Dutch case study

A ban on investments in producers of cluster munitions

PAX

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About PAX (formerly IKV Pax Christi)

PAX stands for peace. Together with people in conflict areas and critical citizens in the Netherlands, we work on a dignified, democratic and peaceful society, everywhere in the world.

Peace requires courage. The courage to believe that peace is possible, to row against the tide, to speak out and to carry on no matter what. Everyone in the world can contribute to peace, but that takes courage. The courage to praise peace, to shout it from the rooftops and to write it on the walls. The courage to call politicians to accountability and to look beyond your own boundaries. The courage to address people and to invite them to take part, regardless of their background.

PAX brings people together who have the courage to stand for peace. We work together with people in conflict areas, visit politicians and combine efforts with committed citizens. **www.paxforpeace.nl**.

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Summary

Cluster munitions have killed and injured thousands of civilians during their history of use and continue to do so today. They cause widespread harm on impact and remain dangerous, killing and injuring civilians, long after a conflict has ended.

The 2008 Convention on Cluster Munitions (CCM) prohibits the use, production, transfer and stockpiling of cluster munitions. Yet cluster munitions continue to be produced in a number of countries that have not yet outlawed these weapons. Although countries that have joined the Convention must stop producing cluster munitions, some banks and other financial institutions in or from these countries continue to fund the production of cluster munitions by investing in corporations that manufacture them elsewhere. Ten countries have installed national legislation to prevent such investments.

This publication looks at the implications and impact of disinvestment legislation. In order to do so, it examines the Dutch prohibition on direct and demonstrable investments in cluster munitions producers. Futhermore, it presents a number of Dutch financial institutions' and other stakeholders' (such as the ban's regulator and trade associations) views on and experience with the disinvestment ban.

The report highlights both the perceived positive and negative effects of the ban and, in conclusion, holds that it is not only possible to install disinvestment legislation, but that financial institutions largely agree that such a ban is a positive development. PAX hopes that this report will inspire other states to install national disinvestment legislation of their own. The experience with the Dutch law could offer useful insights and lessons for all states, both States Party and States not Party to the CCM.♦

Introduction

Cluster munitions contain multiple explosive submunitions. Cluster munitions are dropped from an aircraft or fired from the ground, opening up in mid-air to release tens or hundreds of submunitions, which can saturate an area up to the size of several football fields. Anybody within the strike area of the cluster munition, be they military or civilian, is likely to be killed or seriously injured. Moreover, many of the submunitions do not explode as intended, which leaves them to function as landmines. Submunitions can remain a fatal threat to anyone in the area long after a conflict ends. Most victims of cluster munitions are civilians.

Driven by a commitment to end the humanitarian harm caused by cluster munitions, a group of 94 states signed the Convention on Cluster Munitions (CCM) on 3 and 4 December 2008. The CCM categorically prohibits the use, production, transfer and stockpiling of cluster munitions. As of August 2015, 117 states have joined the CCM of which 93 are States Parties.[iii] But why would one ban a weapon for the humanitarian harm it causes, yet continue to allow for investments in companies that produce them elsewhere?

Article 1(1)(c) of the Convention on Cluster Munitions states:

> *"Each State Party undertakes never under any circumstances to assist, encourage or induce anyone to engage in any activity prohibited to a State Party under this Convention."*

The Cluster Munition Coalition (CMC)[1] and a growing group of states interpret the prohibition

"Well, **first** there was a **bomb flying**. Many smaller bombs came out of it. It **exploded**, and with the explosion, more came from it. Like an **umbrella**. It exploded in **the air**, and on **the ground**, everywhere. [...] While **we ran**, one boy was hit in the shoulder and **I was hit** in the leg."[i]

Quote from thirteen years old Vlad, who had been playing in the courtyard of his apartment block in eastern Ukraine when he suddenly heard explosions from cluster muntions.[ii]

on assistance in the Convention on Cluster Munitions to include a prohibition on investments in cluster munitions.[iv] Investment would amount to assistance with production of cluster munitions, which is prohibited under the Convention. More than 25 CCM States Parties or signatories have already made interpretive statements that investments in cluster munitions are, or can be seen as, prohibited under the CCM.[2] Ten states have implemented laws that prohibit investments in cluster munitions.[3]

While financial institutions often argue that governments, not financial institutions, should decide whether investments in certain sectors should be forbidden, governments tend to argue that financial institutions have to set their own standards for socially responsible investment. Governments can, of course, lead the way by providing good examples. Governments cannot afford to maintain a double standard by opposing the use of cluster munitions, while continuing to allow investments in companies that are involved in their production. Any governmental effort to oppose the misery that cluster munitions cause should include efforts to end the supply of capital that funds the companies that produce these weapons.

1 The Cluster Munition Coalition is a global civil society campaign, active in around 100 countries in the world, working to eradicate cluster munitions, prevent further casualties from these weapons and put an end for all time to the suffering they cause.

2 Currently, 27 states have expressed the view that investments in cluster munitions are, or can be seen as, prohibited by the CCM. Australia, Bosnia and Herzegovina, Canada, Cameroon, Colombia, the Democratic Republic of Congo (DRC), the Republic of Congo, Croatia, the Czech Republic, France, Ghana, Guatemala, the Holy See, Hungary, Lao PDR, Lebanon, Madagascar, Malawi, Malta, Mexico, Niger, Norway, Rwanda, Senegal, Slovenia, the United Kingdom and Zambia.

