

RESEARCH GUIDELINES 'Worldwide Investments in Cluster Munitions; A shared responsibility' – May 2011 update

RESEARCH GUIDELINES RED FLAG LIST

- **Definitions**

Our research project adopted the definition of cluster munitions and explosive submunitions in the Convention on Cluster Munitions:

Cluster munitions means a conventional munition that is designed to disperse or release explosive submunitions each weighing less than 20 kilograms, and includes those explosive submunitions. It does not mean the following:

- a. A munition or submunition designed to dispense flares, smoke, pyrotechnics or chaff; or a munition designed exclusively for an air defence role;
- b. A munition or submunition designed to produce electrical or electronic effects;
- c. A munition that, in order to avoid indiscriminate area effects and the risks posed by unexploded submunitions, has all of the following characteristics:
 - i. Each munition contains fewer than ten explosive submunitions;
 - ii. Each explosive submunition weighs more than four kilograms;
 - iii. Each explosive submunition is designed to detect and engage a single target object;
 - iv. Each explosive submunition is equipped with an electronic self-destruction mechanism;
 - v. Each explosive submunition is equipped with an electronic self-deactivating feature;

Explosive submunition means a conventional munition that in order to perform its task is dispersed or released by a cluster munitions and is designed to function by detonating an explosive charge prior to, on or after impact;ⁱ

We define **cluster munitions producer** as follows:

- Any company or group of companies that, in its own name or through a subsidiary, develops or produces cluster munitions and/or explosive submunitions according to the definitions in the Convention on Cluster Munitions.
- Any company or group of companies that, in its own name or through a subsidiary, develops or produces key components of cluster munitions or explosive submunitions. Key components are components which form an integral and indispensable part of the cluster munitions or explosive submunition.

We consider a company or group of companies to be a cluster munitions producer when any part, however small, of its total turnover is derived from producing (key components for) cluster munitions or explosive submunitions, regardless of the nature of the company's other activities.

We do so, because most cluster munitions are produced by companies that also produce other defence and/or civil products. Companies and groups can easily reallocate capital internally; profit from one production line can be invested in other production lines; money for general corporate purposes can be used for any of the company's activities, etc. Focussing solely on financing for cluster munitions is impossible and undesirable given the companies' financial structures. Moreover, even if a company only gets 1% of its turnover from cluster

munitions, this 1% can represent a considerable amount of money and can mean the production of large amounts of cluster munitions.

- **Selection and research**

For this research project we have compiled a long list of cluster munitions producers that meet at least one of the following two criteria:

- There is sufficient evidence that the company produced (key components for) cluster munitions or explosive submunitions since 30 May 2008 (the day the Convention text was adopted in Dublin) and the company has not stated publicly that it will end its involvement in the coming 12 months;
- There is sufficient evidence that over the past year the company has become involved in planned production or development of (key components for) cluster munitions or explosive submunitions and the company has not stated publicly that it will end its involvement in the coming 12 months;

A clear description of a delivery of the product in a company publication or trade journal is considered as sufficient evidence that a company is involved in present or planned production. This is also the case when a budget line for the product is included in a recent government budget.

If over the past year the company has advertised (key components for) cluster munitions or explosive submunitions at exhibitions, in brochures, or on its website, this is seen as evidence of development or production. However, if other evidence is found that contradicts this or if the advertising refers to (key components for) cluster munitions or explosive submunitions that, to our knowledge, have not been produced since 30 May 2008, we do not place the company on the long list.

As a consequence, some companies which mention (key components for) cluster munitions or explosive submunitions on their websites are not included on the long list. A brochure may date from before May 2008, or other evidence may suggest that these products are no longer being produced. Furthermore, some companies that produce (key components for) cluster munitions or explosive submunitions at present are not included on the long list because we could not find sufficient evidence of their production activities.

From long list to short list (our “red flag list”)

For all cluster munitions producers on the long list we researched if financial links with one or more financial institutions could be confirmed with reliable information in the public domain.

