Global Cluster Munitions Legislation and Implications for Investors

MSCI ESG Research Analysis by Whitney Rauschenbach

Introduction to Cluster Munitions

Cluster munitions, also known as cluster bombs, are a collection of ten to several hundred individual sub-munitions, weighing less than 20 kilograms each, designed to scatter and explode over an area as large as several football fields. Cluster munitions are fired from the ground or dropped from the air and explode mid-flight. Sub-munitions that fail to detonate become de facto landmines, causing harm for decades. Human rights organizations, non-governmental organizations (NGOs), media, and local governments have campaigned against cluster munitions due to the widespread and indiscriminate damage inflicted upon both soldiers and civilians. Cluster munitions, along with other indiscriminate weapons such as landmines, are covered by international humanitarian law. The landmark international initiative to ban the use, manufacture and stockpiling of cluster munitions, as well as the Convention on Cluster Munitions (CCM), introduced in Dublin, Ireland in May 2008, opened the door for national parliaments to pass binding prohibitive legislation.

This article reviews the international and country-specific cluster munitions mandates, including recent developments in the Netherlands, and provides a focused view on the legislation prohibiting investments, where direct investments refers to a financial institution that buys shares or bonds of a company for their own account and indirect investments refers to a financial institution that buys shares or bonds of a company on behalf of a third party, for example, the purchase of one or more shares of an investment fund.

Implications for Investors

While the CCM and country legislation clearly prohibits the manufacture, use, and stockpiling of cluster munitions and the components of these weapons, the implications for financial support of companies that manufacture cluster munitions is less clear. The approach varies by institution and by country when it comes to the question of prohibiting or allowing investments in cluster munitions producers: some prohibit all investments, some prohibit only direct investments, and lastly, some have not yet banned investments. In response to legislation on the country level, many financial institutions have adopted strong policies on cluster munitions investments and subsequently disinvested from companies involved in controversial weapons, including institutional investors managed by national governments, such as the New Zealand Superannuation Fund and the Norwegian Government Pension Fund – Global.

Given the debate on whether or not the CCM is intended to prohibit financing of cluster munitions producers, investors have taken different approaches to investing or disinvesting in companies tied to cluster munitions. Investors managing assets in different countries may choose to fully avoid these types of investments to ensure compliance and reduce reputation risk or may take a client by client approach.

Convention on Cluster Munitions (CCM)

The Convention on Cluster Munitions (CCM) was introduced in Dublin, Ireland in May 2008 where it was adopted by 107 countries and implemented on August 1st, 2010. To date, 111 states have joined the CCM and 66 have ratified it and become “State Parties”, bound by the CCM’s requirements.[1] Each State Party is required to destroy stockpiled cluster munitions within eight years of ratifying the CCM; destroy unexploded ordnance as soon as possible; institute cluster munitions victim assistance, medical care, and rehabilitation; and submit annual reports to the Secretary-General of the United Nations on implementation measures, stockpile locations and cluster munitions count, and other items. The United States has not yet joined the CCM.

Additionally, the CCM calls for each State Party to never “use…develop, produce, otherwise acquire, stockpile, retain or transfer to anyone, directly or indirectly, cluster munitions.”[2] The Convention also prohibits assisting or encouraging the use or development of cluster munitions.

The international community, particularly European countries that have ratified the CCM, have not yet agreed upon the restrictions related to the financing of cluster munitions producers. While CCM article 1(c) which prohibits assisting is thought to apply to investments[3], it does not provide specifics on financing or on the treatment of indirect and direct investments in cluster munitions. As a result, the investment-specific cluster munitions legislation varies by country.

International Legislation

The countries bound by the CCM’s provisions have agreed to ban the production, use, and stockpiling of cluster munitions and their components. However, where national parliaments disagree in their interpretation of the CCM is in the legality of investing in cluster munitions companies. Of the four countries that have passed cluster munitions legislation, three have adopted a comprehensive view on investments, prohibiting investments of any kind. Several other countries have included a ban on investments in draft bills and motions, but many have not prohibited both direct and indirect investments, thereby leaving loopholes or uncertainty.

In November 2006, preceding the CCM, Belgium became the first country to ban the production and use of cluster munitions, which was then followed by a 2007 law that prohibited “the financing of a company under Belgian law or under the law of another country, which is involved in the manufacture, use, repair, marketing, sale, distribution, import, export, stockpiling or transportation of anti-personnel mines and or sub-munitions…”[4]. The legislation defines financing to mean “all forms of financial support” and prohibits banks, investment funds, pension funds, and other investors from acquiring shares in a company tied to cluster munitions, with the exception of index funds.

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[1] Cluster Munition Coalition. October 26, 2011. http://www.stopclustermunitions.org/treatystatus/

[2] Convention on Cluster Munitions. *Diplomatic Conference for the Adoption of a Convention on Cluster Munitions.* p. 3. May 30, 2008. Dublin, Ireland. http://www.clusterconvention.org/files/2011/01/Convention-ENG.pdf

[3] Convention on Cluster Munitions. *Diplomatic Conference for the Adoption of a Convention on Cluster Munitions.* p. 3. May 30, 2008. Dublin, Ireland. http://www.clusterconvention.org/files/2011/01/Convention-ENG.pdf

[4] The Belgian Act on the prohibition of the financing of production, use and possession of anti-personnel mines and sub-munitions. N. 2007 — 1661 March 20, 2007. http://www.stopexplosiveinvestments.org/uploads/pdf/belgiumaweng.pdf

In addition to Belgium, both Ireland and New Zealand have also enacted legislation that prohibits both direct and indirect investments in cluster munitions.