3 Belgium, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, New Zealand, Samoa, Spain and Switzerland.

Recent years have shown an increase in legislative measures to ban investments in cluster munitions. Some countries addressed the investment issue as part of their Convention on Cluster Munitions ratification implementation while others issued separate laws. At the time of writing, ten states have adopted legislation that prohibits (various forms of) investments in cluster munitions: Belgium, Ireland, Italy[4], Liechtenstein, Luxembourg, the Netherlands, New Zealand, Samoa, Spain[5] and Switzerland.

The existing disinvestment laws differ in scope and implementation. None of the existing laws are fully encompassing, yet each law contains certain positive elements that can serve as an example for other states when drafting disinvestment legislation. PAX's 2014 paper "Banning Investment in Cluster Munitions producers; national legislation"[6] highlights the strong components of the various investment prohibitions.

This publication looks deeper into the implications and impact of disinvestment legislation. In order to do so, it examines the Dutch prohibition on direct and demonstrable investments in cluster munitions producers and presents a number of Dutch financial institutions' and other stakeholders' (such as the ban's regulator and trade associations) views on and experience with the disinvestment ban. PAX hopes that this report will inspire states to install national disinvestment legislation of their own. The experience with the Dutch disinvestment law could offer useful insights and lessons for all states, both States Party and States not Party to the CCM.[7]

The first chapter will give an overview of how the Dutch ban on direct and demonstrable investments in cluster munitions producers came about. The second chapter provides an analysis of the provisions of the Dutch prohibition, plus observations by a number of financial institutions and other stakeholders about the implementation and impact of the legislation. The final chapter presents concluding remarks and recommendations for states that intend to install cluster munition disinvestment legislation.♦

4 Art. 7 (1) of the Italian implementation law criminalizes financial assistance to acts that are prohibited by the No. 95 legislation. A draft bill was submitted to the Senate on 26 May 2010 to create separate legislation with a specific prohibition on the "financing of the production, use, repair, promotion, sale, distribution, import, export, storage, possession, or transport of

5 On 30 July 2015, Spain enacted legislation to amend Law 33/1998 to incorporate a total ban on cluster munitions and similar arms. Among the provisions is a paragprah with a prohibition "to finance [...] this type of weapons [...] by any means." "Boletín Oficial del Estado", page 5, 28 July 2015, available at: www.boe.es/boe/dias/2015/07/29/pdfs/BOE-A-2015-8471.pdf. antipersonnel mines and cluster bombs and submunitions thereof."

6 PAX, "Banning Investment in Cluster Munitions producers; national legislation", April 2014, available at www.paxvoorvrede.nl/publicaties/4. Please note that this publication does not take the Spanish legislation into account since it came into existence after the report was published.

7 A prohibition on investments in cluster munitions producers can be included as part of the ratification of the CCM or of national implementation legislation required under Article 9 of the Convention, or can be covered in separate laws.

1. Investments in cluster munitions producers

1.1 Background

Cluster munitions have killed and injured thousands of civilians during their history of use and continue to do so today. They cause widespread harm on impact and remain dangerous, killing and injuring civilians long after a conflict has ended.

The 2008 Convention on Cluster Munitions prohibits the use, production, transfer and stockpiling of cluster munitions. Yet cluster munitions continue to be produced in a number of countries that have not yet outlawed these weapons. Although countries that have joined the Convention must stop producing cluster munitions, some banks and other financial institutions in or from these countries continue to fund their production by investing in corporations that manufacture them elsewhere. This undermines the commitment these countries have made to ban cluster munitions and runs counter to their obligations under international law.

Long before the Netherlands signed the Convention on Cluster Munitions in 2008, intense debate took place in the Netherlands about investments by Dutch financial institutions in producers cluster munitions. In March 2007, Dutch television programme Zembla broadcasted a documentary which brought these investments to light and sparked both public and political indignation.[v] Two years later, the Dutch Fair Bank Guide, in cooperation with PAX[8], launched a report about investments by Dutch

8 The Fair Bank Guide is an initiative by Oxfam Novib, Amnesty International the Netherlands, Friends of the Earth Netherlands, Dutch labour union FNV, PAX and the Dutch Society for the Protection of Animals. PAX joined the coalition in 2011. The aim of the Fair Bank Guide is to create a race to the top amongst banks on their Corporate Social Responsibility policies and practices. For more information, please see: www.eerlijkegeldwijzer.nl.

banks in companies involved in (amongst others) the production of controversial weapons, including cluster munitions.[vi] The report attracted widespread media coverage and led to public outrage. In October 2009, PAX and FairFin (then called IKV Pax Christi and Netwerk Vlaanderen) launched their first state-of-the-art report on investments in cluster munitions producers by global financial institutions.[9] On the same day, the Cluster Munition Coalition launched the international Stop Explosive Investments campaign.[10] The updates of the 'Worldwide Investments in Cluster Munitions; a shared responsibility' report and additional (national) research showed that Dutch financial institutions continued to invest in cluster munitions producing companies even after the Netherlands signed the CCM in 2008.