Chapter 1 sections 2 and 3 contain a summary of the links we found.

When we could find no links to financial institutions, we decided not to include the cluster munitions producer in this report. This was mostly the case with state-owned and privately-owned companies. Because these companies are not taken into account, the short list of companies in this report can by no means be considered an exhaustive list of the companies, worldwide, involved in the production of (key components for) cluster munitions or explosive submunitions at present.

RESEARCH GUIDELINES HALL OF SHAME

We consider any kind of financial or investment link with a cluster munitions producer to be financial involvement with this producer.

We apply different thresholds to different companies for investment in shares and bonds. Due to the different shareholding structure in the various companies,¹ we chose a 0.1% floor limit for Hanwha Corporation, Poongsan, and Singapore Technologies Engineering and a 1% limit for ATK, Lockheed and Textron.

Since there are so many shareholders in ATK, Lockheed Martin and Textron that hold less than 1% of the shares, listing all of them is beyond the scope of this report. We made a pragmatic choice to apply the abovementioned thresholds.

Research institute Profundo (the Netherlands) provided a list of financial institutions derived from stock exchange filings and other publications by financial institutions and cluster munitions producers, as well as from commercial databases with information supplied by financial institutions.

We included all credits and underwriting activities dated after 1 May 2008 for which we found information and also included the most relevant data on shareholdings and bond holdings available in March 2011, the date Profundo concluded its research on financial links to cluster munitions producers.

We define investor as someone financially involved in a cluster munitions producer. The following factors are irrelevant to our definition:

- the investor's importance for the cluster munitions producer;
- the investment's importance for the investor's portfolio;
- the contribution of cluster munitions production to the company's total turnover; or
- cluster munitions producer's other activities.

We consider them irrelevant, because a financial institution cannot possibly be certain that the financial services it provides for a company will not be used to produce cluster munitions. It is common for weapon producers to finance cluster munitions facilities from general corporate capital. So far, we have never come across a project intended specifically to finance cluster munitions facilities.

As we already noted, the list in the Hall of Shame is not an exhaustive list of financial institutions with investments in cluster munitions producers. We apply different thresholds to different companies for investment in shares and bonds. Since the red flag list is not exhaustive, a financial institution could have invested in a producing company not included in our research. There is little or no transparency on what credits were given to whom. This makes it very hard to find out whether a financial institution has granted a loan to a controversial company.

RESEARCH GUIDELINES IN FOCUS: Public Pension Funds and Sovereign Wealth Funds

Due to their growing importance, we think that sovereign wealth funds (SWFs) and public pension funds (PPFs) merit special attention. This second chapter takes a closer look at a few sovereign wealth funds and public pension funds.

Sovereign wealth funds have been around since at least the 1950s but they have expanded dramatically over the past 10-15 years.² According to the International Monetary Fund (IMF), sovereign funds that probably held no more than US\$500 billion in 1990 controlled an estimated US\$3 trillion in September 2007.ⁱⁱ International Financial Services London (IFSL)

¹ Asian companies seem to have a few large (local) shareholders and a group of foreign shareholders with less than 1%. That is why we lowered the threshold for Hanwha, Poongsan and Singapore Technologies Engineering.

² The article dates from 2007.

estimated in March 2009 that assets under sovereign wealth funds' management grew by 18% in 2008 to reach US\$3.9 trillion. IFSL projections are that sovereign wealth funds are likely to double their current level to reach US\$8 trillion by 2015.ⁱⁱⁱ Like most private equity funds, sovereign wealth funds suffered losses on their investments during the credit crisis. They had made several high-profile investments in US and European banks. Still, sovereign wealth funds increased the assets under their management by 11 per cent in 2010 to \$4,000 billion, for the second year in succession. While some SWFs have suffered withdrawals, the aggregate assets under management increased from \$3,590 billion in 2010 to \$3,980 billion at the start of 2011.^{iv}

