

Background Information on Cluster Munitions and Investments

1 Background

In March 2008, the Board of Guardians of New Zealand Superannuation unanimously agreed to the following recommendation from the Responsible Investment Committee on the issue of cluster munitions and investment by the New Zealand Superannuation Fund.

The Guardians of New Zealand Superannuation will develop an engagement, divestment, and exclusion plan related to companies involved in the manufacture of cluster munitions. The plan should include:

- Developing a list of companies that have a substantial involvement in cluster munitions;
- Identifying and engaging with those companies the Guardians think will respond to the Guardians seeking their agreement to cease cluster munitions production¹; and
- Divesting from, or excluding, the remainder of these companies from the Fund².

The Guardians will implement the plan consistent with the cluster munitions definition contained in the forthcoming international treaty relating to cluster munitions under the Oslo Process and on the signing of this internationally binding instrument by the New Zealand government.

This paper provides background to this decision.

2 Responsible Investment Policy Guidelines

The Guardians reviewed the issue of investment in companies involved in the production and manufacture of cluster munitions against their Responsible Investment Policy guidelines.

The Guardians' decision must not be inconsistent with their mandate, which is to manage the Fund in a prudent and commercial manner consistent with:

- Best-practice portfolio management;
- Maximising return without undue risk to the Fund as a whole; and
- Avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

As outlined in Sections 1.3 and 3.2 of the Guardians' Responsible Investment Policy, Standards and Procedures, the review of cluster munitions and investment included:

- the nature of involvement by the company and the Fund;
- the materiality of the issue or breach of Responsible Investment standards;
- the regulatory environment, including international conventions and New Zealand law;
- the effectiveness of shareholder actions; and
- the impact on the Fund's portfolio.

The Guardians have a transparent framework for responsible investment processes (<http://www.nzsuperfund.co.nz/files/Responsible%20Investment%20Policy%20Standar>

¹ Companies that do not respond to engagement (i.e. make a commitment to cease their involvement in the manufacture of cluster munitions) will be added to the exclusion list.

² From portfolios managed exclusively for the New Zealand Superannuation Fund.

[ds%20and%20Procedures%20270607.pdf](#)), and a range of options for shareholder action. The Guardians primarily seek to influence the practices of companies, in their role as shareholders, through engagement and by exercising their voting rights. Under certain circumstances, divestment and exclusion will be considered.

3 Definition

The Oslo Process aims to conclude an internationally binding instrument during 2008 banning cluster munitions that cause unacceptable harm to civilians. The process also requires negotiating an internationally accepted definition of a cluster munition. In the current draft convention to the Oslo Process the definition is still under development and currently reads as follows:

“Cluster munition” means a munition that is designed to disperse or release explosive sub-munitions, and includes those explosive sub-munitions.

It does not mean the following:

- (a) a munition or sub-munition designed to dispense flares, smoke, pyrotechnics or chaff;
- (b) a munition or sub-munition designed to produce electrical or electronic effects;
- (c) ,,,³

4 Delineation

The Guardians analysis of this issue focuses on companies with substantial involvement in the production of cluster munitions. Substantial involvement in the manufacturing of cluster munitions can be defined as involvement by the company in the manufacture or supply of one or more types of cluster munitions as a finished product, or the supply of essential and/or customised semi-finished parts for one or more types of cluster weapons. Companies that have a controlling interest in a subsidiary or joint venture with a substantial involvement in the manufacturing of such weapons are also included.

5 Materiality of the issue

According to estimates, a very high proportion of cluster munitions victims are civilian. The impact is both historic, with major cluster-munitions clearance operations still required from past conflicts (e.g. Cambodia, Bosnia), and ongoing, with munitions still being actively produced and used, (for example, in Iraq and Lebanon). One of the key reasons cluster munitions are dangerous after use is the high rate of failure to detonate on impact. These unexploded munitions then present a significant risk to civilians. The speed with which cluster munitions can be spread contrasts with the labour intensive mine-clearance operations that are required to rehabilitate affected land.

6 Nature of involvement (Company)

For the majority of firms with capabilities to produce components for cluster munitions, these activities are not a core business area. The major armament and defence companies involved will only derive a small percentage of revenue from cluster-munitions related contracts. Such contracts are generally part of a wider supplier relationship with government defence procurement departments. Sometimes the company’s involvement may be through subsidiaries or joint ventures. Nevertheless, these activities can be significant in terms of the market for this type of weapon. Types of involvement may include the assembly and finishing of the munitions or, as is more

³ (c) represents additional wording that may be added in finalising the definition.

often the case, production of key components. Components may include the bomb canister, the bomblets, fuses, delivery mechanisms and other parts essential to the functioning of the weapon. Each individual cluster bomb may contain anything from a handful, to up to 650, bomblets or sub-munitions.

7 Nature of Involvement (Fund)

7.1.1 As of 30 June 2007, the Guardians held approximately NZ\$26 million in companies that have been identified by independent analysis as being involved in the production of cluster munitions. This is equivalent to 0.20% of total funds under management.

Company Name	Value in NZ dollars
Lockheed Martin Corp.	21,850,772
Raytheon Company	2,294,974
Poongsan Corp.	1,582,636
Total	25,728,382

Further analysis, by external screening agencies used by the Guardians, continues on a number of companies that have potential, but as yet unverified, involvement in cluster munitions productions. This includes investigating reports that some companies have since exited such activities. The definitions currently used by these agencies may not necessarily replicate the finalised Oslo Process definition.