1.2 Towards a ban on investments in cluster munitions producers

For many years, the Netherlands held the view that investment in cluster munitions ran counter to the spirit of the Convention on Cluster Munitions, but that it was not banned by the treaty. Furthermore, it said that the Convention applied to states and not to individuals or investors and that separate legislation to counter investments was not needed.[11]

In 2009, the Dutch House of Representatives unanimously adopted a motion that called for a prohibition on investments in cluster munitions.[vii] However, the then-Minister of Finance informed parliament it would not implement the motion and reiterated the position that a legal prohibition on investment would be counterproductive to efforts by financial institutions under the corporate social responsibility regime and would be unenforceable.[viii]

Two more motions were tabled and adopted in both the Senate and the House of Representatives. The Senate's motion called for a legal ban on 'demonstrable and direct investments' in companies that produce cluster munitions.[12] [ix] In 2012, the then-Minister of Finance Jan Kees de Jager announced to the Senate that the government would introduce a legal prohibition on direct and demonstrable investments in cluster munitions producers by financial institutions, citing concern about the humanitarian impact of cluster munitions as a major impetus to do so. The minister stated: "Cluster munitions cause unacceptable harm which is why I find it very important that there are no direct investments in the production, sale or distribution of these weapons."[x] His successor Jeroen Dijsselbloem furthermore underlined the importance the Dutch government attaches to act preventatively against investments in cluster munitions production.[xi]

On 1 January 2013, the prohibition on direct and demonstrable investments in cluster munitions producers by Dutch financial institutions came into effect.♦

9 Updates of the report 'Worldwide Investments in Cluster Munitions; a shared responsibility' were published in 2010 - 2014. In 2013, PAX and FairFin ended their corporation in producing the report. The 2013 and 2014 editions were published by PAX and build on the previous editions published in conjunction with FairFin. The November 2014 report is available at www.stopexplosiveinvestments.org/report.

10 For more information, see: www.stopexplosiveinvestments.org.

11 More information on the Netherlands' position on the CCM can be found in its Cluster Munition Monitor's profile, available at www.the/monitor.org.

12 On 18 March 2011, the Dutch Labour Party proposed a Senate motion calling for a prohibition on "demonstrable direct investments in the production, sale, and distribution of cluster munitions." The motion was adopted on 29 March 2011. On 13 December 2011, the House of Representatives adopted a motion that, amongst others, requested the government to follow up on the Senate's motion and "create legislation regarding the prohibition on demonstrable direct investments in the production, sale, and distribution of cluster munitions for all financial institutions as soon as possible."

2. A ban on investments in cluster munitions producers

2.1 The prohibition on direct and demonstrable investments

On 1 January 2013, the amended Market Abuse (Financial Supervision Act) Decree entered into force. It prohibits an enterprise from "directly supporting any national or foreign enterprise which produces, sells, or distributes cluster munitions" with a view to restricting as much as possible investments in cluster munitions producers.

The text of the prohibition on direct and demonstrable investments can be found on page 15.

2.2 PAX's commentary on the Dutch investment prohibition

In order to stem all investment flows to producers of cluster munitions and to provide adequate clarity to financial institutions, national disinvestment legislation should be as clearly defined and as comprehensive as possible. In order to assess the Dutch disinvestment legislation, a commentary of the Dutch prohibition follows below. The following questions, that can be considered as a starting point for countries creating disinvestment legislation, are used to structure our commentary:

1. **What exactly does the legislation exclude from investment?**
   The definition of cluster munitions producers should be as comprehensive as possible.

The Dutch legislation against direct and demonstrable investments in cluster munitions producers

The prohibition, set out in Article 21a of the Decree, is formulated as follows:

1. An enterprise as referred to in Article 5:68 (1) of the Act, not being a clearing institution, will take adequate measures to ensure that it does not:
    a. carry out transactions or has transactions carried out with a view to acquiring or offering a financial instrument that has been issued by an enterprise that produces, sells or distributes cluster munitions as referred to in Article 2 of the Convention on Cluster Munitions which was concluded in Dublin on 30 May 2008 (published in the Bulletin of Treaties 2009, 45) or essential parts thereof;
    b. provide loans to an enterprise as referred to in subsection (a) above;
    c. acquire non-marketable holdings in the capital of any enterprise described under (a) above.

2. The first section above is equally applicable to carrying out transactions, or having them carried out, with a view to acquiring or offering a financial instrument that has been issued by any enterprise that holds more than half of the share capital of an enterprise as referred to in subsection 1 (a) and also to loans to, or non-marketable holdings in such an enterprise.

3. Section 1 above will not apply to:
    a. transactions based on an index in which enterprises described in subsection 1 (a) constitute less than 5 percent of the total;
    b. transactions in investment funds operated by third parties in which enterprises described in subsection 1 (a) constitute less than 5 percent of the total; and
    c. investments in clearly defined projects carried out by an enterprise described in subsection 1 (a) insofar as such funding is not utilised for the production, sale or distribution of cluster munitions.

4. Without prejudice to the provisions of section 1 above, enterprises that do hold financial instruments, loans or non-marketable holdings as described in that section should dispose of them or terminate them within a reasonable period of time."[xii]

A Dutch financial institution in violation of Article 21a of the Market Abuse (Financial Supervision Act) Decree can be sanctioned to a fine with a set basic amount of €500,000 and a maximum of €1,000,000.[13] [viii]

13 A fine of category 2 applies to a financial institution in breach with Article 21a of the Market Abuse (Financial Supervision Act) Decree. The set basic amount is €500,000 with a maximum of €1000,000. The Netherlands Authority for the Financial Markets can increase or decrease the basic amount as it sees fit, according to duration and nature of the violation.