Pension funds are even bigger institutional investors. Total assets of the world's largest 300 pension funds grew by over 8% in 2009 to US\$11.3 trillion, up by around US\$1 trillion from the 2008 figure. Despite this growth in total assets, compound annual growth of all funds during the past five years has fallen to just over 6% from the 2008 figure of 10%. The economic crisis has hit pension funds hard leaving them to recover slowly.^v

They are particularly interesting because most are state owned. This becomes even more important when a sovereign wealth fund's or public pension fund's home country has signed the Convention on Cluster Munitions.

Moreover, sovereign wealth funds and public pension funds sometimes hold a substantial stake in the capital of companies. This gives them considerable voting power at annual meetings, and sometimes even one or more seats on boards of directors.

- **Selection and research**

Our research targeted 15 sovereign wealth funds and public pension funds, chosen for their importance and country of origin (to ensure a broad geographical spread). For each of the funds listed below, we report all investments in producers of cluster munitions (including investments below the 1% threshold for US companies or 0.1% for Asian companies for the shares or bonds issued). These include sovereign wealth funds

Abu Dhabi Investment Authority (Abu Dhabi)
Alaska Permanent Fund Corporation (United States)
Alberta's Heritage Fund (Canada)
Australian Future Fund (Australia)
Libyan Investment Authority (Libya)
National Welfare Fund (Russia)
SAFE Investment Company (China)
SAMA Foreign Holdings (Saudi Arabia)
Strategic Investment Fund (France)
Swiss Federal Social Security Fund (Switzerland)

and public pension funds

California Public Employees' Retirement System (CalPERS) (United States)
Government Pension Investment Fund (Japan)
National Pension Service (South Korea)
Caixa de Previdência dos Funcionários do Banco do Brasil (PREVI) (Brazil)
Quebec Pension Plan (Canada)

Many of these funds are entrusted to managers. This makes it difficult to determine in which companies they hold assets. Some funds are very transparent and publish a list with shares on their website (e.g. Alaska Permanent Fund, Swiss Federal Social Security Fund and CalPERS). We found information on assets for twelve funds, three of which own or manage assets in the companies on our red flag list. These funds are only involved through asset

management, since financing and investment banking are not part of their business operations.

We have listed all the shareholdings that we could document, including those under the 1% threshold. For the rest, we applied the same research criteria used for the financial institutions in our Hall of Shame. In what follows, we describe the twelve funds for which we found information.

RESEARCH GUIDELINES HALL OF FAME

To identify financial institutions with a policy on cluster munitions, we researched a variety of sources: NGO reports, screening-agency information, financial institutions' reports and websites, information from campaigners worldwide and other public sources. We worked within the limits imposed by language (English and Dutch) and accessibility. In some cases we have received translations of disinvestment policies that were not available in Dutch or English in the public domain, but in most cases we were limited to policies' availability in Dutch or English. The Hall of Fame is far from comprehensive. We believe that the financial institutions listed are only the tip of the iceberg. It is impossible to research the policies of every financial institution worldwide. Financial institutions that did not respond to our questions on their published policies were not included in this chapter. Our Hall of Fame is an invitation to financial institutions with a comprehensive policy banning investment in cluster munitions to provide us with their policies and to publish it on their websites in order for us to include them in either the runners-up category or the Hall of Fame.

Since an investment policy is usually stipulated by the banking group and since this group directly or indirectly supervises its subsidiaries, we researched the group's policy. We contacted all financial institutions in this list prior to publication to verify our research findings and to be sure we interpreted their policies correctly. We only include policies publicly available at the time of writing. Even if we were notified that a new policy is on its way, and were allowed access to the new policy we still could not include the new policy in the report before it became accessible to the public at large.