Luxembourg, on the other hand, which ratified a national law based on the CCM in 2009, does not delineate whether or not assets of every kind are prohibited. The law prohibits "…knowingly financing cluster munitions or explosive sub-munitions."[5]

Several countries have introduced ministerial statements, parliamentary initiatives, or draft legislation to ban investments, including the U.K., France, Germany, Italy, and Norway. Both Switzerland and the Netherlands, in June 2010 and March 2011, respectively, adopted motions to develop cluster munitions legislation. Of these, the U.K. is the only country to explicitly allow for indirect financing of cluster munitions. The loophole in the U.K. law has resulted in ongoing scrutiny by organizations such as Amnesty International and the Cluster Munition Coalition NGO, who point to large UK-based financial institutions that continue to provide financing to the industry.

The Netherlands' original motion called for the prohibition of direct investments only, however, on October 13th, 2011, the Dutch Minister of Finance stated that "The government shares the opinion of the Senate that cluster munitions causes unacceptable humanitarian harm and strives to present a plan for the further implementation of this prohibition for all financial institutions by the end of this year,"[6] indicating that the country may review indirect investments as well. The statement follows the March 2010 announcement by the Minister of Finance and the Minister of Social Affairs that the motion would not be implemented with the rationale that investments counteract the intentions of the CCM but are not explicitly banned.[7]

The following countries have issued statements that, in their view, investments in cluster munitions producers are prohibited under the CCM: Cameroon, Colombia, Croatia, Guatemala, the Vatican, Hungary, Lebanon, Madagascar, Malawi, Malta, Mexico, Rwanda, and Zambia. The countries have not gone so far as to introduce draft bills or to make the distinction between indirect and direct investments, however.

The Australian proposed legislation, which would enforce the CCM, has been criticized for failing to extend to investments. Numerous other loopholes have also been pointed out, including an omission in the proposed legislation that allows for Australian forces to assist joint military operations with allies outside of the treaty, such as the United States, and in doing so to use cluster munitions without criminal suit.

[5] Stop Explosive Investments. Translation of Luxembourg Legislation. *Convention Sur Les Armes A Sous-Munitions.* May 7, 2009. http://www.stopexplosiveinvestments.org/uploads/pdf/law_luxembourg_eng.pdf

[6] Stop Explosive Investments: Legislation. October 26, 2011. http://www.stopexplosiveinvestments.org/legislation

[7] Stop Explosive Investments: Legislation. October 26, 2011. http://www.stopexplosiveinvestments.org/legislation

MSCI Cluster Bomb Research

MSCI ESG's Business Involvement Screening and data feed product provides research on publicly traded companies that manufacture cluster munitions, including components and the delivery platforms for these weapons. Additionally, in order to accommodate client criteria and legislative mandates, MSCI's research flags investors that own a 1-19.99% consolidated stake in cluster munitions producers, companies that own between 20-49.99% of cluster munitions producers, and majority owned subsidiaries of cluster munitions producers.

Companies on MSCI's cluster bomb screen receive a 360-degree update once annually, which includes company communication to confirm continued involvement, as well as ongoing monthly maintenance and corporate events tracking. As of October 2011, MSCI ESG Research had identified approximately 60 publicly traded companies with ties to cluster munitions, with over half identified as investors and owners.

MSCI ESG Research classifies company involvement with cluster bombs into the following categories:

- **Cluster Bomb Manufacturer** – Companies that manufacture cluster munitions whole systems or components.
- **Investor** – Companies that have a one to 19.99 percent investment stake in companies involved in the manufacture of cluster bombs. *NOTE: Financial institutions that own anywhere from 1 to 49.99 percent consolidated stakes in cluster bomb manufacturers will be considered investors.*
- **Ownership of a Cluster Bomb Company** –Companies that own 20 to 49.99 percent of a company that manufactures cluster bombs. When a company owns 50 percent or more of a company with involvement, MSCI ESG Research treats it as a consolidated subsidiary unless the parent company in question is a financial institution. *NOTE: Financial institutions that own 50 percent or more of a cluster bomb manufacturer will be considered owners and will not be given the manufacturer concern.*
- **Ownership by a Cluster Bomb Company** – Companies that are 50 percent or more owned by a company with involvement.
- **Any Tie** – Companies with an industry tie to cluster bombs through any of the above categories.

Sources and Further Reading:

1. ETHIX SRI Advisors. *Defining controversial weapons for European institutional investors: Report on definitions, criteria and process for assessing corporate involvement in controversial weapons – endorsed by BEAMA.* March 2011. http://www.beama.be/duurzame-icbs/actualiteit/Ehix%20SRI%20Advisor%20-%20Defining%20Controversial%20Weapons%20for%20Investors%20-%202011%2003.pdf
2. IKV Pax Christi and Netwerk Vlaanderen. *Worldwide Investments in Cluster Munitions: A Shared Responsibility.* May 2011. http://www.ikvpaxchristi.nl/files/Documenten/wap%20cluster%20munitie/CMC%20rapport%2025%20mei%202011/Worldwide%20Investments%20in%20Cluster%20Munitions.pdf;%20a%20shared%20responsibility%20-%202011.pdf
3. Taylor, Jerome. *The Independent.* "UK banks fund deadly cluster-bomb industry." August 16th, 2011. http://www.independent.co.uk/news/uk/home-news/uk-banks-fund-deadly-clusterbomb-industry-2338168.html
4. Stop Explosive Investments. http://www.stopexplosiveinvestments.org/
5. Landmine and Cluster Munition Monitor. http://www.the-monitor.org/

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