2. **How does the legislation define ‘investment’ or ‘financing’?**
The legislation should exclude any financial or investment link or service offered to producers of cluster munitions.
3. **To whom does the legislation apply?**
To create a complete ban on investment, legislation should clearly forbid any investment by any party.

4. **How is the legislation enforced?**
Legislation on disinvestment is powerless without monitoring, whether by public institutions, ethical councils or others explicitly assigned to audit compliance with the law.

1. WHAT DOES THE LEGISLATION EXCLUDE FROM INVESTMENT?

The legislation defines the subject of financial exclusion as “an enterprise that produces, sells or distributes cluster munitions” or “essential parts thereof.” The explanatory note defines essential parts as “those (components) which are indispensable for the functioning of cluster munitions.” Dual use components are explicitly excluded from the scope of the definition in the explanatory note.[xiv]

The prohibition is equally applied to holdings containing a subsidiary with activities related to cluster munitions. According to the explanatory notes: “without this addition, it would be relatively easy to evade the provision by establishing a parent company (holding) in which investments could be made and transferring the activities related to cluster munitions to a separate, wholly or partly-owned subsidiary.” However, the legislation only applies to enterprises “holding more than half of the share capital” of a company involved in cluster munitions.[xv]

The ban does not apply to financing specific projects of companies involved in the production, sale or distribution of cluster munitions when it can be demonstrated that the financing will not be used for operations linked to cluster munitions. To ensure exemption, financial institutions need a written declaration confirming the nature of the project and that financing will not be used for operations linked to cluster munitions. This still permits investors and lenders to finance projects of companies identified as cluster munitions producers, but only when the project has nothing to do with the forbidden activities. This exception weakens the law, for it will not hinder recipient companies from transferring money internally to projects that are connected with cluster munitions.

2. HOW DOES THE LEGISLATION DEFINE ‘INVESTMENT’ OR ‘FINANCING’?

The legislation applies only to “direct and demonstrable investments.” The ban defines “direct and demonstrable investments” as investments, loans or non-marketable holdings in or to an enterprise that produces, sells or distributes cluster munitions.[xvi] The “adequate measures to prevent investment” pertain particularly to measures by a financial institution that are legally possible and are unilaterally enforceable. According to the explanatory notes, “this is at least the case when an institution is acting on its own behalf and for its own account, is itself manager of an investment fund or receives explicit instructions from a client, without an associated request for advice, to invest in an enterprise as referred to in subsection 1 (a); this is known as an 'execution only' situation.”

The prohibition contains several exceptions, as laid out in subsection 3:
Subsection (3) (a) provides an exception for transactions following an index, when less than five

Clarification from the Authority for Financial Markets on the implementation of the law

The Netherlands Authority for Financial Markets (AFM) is tasked with the implementation and monitoring of the ban on direct and demonstrable investments in cluster munitions producers. On its website, it has published an overview with Frequently Asked Questions which seeks to provide clarity on the implementation of the law. It contains answers about the scope of the legislation as well as on how the AFM monitors adherence to the law.

For example, the AFM has stated how it interprets the requirement for 'adequate measures.' It explains that "The AFM considers (that) the legal phrase "adopting adequate measures" is an obligation to take action. The ban and the indicative list should be soundly embedded in the organisation. The financial enterprise has to meet the requirements for ethical and controlled operations, with internal controls designed to effectively instil the ban in the organisation. This can be achieved through internal reporting, regular assessments and the procedure for dealing with infringements. [...]"

The AFM's answers to a number of frequently asked questions are available online at www.afm.nl/en/professionals/veelgestelde-vragen/marktmisbruik-clustermunitie-investeringsverbod.

percent of the total assets of that index are invested in companies that produce, sell or distribute cluster munitions. Transactions based on an index are deemed to include "index funds, index trackers, the replication of indices in a 'basket', and similar financial products."[xvii]
Subsection 3 (b) holds a similar exception for "transactions in investment funds managed by third parties, where one or more of the enterprises that produce, sell or distribute cluster munitions constitute less than five percent of the total."[xviii] This means that funds following an index and investment funds may still contain the specified percentage of cluster munitions producing companies. This exception weakens the prohibition, especially since companies involved in the production of cluster munitions usually do not represent more than 5% in funds that follow an index or investment funds.

3. TO WHOM DOES THE LEGISLATION APPLY?

The prohibition's scope is limited to financial institutions that operate in the Netherlands and that have substantial dealings with the financial markets. This means that Article 21a does not apply to individuals, clearing institutions, legal entities that are not financial enterprises, or to foreign subsidiaries of financial institutions in the Netherlands.

4. HOW IS THE LEGISLATION ENFORCED?

Financial institutions that violate the prohibition are subjected to financial penalties or can be charged under the Public Prosecution Service. The Netherlands Authority for the Financial Markets (AFM) is in charge of monitoring the implementation of the prohibition.

The prohibition does not provide for specific monitoring tools or auditing methods, nor does it provide for a black list of companies involved in the production of cluster munitions.[14] The law does appoint the Netherlands Authority for the Financial Markets as supervisor to regulate all of these issues.

Exclusion list

A key element for effective disinvestment legislation is providing clarity about what entities are subject to exclusion. For the legislation to be meaningful and effective, it should exclude companies that are involved in the production of (key components of) cluster munitions and/or explosive submunitions. Furthermore, legislation should provide for supervision or monitoring tools, whether by public institutions, by ethical councils or by other actors explicitly assigned to audit the implementation of the law.