Financial institutions must meet the following criteria to be included in our Hall of Fame:

- An investor must be transparent and accountable on its cluster munitions policy. This means that the investor has published its policy and/or a summary of it.
- Its policy must exclude investment in cluster munitions producers (recalling past investment and avoiding further investment).
- The policy must have an 'all-in' comprehensive scope:
 - no exceptions for any types of cluster munitions producers
 - no exceptions for any types of activities by cluster munitions producers
 - no exceptions for any type of financing or investment by the investor

We researched investment in red flag companies for each financial institution in our Hall of Fame. This included shareholdings under the thresholds we use for the Hall of Shame. We chose to do so because any involvement at all in a cluster munitions producer, after publication of a policy excluding this, is evidence of poor implementation. When we found evidence that financial institutions listed in our Hall of Fame had financial links with cluster munitions producers, we contacted the institution to confront it with our findings. When there were no legal constraints preventing a financial institution's immediate disinvestment, we removed it from our Hall of Fame.

RESEARCH GUIDELINES RUNNERS-UP

To identify financial institutions with a policy on cluster munitions, we researched a variety of sources such as NGO reports, screening agency information, financial institutions' reports and websites, information from campaigners worldwide and other public sources. We worked within the limits imposed by language (English and Dutch) and accessibility. In some cases we have received translations of divestment policies that are not publicly available in Dutch or English, but in most cases we were limited to policies' availability in Dutch or English. This following list is therefore by no means exhaustive. We welcome additions from those able to provide them.

Since an investment policy is usually stipulated by the banking group and since this group directly or indirectly supervises its subsidiaries, we researched the group's policy.

Financial institutions have to meet the following criteria to be considered a runner-up:

- An investor must be transparent and accountable on its cluster munitions policy. This means that the investor has published its policy and/or a summary of it.
- Its policy must exclude investment in cluster munitions producers (recalling past investment and resolving to avoid further investment).

The runners-up category lists financial institutions which meet the two foregoing criteria. They differ from those in our Hall of Fame in that they do not yet meet the following criteria:

- The policy must have an 'all-in' comprehensive scope:
 - no exceptions for any types of cluster munitions producers
 - no exceptions for any types of activities by cluster munitions producers
 - no exceptions for any type of financing or investment
 - no breaches of this all-in comprehensive policy after the publication or announced implementation date of the policy.

RESEARCH GUIDELINES COUNTRIES' BEST PRACTICES

To be considered as a country banning investments in cluster munitions, a country must either have stated officially that it considers investment to be part of the Convention on Cluster Munitions, or have proposed or passed legislation banning investments. Legislative proposals need not be comprehensive, but they should meet the following criteria:

- The proposed law should be discussed in Parliament or another body with power to issue legislation.
- The proposed law should contain an explicit ban on investment in cluster munitions.

ⁱ Article 2: *Definitions*. In: "The Convention on Cluster Munitions", available at: http://untreaty.un.org/English/Opening_Signature/english.pdf, last viewed 31 March 2011.

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- ii Johnson, Simon, "The Rise of Sovereign Wealth Funds", September 2007, Volume 44, Number 3, Finance and Development, available at <http://www.imf.org/external/pubs/ft/fandd/2007/09/straight.htm>, last viewed 12 April 2011.
 - iii Marko Maslakovic, Marko, "Sovereign Wealth Funds 2009", March 2009, pp. 1-2, IFSL Research, available at http://www.thecityuk.com/media/2313/CBS_Sovereign_Wealth_Funds_2009.pdf, last viewed 12 April 2011.
 - iv Sakoui, Anoushka, "Sovereign Wealth Funds Assets Rise to \$4,000bn", 8 March 2011, Financial Times, available at <http://www.ft.com/cms/s/0/a94d23b0-49be-11e0-acf0-00144feab49a.html#ixzz1HtAmlrhM>, last viewed 28 March 2011.
 - v Towers Watson, "Top Pension Funds on the Road to Recovery", 7 September 2010, available at <http://www.towerswatson.com/press/2767>, last viewed 28 March 2011.