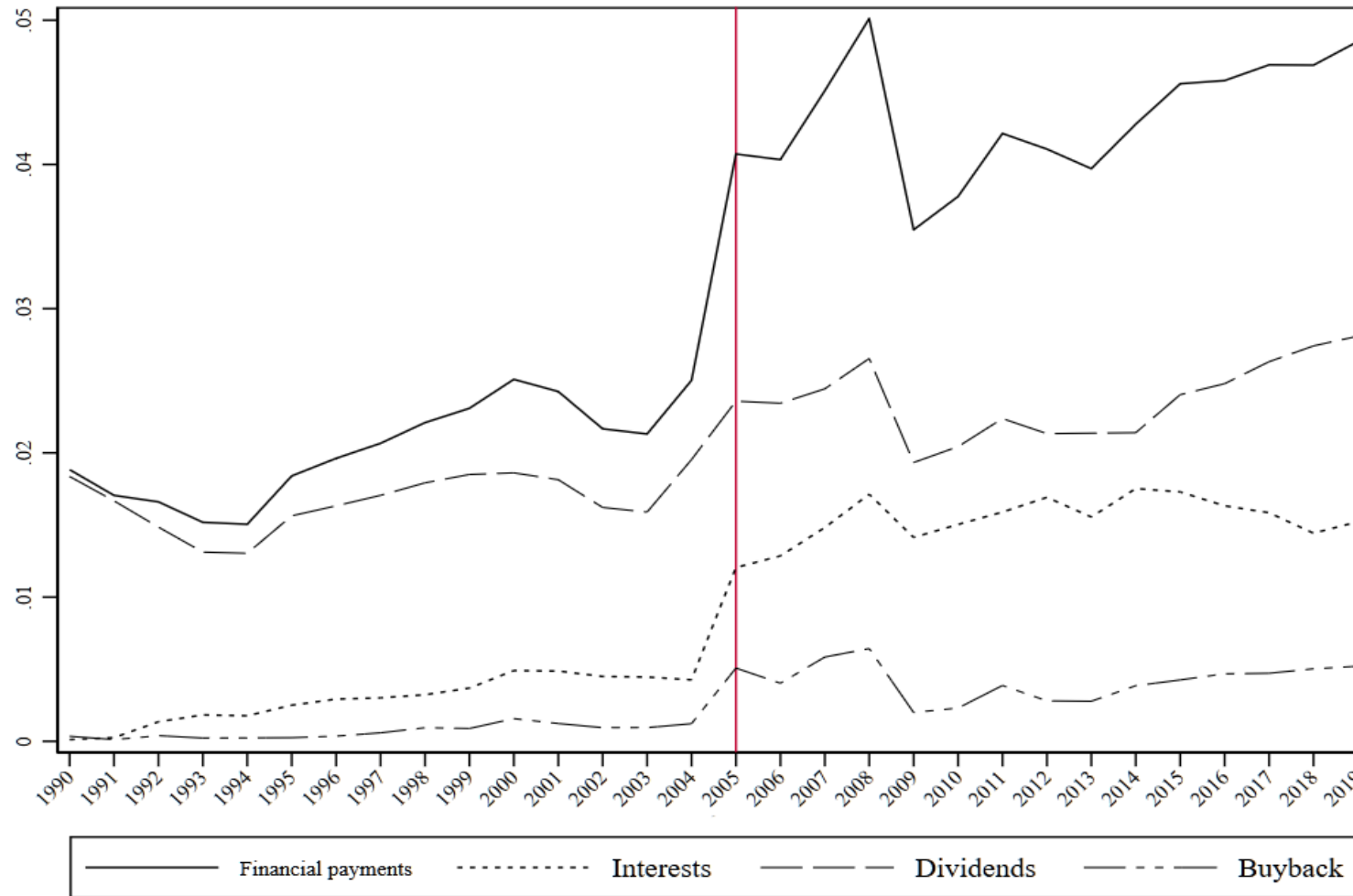
Source: our elaboration on 79 048 observations in 1990-2004 (DGAAP – 34 834 observations) and 2005-2019 (IFRS – 44 214 observations). Sectors are determined by Fama&French 12-industry classification.

Trends in investment levels and investment opportunities (1990-2019)



Source: our elaboration on 79 048 observations in 1990-2004 (DGAAP – left of red lines) and 2005-2019 (IFRS – right of red lines). Investment levels are scaled by lagged Total Assets (top) and lagged Sales revenues (bottom)

Trends in financial payments (1990-2019)



Source: our elaboration on 78 930 observations in 1990-2004 (DGAAP – left of red lines) and 2005-2019 (IFRS – right of red lines). All measures are scaled by lagged Sales revenues

Regression model

$$I_{it} = \beta_0 + \beta_1 OPP_{it} + \beta_2 (IFRS_{it} \times OPP_{it}) + \beta_3 PROF_{it} + \beta_4 (IFRS_{it} \times PROF_{it}) + \\ + \beta_5 D_{it} + \beta_6 P_{it} + LC_{it} + MFPI_{kt} + IR_{kt} + \varphi_j + \psi_k + \eta_t + \varepsilon_{it}$$

where i, j, k , and t are firms, sectors, countries, and fiscal years, respectively. I is one of the investment level measures, $IFRS$ is a dummy variable for whether the firm adopts IFRS (1) or DGAAP (0);

OPP are investment opportunities (Q or *sales growth*), $PROF$ is the profitability (ROA or ROS);

Other firm characteristics: D is *book leverage*, P is *financial payments*, LC_{it} is the firm's *life cycle* stage, as defined above;

External factors: $MFPI$ is the country-level Multi-factor Productivity Index [OECD, 2022a]; and IR is the country-level long-term *interest rate* (10-year government bond; [OECD, 2022b]).