Monitoring is only possible with a clear agreement on the definition of a cluster munitions producer. Therefore, it is recommendable to publish an exclusion list of entities that fall under the ban. This clarifies which companies are off limits for investment by financial institutions due to involvement with cluster munitions. Such a list greatly aids a financial institution in structuring its processes and, for instance, explain to clients why certain transactions are not executed. Whereas in the Netherlands a supervisory body to monitor compliance was assigned, such a list of companies was not provided.

The financial sector, at the request of the supervisor, established a so-called "indicative list" of cluster munitions producers that are subject to the ban. At the end of each calendar year the list is updated for the subsequent calendar year. The list is used as a "risk radar" by the AFM which starts an investigation if investments in any of the identified companies occur. On a monthly basis, the AFM checks if financial institutions have taken positions in the excluded enterprises and if so, checks whether the investment is allowed under the exceptions of the law. The AFM will take enforcement action if an enterprise cannot explain why it invested in a company subject to the ban.[xix]

Regrettably, the list was only made publically available the first time it was created. Annual updates of the list have not been shared outside of the financial sector. In order to truly provide a level playing field for financial institutions and promote compliance, the indicative list should be made publically available and accessible to all financial institutions and the wider audience alike.

2.3 Impact on investments

As described in Chapter 1, Dutch financial institutions' investments in companies involved in the production of (key components) of cluster munitions or explosive submunitions was met with disapproval by the wider public, politicians and civil society in the Netherlands.

The report 'Worldwide Investments in Cluster Munitions; a shared responsibility' documents investments in cluster munitions producers by financial institutions worldwide. These financial institutions are listed in the so-called Hall of Shame.

The Hall of Shame is not an exhaustive list of financial institutions that invest in cluster munitions producers. Firstly, the so-called red flag list of cluster munitions producers is not exhaustive.[15] Secondly, the report applies different thresholds to different companies for investment in shares and bonds. Due to the different shareholding structure in the various companies, a 0.1% floor limit for Asian companies and a 1% limit for American companies was chosen. These thresholds are a pragmatic decision, as without them, the list of financial institutions would be too long to handle in the report. Even when a financial institution has invested in a cluster munitions producer, as long as its shares are below 0.1% in the listed Asian companies or 1% in the listed American companies, it wil not feature in the Hall of Shame.

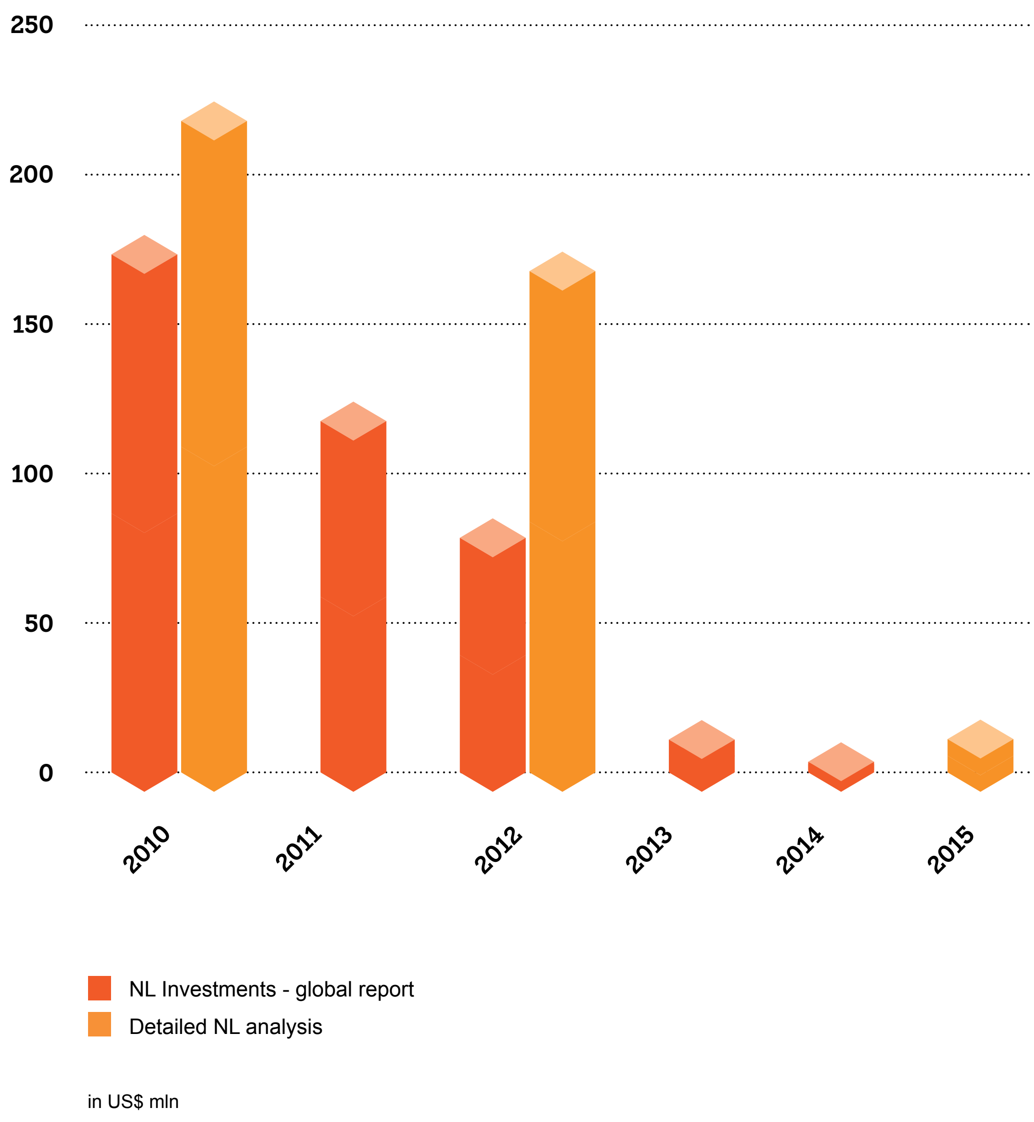
In the first report, launched in 2009, no Dutch financial institutions featured in the Hall of Shame.[16] This was most likely due to the applied thresholds for shares and bonds, as Dutch investments tend to fall below these thresholds. From 2010 onwards, additional research was conducted to identify investments in shares and bonds below the thresholds.
Furthermore, PAX published additional reports that looked deeper at investments by Dutch banks, pension funds and other financial institutions in 2010 and 2012.[xx] Here, not only self-managed investments were considered, but also investment funds offered under the name of (a subsidiary of) a Dutch financial institution for which the management has been outsourced to other fund managers. The annual 'Worldwide Investments in Cluster Munitions; a shared responsibility' research, the investments in shares and bonds below the threshold, as well as the additional reports specifically focussing on Dutch financial institutions, showed the extent to which Dutch financial institutions were investing in cluster munitions producers.
Figure 1 visualises the investments by Dutch financial institutions in cluster munitions producers between 2010 and 2015.