8 International Law

Cluster munitions are not subject to restrictions under specific international law. The use of cluster munitions could be considered to breach International Humanitarian Law, but there is disagreement between countries on this. International Humanitarian Law aims to restrict the means and method of warfare, and protect civilians.

The Geneva Convention Protocol 1 and the Conventional Weapons Convention (CCW) are the main pieces of Treaty law directly relevant to the issue of cluster munitions. Although some countries believe the use of cluster munitions breaches Protocol 1, the US, Israel, China and Russia, in particular, disagree. Attempts in recent years to renegotiate the CCW to broaden its scope and specifically include cluster munitions have not been successful.⁴

The objective of the Oslo Process (discussed below) is to strengthen International Humanitarian Law through a separate treaty specific to cluster munitions.

9 The Oslo Process

Norway started an independent process, called the Oslo Process, outside the CCW with the objective to conclude a new international treaty banning cluster munitions “that cause unacceptable harm to civilians” by 2008. As part of the process, New Zealand hosted the Wellington Conference on the 18-22 February 2008, during which 82 states subscribed to the Wellington Declaration, thereby affirming their commitment to the objective of the Oslo Process. The diplomatic conference to be held in Dublin in May 2008, aims for the Treaty text to be negotiated and concluded.

Following agreement on the text, the New Zealand Government is responsible for approving the signing of the Treaty.

10 New Zealand Law

⁴ Landmine Monitor Report 2007

New Zealand is a signatory to Geneva Protocol 1. It is also a signatory to the CCW and ratified Protocol V of the CCW in November 2007.

There is no New Zealand law which applies specifically to cluster munitions.

If New Zealand becomes a party to a new international instrument banning cluster munitions, new national legislation will be required to enact this obligation.

11 Crown actions

New Zealand has an active foreign policy on disarmament. With regards to cluster munitions, New Zealand co-chaired the first meeting in the Oslo process, which resulted in the Oslo Declaration. New Zealand hosted a key meeting for the treaty in Wellington in February 2008.

In February 2008, the New Zealand Government subscribed to the Wellington Declaration, the next step in the Oslo Process. During the February 2008 conference, the New Zealand Minister for Disarmament announced a new commitment on cluster munitions as follows:

“New Zealand does not possess, will not acquire, and will not use cluster munitions.”

12 Guardians’ Mandate

The Guardians manage the Fund consistent with their mandate and the review integrates key factors important to this mandate into its analysis.

12.1 Risk of prejudice to New Zealand’s reputation as a responsible member of the world community:

There is broad international censure over the use of cluster munitions by military forces. The Oslo Process is the key international response addressing concerns over these weapons, and the draft convention encompasses the main control measures. The draft convention does not include specific reference to investment in company shares, or to restrictions in governmental dealings with companies and their activities, outside of those related to cluster munitions. Companies listed on the major stock exchanges, including those involved in cluster munitions manufacture, are likely to be common across other government investment funds. Some international non-governmental organisations have been critical of investments in companies involved in cluster munitions production. Although this presents a potential reputation risk to institutional investors, the Fund’s investments are unlikely to present a reputation risk to New Zealand’s reputation as a responsible member of the world community.

12.2 Best-Practice Portfolio Management:

Companies involved in the production of cluster munitions may breach the United Nations Global Compact principles (UN Global Compact) on human rights due to the inherent nature of the finished product, and through their customers’ use of such products. The Guardians Responsible Investment Policy includes the UN Global Compact as a key benchmark for corporate behaviour. If a new treaty banning cluster munitions is concluded, the use of cluster munitions will be widely seen as a definitive breach of International Humanitarian Law. Where there is a significant breach of the Guardians’ Responsible Investment standards, the Guardians may decide to engage with that company, or take other action as appropriate, including exercising voting rights, divestment or exclusion.

Although there are over 100 asset owner signatories to the United Nations Principles for Responsible Investment, few of these apply exclusions to their funds on social or environment grounds, and exclusions on the basis of corporate involvement in cluster munitions manufacture are rare amongst peer funds. The Guardians take into account

that most of their peer funds do not have a legal requirement to have a responsible investment policy, so are less likely to exclude stocks on non-financial grounds.

12.3 Maximise return without undue risk to the Fund as a whole

The impact of exclusion of companies identified for their involvement in the production of cluster munitions, on the Fund's portfolio as a whole, is low. Exclusions could have a larger impact on some individual active mandates. However, such exclusion does not alter the efficiency of the portfolio in a material sense and is not inconsistent with maximising returns without undue risk to the portfolio as a whole.

13 **Shareholder action and implementation**

There is little history of engagement with companies on the issue of cluster munitions. The Ottawa Convention banning anti-personnel mines (APM) led to some companies ceasing their APM activities. Although the changing legal environment was the key driver, investor engagement and divestment also appear to have been influential to company decisions to exit this activity. A treaty on cluster munitions could lead to a similar response. However, where there is a strong reliance on servicing a government client, this relationship is highly likely to take precedent over investor concerns. The Guardians could use engagement to encourage companies, open to such dialogue, to exit activities related to cluster munitions manufacture.

Divestment and exclusion can be applied to companies identified by independent expert agencies, in a similar fashion to the Guardians' policy on anti-personnel mines. There are some challenges to verifying company involvement in cluster munitions manufacture. Involvement may be through subsidiaries or joint-ventures, and company disclosure on the subject can be poor. The Guardians therefore utilise the services of external screening agencies to identify companies involved in cluster munitions production or manufacture.