$\varphi_j, \psi_k, \eta_t$ are the sector, country, and year fixed effects, respectively. Standard errors are clustered at the firm level.

Following Petersen (2009), we use robust standard errors clustered by firm to control for residual correlation across firms.

Regression results (1)

	Panel A. Investment measures, opportunities and profitability scaled by TA_{t-1}							Panel B. Investment measures, opportunities and profitability scaled by S_{t-1}						
Investment measure	CAPEX	CAPEX +M&A	Gross	Gross NCA	Gross NCA+ R&D	Net	Net NCA	CAPEX	CAPEX +M&A	Gross	Gross NCA	Gross NCA+ R&D	Net	Net NCA
	(1a)	(2a)	(3a)	(4a)	(5a)	(6a)	(7a)	(1b)	(2b)	(3b)	(4b)	(5b)	(6b)	(7b)
Investment Opportunity	0.013	0.020	0.029	0.066	0.073	0.020	0.055	0.090	0.110	0.255	0.441	0.559	0.142	0.326
	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)
× IFRS	-0.004	-0.004	-0.006	-0.002	0.005	-0.005	0.000	-0.036	-0.025	-0.069	-0.089	-0.142	-0.043	-0.051
	(<.001)	(0.006)	(<.001)	(0.618)	(0.289)	(<.001)	(0.986)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)
Profitability	0.111	0.172	0.198	0.249	0.169	0.092	0.138	0.085	0.114	0.177	0.371	0.139	0.091	0.241
	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(<.001)	(0.011)	(<.001)	(<.001)
× IFRS	-0.046	-0.080	-0.042	-0.032	-0.062	-0.010	-0.003	-0.072	-0.090	-0.107	-0.217	-0.183	-0.036	-0.127
	(<.001)	(<.001)	(0.012)	(0.230)	(0.199)	(0.301)	(0.884)	(<.001)	(<.001)	(<.001)	(<.001)	(0.004)	(0.001)	(<.001)
Other characteristics, external factors, sector, country, and year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	63,466	50,744	63,466	63,023	26,335	63,437	63,047	64,952	51,811	64,952	64,505	26,779	64,922	64,530
Firms	4,912	4,418	4,912	4,896	2,574	4,912	4,896	4,944	4,450	4,944	4,929	2,599	4,944	4,929
R ² · Overall	0.252	0.272	0.166	0.209	0.289	0.183	0.224	0.266	0.281	0.222	0.248	0.293	0.211	0.229

p -values in parentheses below coefficients. Gross stands for gross investment, Net for net investment, NCA for noncurrent assets.

Other firm characteristics include Book Leverage (D), Financial Payments (P), and Lifecycle stage (LS). Other external factors include Multifactor Productivity Index and *Interest rate*.

Standard errors (not reported) clustered at the firm level. Sectors are determined by Fama & French 30 industry classification. Variance inflation factor (VIF) is below critical levels

Our Conclusions

- From a macroeconomic perspective, econometric analysis suggests that the IFRS adoption hinders **investments in fixed assets and innovation, which are necessary to green the economy.**
- From a financial perspective, lower investments in climate change mitigation and adaptation may pose **severe risks to the stability of the banking sector and capital markets.**
- Overall, our findings demonstrate that **financial reporting rules have public-policy profile**, thus supporting the request made by the European Commission to explore whether IFRS represent an obstacle to long-term investment.
- Our results should definitely be taken into account when discussing the **extension of IFRS to private firms, which are the backbone of the EU economy and key actors in driving the shift toward a more sustainable economic model.**
- Recently, considerable attention has been paid to increasing the quantity and quality of corporate sustainability information to reduce the information asymmetry between firms and their stakeholders, particularly investors, to reorient capital flows toward sustainable investments (e.g., CSRD). **Our study raises the concern that sustainability may not develop adequately without a consistent financial reporting framework capable of supporting investments.**
- Since the Lisbon Treaty ranks the highest in law hierarchy, and sustainable development represents the ultimate societal objective against which any European directive or regulation should be tested, there is **evidence that Regulation 1606/2002 mandating IFRS in the EU is inconsistent with the Lisbon Treaty.**



From accounting as a financialization tool.....



.....To accounting as a means for cultivating sustainability and common goods

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Thank you for the attention!
Grazie per l'attenzione!

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