14 The financial sector established an "indicative list" of cluster munitions producers to be used as a so-called "risk radar" by the AFM. The AFM will start an investigation if investment in any of the identified companies occur. The list will be periodically updated by the financial sector and the AFM.

15 The research criteria for including a company on the red flag list of cluster munitions producers are explained on pages 33-35 of the 2014 update of 'Worldwide Investments in Cluster Munitions; a shared responsibility.' The report is available at www.stopexplosiveinvestments.org/report.

16 Research by economic research company Profundo. For more information, see www.profundo.nl.

Figure 1.
Investments of Dutch financial institutions in cluster munitions producers



The information in figure 1 is derived from various sources. It combines the research of the annual ‘Worldwide Investments in Cluster Munitions; a shared responsibility’ report and additional research into investments under the threshold for shares and bonds – referred to in figure 1 as ‘NL Investments – global report’. Furthermore, the additional and more detailed – yet less frequent- research on investments by Dutch financial institutions from 2010, 2012 and 2015[17] are referred to as ‘Detailed NL analysis’. Combined, figure 1 provides an indication of a decrease in investments by Dutch financial institutions in companies involved with cluster munitions over the years.[18]

It should be noted that, overall, the total amount invested by financial institutions in the Hall of Shame dropped from US$43 billion in the 2012 update to US$24 billion in the 2013 update. The US$19 billion drop was due to the fact that Lockheed Martin stopped their involvement with production of cluster munitions components and thus no longer appeared on the red flag lists of producers in the 2013 report update.

The investments in figure 1 that occurred after the law entered into force in January 2013 likely fell within the boundaries of the ban’s exceptions. The investments that featured in the 2013 research were investments in shares and bonds owned or managed by foreign subsidiaries of two Dutch financial institutions (Aegon and ING[19]). As the commentary in Chapter 2 explains, the Dutch prohibition does not extend to foreign subsidiaries of Dutch financial institutions. The same applies to the investments in 2014, which were done by foreign subsidiaries of one financial institution (Aegon). The 2015 investments by three Dutch financial institutions (Aegon, ING and Pensioenfonds PGB[20]) were also most likely done within the boundaries of the Dutch investment prohibition. Yet, these investments demonstrate (some of the) loopholes in the legislation that substantially weaken it.

The AFM, the ban’s regulator, has not issued fines or pressed charges with the Public Prosecution Service for violations of the law. However, after research into transactions and assessing the explanation by the financial institution concerned, the AFM has communicated on a breach of standard on a few occasions.[xxi]

17 Please note there will not be an update of ‘Worldwide Investments in Cluster Munitions; a shared responsibility’ in 2015. The next report is scheduled to be launched in the first half of 2016. For investments in 2015, Profundo conducted (unpublished) additional research into investments in the companies listed as cluster munitions producers in the 2014 ‘Worldwide Investment in Cluster Munitions; a shared responsibility’ report.

18 It is important to note that these figures are most likely not comprehensive. The research is dependent on the availability of public information and there is often a lack of transparancy about financial institutions’ investments. This applies for instance to fund portfolios or to pension funds that do no publish their (complete) portfolio. However, the analysis still indicates that there has been a decrease in investments by Dutch financial institutions in cluster munitions producers over the years.

19 ING U.S. was previously a wholly-owned subsidiary of ING Group. In April 2014, ING U.S. changed its name to Voya Financial which became a standalone company.

20 Pensioenfonds PGB informed PAX in August 2015 that this investment has been sold.

2.4 Commentary on the effects of the ban by Dutch financial institutions and other stakeholders

It has been well over two years since the ban on direct and demonstrable investments in cluster munitions producers entered into force on 1 January 2013. Therefore, the time is right to assess what impact the legislation has had, which steps financial institutions have undertaken to adhere to the prohibition and what they view as the most important effect of the legislation.

