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Towards investment clarity on controversial weapons

Could non-compliance with prohibition of controversial weapons be a problem for institutional investors?



by **Reinhilde Weidacher** | September 26th, 2010

In 2004, Belgium was the first country to introduce legislation explicitly prohibiting the financing of anti-personnel mines, a weapon banned under the 1997 Mine Ban Treaty. Since then, Belgium has progressively extended its prohibition to cover other controversial weapon categories, including cluster munitions, ahead of the signing of the international Convention on Cluster Munitions in late 2008, and depleted uranium ammunition. A proposal to extend the prohibition to also cover incendiary weapons with white phosphorus is now under discussion.

However, the Belgian government has provided little guidance to investors regarding what is required to be in compliance with the law. Similar financing prohibitions are being discussed across Europe, with Ireland and Luxembourg having already introduced financing prohibitions on anti-personnel mines and cluster munitions. Also, a significant number of investors have taken action to address concerns regarding controversial weapons. The Norwegian Government Pension Fund Global and Storebrand, the Norwegian financial services group, as well as Belgian bank KBC and Dutch bank ING were among the first, in the mid-2000s, to extend their exclusionary policies from

anti-personnel mines to cluster munitions. In 2007, Dutch pension funds PGGM and ABP introduced exclusionary policies regarding controversial weapons in reaction to the television broadcast Zembla attracting public attention on the issue. Major Danish and Swedish investors followed suit.

Belgian law regarding controversial weapons envisaged that an official list of restricted entities would be published by 2008. While the list has not yet been issued, there is a common understanding that those not compliant with the prohibition could be prosecuted. In 2005, through the Belgian Asset Managers Association (BEAMA), investors established a tailored screening service provided by Ethix SRI Advisors that produces a list of companies with reported involvement in controversial weapons. Moreover, several investors, both in and outside Belgium, publish lists of companies with reported involvement in controversial weapons. The challenge is that

there are differences between the lists. Given the increased likelihood of more regulations relating to the financing of controversial weapons, there is a critical need for increased clarity on legal requirements and, ideally, for a solid consensus regarding the criteria that should be used for assessing whether companies are involved in controversial weapons.

In early 2010, Ethix SRI Advisors initiated a consultation process with key stakeholders to explore the basis for consensus on the implementation of investment restrictions regarding controversial weapons. We held expert workshops in several European cities, hosted by Danske Capital, KBC Asset Management, Nordea Investment Fund, Seventh AP Fund and Syntrus Achmea, respectively, with the participation of investors, leading civil society groups and policy makers. The principal aim was to develop a common understanding of what constitutes corporate involvement in anti-personnel mines and cluster munitions. The consultation process has identified two key challenges for investors. First, there are clear differences between countries in the scope of prohibitions. Belgian law covers 'all forms of financial support', credits, bank guarantees and the acquisition of any financial instruments issued by a company involved in weapons covered under the financing prohibition – but allows for the exemption of index-tracking funds. The necessity of such an exemption has been questioned by both civil society groups as well as a significant number of investors. In Luxembourg, investors are still waiting to receive clarification from the government regarding the coverage of the prohibition introduced in 2009. The language of the law, referring to 'knowingly financing cluster munitions', leaves a significant margin for interpretation. Similar discussions are taking place in countries which ratified both the Mine Ban Treaty and the Convention on Cluster Munitions without explicitly covering article 1©, prohibiting to 'assist, encourage or induce' anyone to engage in activities prohibited under the conventions. The article is commonly understood to also be of concern to investments.

While voluntary investment restrictions largely focus on equities, investments in bonds, including government bonds, are increasingly discussed. The second key challenge relates to uncertainties regarding the boundaries of corporate involvement subject to investment restrictions. Companies with a lead role in developing and integrating weapons are at the centre of this discussion, but neither international conventions nor national laws provide additional guidance regarding the level of involvement in components or related services that are to be considered subject to exclusion.

We will publish the key findings from our research in December 2010. These will include a proposed set of clear rules and criteria for assessing corporate involvement in anti-personnel mines and cluster munitions, and a proposed list of companies verifiably involved in anti-personnel mines and cluster munitions according to the above criteria. The rules, criteria and list of companies will be publicly available on the forthcoming Controversial Weapons Resource Centre – an online resource library for investors and other stakeholders. We welcome comments or questions on the initiative.

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