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Socially Responsible Investing: Creating an Investment Ethic based on Criminal Law

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Introduction

Whoever reads, with a philosophic eye, the history of nations, and their laws, will generally find, that the ideas of virtue and vice, of a good or a bad citizen, change with the revolution of ages

(- C. Beccaria)

- Sustainable finance in the 21st century -> integration of ESG criteria into financial products and decisions
- More and more difficult for the financial market participants to disregard environmental considerations -> EU Green Deal
- Package of EU legal instruments among which 'SFDR' and 'Taxonomy regulation'



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1. The limits of the EU's strive towards green and sustainable finance

Regulation 2019/2088
"SFDR"

**Imposes disclosure
obligations**

Regulation 2020/852
"Taxonomy regulation"

**Defines sustainable
activities**



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SFDR Regulation

Sustainable funds

Dark green funds

Art. 9

Main objective =
sustainable investments

Light green funds

Art. 8

Promotion of ESG
criteria

Unsustainable Funds

How they integrate sustainability risks in their investment decisions and their impact on returns; or at least explain and disclose why they do not integrate them



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Taxonomy Regulation

Criteria to be considered 'sustainable' (art. 3)

(a) contributes substantially to one or more of the environmental objectives set out in Article 9 in accordance with Articles 10 to 16;

- (b) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17;
- (c) is carried out in compliance with the minimum safeguards laid down in Article 18; and
- (d) complies with technical screening criteria that have been established by the Commission in accordance with Article 10 (3), 11(3), 12(2), 13(2), 14(2) or 15(2).



- a) climate change mitigation;
- b) climate change adaptation;
- c) the sustainable use and protection of water and marine resources;
- d) the transition to a circular economy;
- e) pollution prevention and control;
- f) the protection and restoration of biodiversity and ecosystems.



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Articles 5 to 7 : Content of the disclosure according to type of fund (dark green; light green; unsustainable)

Art. 22: Member States shall lay down the rules on measures and penalties applicable to infringements of Articles 5, 6 and 7. The measures and penalties provided for shall be effective, proportionate and dissuasive.

- ⇒ 'greenwashing' does not seem to be covered despite the apparent willingness
- ⇒ cf. recital 11: Making available financial products which pursue environmentally sustainable objectives is an effective way of channelling private investments into sustainable activities. Requirements for marketing financial products or corporate bonds as environmentally sustainable investments, including requirements set by Member States and the Union to allow financial market participants and issuers to use national labels, aim to enhance investor confidence and awareness of the environmental impact of those financial products or corporate bonds, to create visibility and to **address concerns about 'greenwashing'**.



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2. Criminal Law in the time of greenwashing

... a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants

- ESA's 2023 report



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... at national level – The German example (§264a StGB)

Kapitalanlagebetrug

- (1) Wer im Zusammenhang mit
1. dem Vertrieb von Wertpapieren, Bezugsrechten oder von Anteilen, die eine Beteiligung an dem Ergebnis eines Unternehmens gewähren sollen, oder
 2. dem Angebot, die Einlage auf solche Anteile zu erhöhen,

in Prospekten oder in Darstellungen oder Übersichten über den Vermögensstand hinsichtlich der für die Entscheidung über den Erwerb oder die Erhöhung erheblichen Umstände gegenüber einem größeren Kreis von Personen unrichtige vorteilhafte Angaben macht oder nachteilige Tatsachen verschweigt, wird mit Freiheitsstrafe bis zu drei Jahren oder mit Geldstrafe bestraft.

Capital investment fraud

- (1) Whoever in connection with
1. the sale of securities, subscription rights or shares intended to grant participation in the yield of an enterprise; or
 2. an offer to increase the capital investment in such shares, makes incorrect favourable statements or keeps unfavourable facts secret in prospectuses or in representations or surveys about the net assets to a considerable number of persons in relation to circumstances relevant to the decision about acquisition or increase, shall be liable to imprisonment not exceeding three years or a fine.



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DWS case (ongoing)

Suspicion of greenwashing (investment fraud) at the DWS fund. Specifically, it concerns the accusation of greenwashing, meaning that DWS has represented its investments as more sustainable than they actually are. According to statements from the former sustainability head at DWS, the investment firm presented the ESG criteria in their fund products more positively than was the reality.

The extent to which DWS's actions constitute a criminal act is uncertain at this point. "There is currently no regulation that makes greenwashing punishable", according to André Szesny, partner at law firm Heuking Kühn Lüer Wojtek.

=> no clear definition of what ESG and sustainability mean. No criminal charge can be linked to vague terms.

=> principle of certainty, which states that individuals must know exactly what the legal consequences of their behavior are.



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... greenwashing = fraud?

§263 StGB (Betrug)

(1) Whoever, with the intention of obtaining an unlawful pecuniary benefit for themselves or a third party, damages the assets of another by causing or maintaining an error under false pretences or distorting or suppressing true facts incurs a penalty of imprisonment for a term not exceeding five years or a fine.

Art. 640 italian CP (truffa)

Chiunque, con artifizi o raggiri, inducendo taluno in errore, procura a sé o ad altri un ingiusto profitto con altrui danno, è punito con la reclusione da sei mesi a tre anni e con la multa da euro 51 a euro 1.032



Use of stratagems? (omissions, empty claims,...)

Damage for counterparty? (how should the damage be defined? Financial one?)



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Fighting greenwashing at EU level

- Financial law is transnational by essence
- Fostering 'sustainable investments' also requires an enforcement mechanism, lacking at the time being (disclosure obligations ≠ sufficient)

Sustainability and the transition to a safe, climate-neutral, climate-resilient, more resource-efficient and circular economy are crucial to ensuring the long-term competitiveness of the Union economy. Sustainability has long been central to the Union project, and the Treaty on European Union and the Treaty on the Functioning of the European Union (TFEU) reflect its social and environmental dimensions.

(Recital 4, Taxonomy regulation)



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Fighting greenwashing at EU level – Double track approach

Prevention

Due diligence using AML/CFT framework as a blueprint

- ⇒ Evaluation of risks by assessing financial products and issuers
- ⇒ Continuation of the 'KYC'
- ⇒ NCA's control (sanctioning powers?)
- ⇒ Reporting duties?

Repression

Autonomous and common understanding of 'greenwashing'

Qualifying 'sustainable investment'
-> parallelism with future EU Green Claims directive

Should it be seen as an 'environmental crime'?



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