PAX reached out to a number of financial institutions to accertain their views. Other stakeholders include the ban's supervisory body the Authority for Financial Markets, Eumedion[21], the Dutch Association of Insurers (Verbond van Verzekeraars) and responsible investment research agency Sustainalytics. In what follows, these parties will collectively be referred to as stakeholders. For more information on how this research was conducted, please refer to the 'Methodology' text box op page 23.

This chapter offers a synthesis of the stakeholders' experience with and views on the legislation. While this report is by no means an exhaustive study, their answers will provide insight to which concrete steps financial institutions have taken, whether the prohibition has had a positive effect on the financial sector and also where the legislation falls short or even has (perceived) negative effects. This will offer insights and valuable lessons to those states that are yet to create national disinvestment legislation.

What follows is a two-track approach. On the one hand, the next subsection will go into what the stakeholders perceive as the most important effect of the legislation and addresses the question if the ban has had a positive effect on the financial sector. The subsequent subsection, by contrast, will focus on what stakeholders' perceive as (possible) negative consequences of the law, or where they identify weak spots. This approach will make it possible to draw valuable lessons for states that intend to install cluster munitions disinvestment legislation, building on the strong elements of the Dutch prohibition while leaving out the weaker elements.

21 Eumedion represents institutional investors' interests in the field of corporate governance and sustainability performance.

Methodology

How was this study conducted?

PAX sent a questionnaire to the stakeholders. The questionnaire addressed among others what they believe has been the most important effect of the ban, what steps financial institutions have taken because of the legislation, what stakeholders think of the scope of the ban and whether the legislation is clearly defined.

Who participated to this study?

The questionnaire was sent to, and answered by, financial institutions ABN Amro, Aegon, APG, ASN Bank, ING, Rabobank; trade associations Eumedion and the Dutch Association of Insurers as well as the Authority for Financial Markets and responsible investment research agency Sustainalytics. The selected financial institutions were a mix of some that were active and public proponents of legislation and financial institutions that were identified as investors in cluster munitions producers by PAX's research between 2009-2014.

Does this study take into account the views of all Dutch financial institutions or relevant stakeholders?

No. As explained above, this research is based on the views of a selected number of financial institutions and other relevant parties. As such, these stakeholders do not constitute the Dutch financial sector nor does the study include all relevant parties that are active in the financial sector by any means. Therefore, this study should not been seen as comprehensive but rather as a sample of views and positions by a number of stakeholders.

Why are there answers anonomous?

For some stakeholders participation to this study depended on anonymity. That is why PAX has aggregated the collected answers and presents the findings without attributing the answeres directly to the stakeholders.

2.4.1 Preceived positive effects of the legislation

Firstly, it must be noted that all financial institutions that participated in the study stated that they already had policies in place banning investment in cluster munitions even before the Dutch legislation entered into force, which for some can be traced back to the public outcry in 2007 and active campaigning by non-governmental organisations. This led to a growing realisation that investing in companies involved in cluster munitions posed undesirable ethical and reputational risks.

However, before the legislation came into effect, it was up to the financial institutions themselves to decide if they had a cluster munitions policy in place and perhaps more importantly, how far they wanted it to go. Therefore, cited as the most important effect of the law by the majority of the stakeholders, is that the legislation created a level playing field for financial institutions and has created clarity of what is expected. The prohibition, as such, has set a norm for excluding investments in companies involved with cluster munitions. Three stakeholders volunteered the view that the prohibition likely diminished access to capital for cluster munitions producers.

Interestingly, a number of stakeholders expressed the view that the ban has had a 'spillover' effect. According to these stakeholders, the Dutch ban has increased awareness about investment in controversial weapons producers, both in the Netherlands and elsewhere. One stakeholder mentioned that foreign asset managers have started to apply cluster munitions exclusions more strictly to their Dutch mandates. Another stakeholder said the legislation encouraged it to sharpen its cluster munitions policy by applying it to the external managers it works with. Mentioned as another positive effect of the legislation is that it has prompted research providers and screening agencies to develop more and improved products to help financial institutions to implement the ban.

Perceived positive effects of the disinvestment legislation

- The prohibition offered clarity and direction for the financial sector
- The prohibition created a level playing field for all financial institutions in the Netherlands
- The prohibition set a (minimum) norm for the financial sector while giving financial institutions the possibility to go beyond what is legally required
- The prohibition led foreign asset managers to apply cluster munitions exclusions more strictly to their Dutch mandates
- The prohibition led to institutionalization of compliance procedures and thorough screening of portfolios
- The prohibition increased consideration by research providers to offer better and specialized products in order for financial institutions to implement the prohibition
- The prohibition increased awareness about investment in controversial weapons producers (both in the Netherlands and elsewhere)
- The prohibition is likely to diminish access to capital for cluster munitions producers

2.4.2 Perceived negative effects of the legislation

In terms of negative effects of the legislation, a few stakeholders believe the legislation is too limited in scope and argue that the legislation potentially diminishes financial institutions' own responsibility and flexibility to go beyond what is legally required. One stakeholder is of the opinion that the exceptions (for instance for investments in index funds) should have been eliminated.[22]

Regardless of the stakeholders' opinion whether the scope is too narrow or just right, most indicated that the Dutch ban is clear in its definition and what is meant by 'direct' investment. Yet, one stakeholder said it would have preffered more guidance on the ban's exeptions for investments in indices or investment funds by third parties.

The legislation has raised some negative feedback regarding the perceived economic consequences. These are mostly seen to affect financial institutions, although one stakeholder pointed out that cluster munitions producers do not depend only on financial institutions for capital. One stakeholder suspected the legislation led to an increase in costs related to compliance for financial institutions. While stakeholders generally share the view that the Dutch ban created a level playing field for Dutch financial institutions, some argue that it created a disadvantage vis-a-vis financial institutions from other European countries and the United States that do not have similar laws, or that it dimished Dutch financial institutions' competitiveness. Related, one stakeholder said it would prefer uniformity at, at least, the European level on this issue.

A number of stakeholders cited the lack of an official exclusion list as problematic. Since neither the legislator, the supervisory authority, or any other body, provides an official exclusion list, there is a lack of clarity for financial institutions about which companies fall under the scope of the prohibition. Stakeholders indicated this leads to confusion and uncertainty; they would have preferred the legislator to have drawn up a list to this end when the ban came into effect.

22 By contrast, another stakeholder stated explicitly that the scope of the ban could not have been extended to also cover so-called indirect investments as this would have created practical implementation issues.

Perceived negative effects of the disinvestment legislation

- The prohibition moved the issue of investing in cluster munitions producers from the corporate social responsibility debate to the juridical domain, potentially undermining financial institutions intrinsic motivation to go beyond what is legally required

- The prohibition led to a (minimum) level playing field in the Netherlands, but resulted in an uneven playing field in the European or global context

- The prohibition itself does not provide for an exclusion list which creates uncertainty for financial institutions about which companies are banned from investment. While the financial sector constructed an indicative list, this list is not public or easily accessible

- The prohibition potentially led to increased costs for internal regulation and compliance mechanisms

- The prohibition's scope is too limited (f.e. it should have covered all indexed investments, third party investment and have eliminated the exclusion for non-cluster munitions related projects)

2.4.3 Conclusion

Most of the stakeholders are of the opinion that the ban sets a clear (minimum) standard and provides clarity for the financial sector. This is generally perceived as the biggest impact of the Dutch ban on direct and demonstrable investments. While some might argue that a legal prohibition diminishes financial institutions' intrinsic motivation to go beyond what is legally required, others hold that nothing prevents financial institutions from adopting more extensive measures. In fact, some have indeed done so. Similarly, whereas some financial institutions may lament a (perceived) loss in competitiveness with peers from countries without investment restrictions, all stakeholders agree that investment in companies involved with cluster munitions is objectionable. There seems to be no debate amongst financial institutions or other stakeholders that cluster munitions producers make uneligible business partners.

If there is one thing that stands out from the stakeholders' responses, it is the need for clarity. On the one hand, this need has been met by the creation of the prohibition itself, which has set a norm for all financial institutions. The legislation and its definitions are mostly clear and the regulator has published information on its implementation. However, the need for clarity about which companies are in practice to be excluded from investment is not adequately met by the prohibition itself, the legislator or the regulator. While the creation of an indicative list by the financial sector, facilitated by the AFM, is seen as helpful in this regard, stakeholders indicated they would have preffered that the legislator had provided such a list when the ban came into effect.♦

3. Conclusion

There is a growing number of states that have indicated investments in cluster munitions are, or can be seen as, prohibited under the Convention on Cluster Munitions (CCM) and currently ten states have installed national legislation to ban these types of investments. However, the majority of governments that have joined the CCM and committed themselves to ridding the world of this atrocious weapon, have not yet made their views known and/or enacted legislation to prohibit investment in cluster munitions producers. It seems a contradiction that a state would oppose the unacceptable humanitarian harm caused by cluster munitions, yet does not ban the supply of capital to cluster munitions producers.

Beyond the moral en legal argument, this case study shows it is not only possible to install disinvestment legislation, financial institutions and other stakeholders largely agree that such a ban is a positive development. The Dutch ban on direct and demonstrable investments in cluster munitions producers has provided clarity and direction for the financial sector. Furthermore, the legislation created a level playing field for all financial institutions in the Netherlands. Finally, the Dutch legislation shows that, even if a country has already drawn up national legislation to implement the Convention on Cluster Munitions or has already ratified the CCM, it is not too late to establish a separate disinvestment legislation.

What stands out from this study is financial institutions' need for clarity. Therefore, it is important that disinvestment legislation is comprehensively and specifically defined. Secondly, it is important to provide clarity about which companies are to be excluded from investments as a result of the legislation. Consequently, states should draw up an exclusion list, wether by public institutions, ethical councils or other actors speciafically assigned to audit the implementation of the law.

Stemming from their commitment to a world free of cluster munitions, governments should take their responsibility and make sure investments in cluster munitions producers end. Therefore, states should:

- Explicitly acknowledge that the treaty prohibits investment in cluster munitions under the ‘prohibition on assistance’ under article 1(1)c of the Convention.

- Install legislation that prohibits investment in companies that develop and/or produce (key components of) cluster munitions or explosive submunitions.

At the Fifth Meeting of States Parties in San José, Costa Rica, the Netherlands encouraged disinvestment legislation by other states. It said that “[...] PAX underlined the impact and importance of [...] disinvestment measures. We call upon other member states, who have not done so yet, to take similar measures.”[xxii] We join this call and encourage states to establish national legislation banning investments in cluster munitions producers, building on the positive examples from states that already have such laws in place. ♦

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