

BRIEFING PAPER JANUARY 2020

ISSUE

Australian superannuation funds face reputational, fiduciary and regulatory risks through exposure to companies associated with the production or maintenance of nuclear weapons (nuclear weapons companies) and should implement comprehensive exclusion policies by EOY 2020.

BACKGROUND

- The United Nations Treaty on the Prohibition of Nuclear Weapons (TPNW) is on track to become international law by 2021, when nuclear weapons will be illegal - just like chemical and biological weapons, cluster munitions, and landmines.
- When the Treaty enters into force, international law will prohibit any assistance to anyone producing nuclear weapons.

CURRENT STATUS

- Most superannuation funds do not have comprehensive policies in place to exclude nuclear weapons companies from investment options, including ethical or socially responsible options.
- Nuclear weapons companies are not yet captured by screens for controversial weapons. Options that claim to exclude armaments may in fact fail to screen out nuclear weapons.
- Many nuclear weapons companies may have positive ESG ratings, so using ESG criteria is insufficient.
- There is a lack of industry-wide clarity and consistency on definitions related to nuclear weapons.

KEY CONSIDERATIONS

Reputational Risk

- Investments in nuclear weapons companies do not meet community standards. 79% of people support Australia signing and ratifying the UN nuclear ban treaty (IPSOS November 2018). 69% agreed or strongly agreed that their superannuation should not invest in nuclear weapons companies, and only 7% disagreed. (IPSOS August 2019).
- PRI signatories claiming to 'avoid harm' may be misrepresenting investors' exposure to armaments.

Fiduciary Risk

- Globally, major investors are limiting their exposure to nuclear weapons activities. Two of the top five pension funds in the world, the Norwegian Government Pension Fund and ABP, have divested from nuclear weapons. Deutsche Bank and KBC are also divesting. The overall number of divested funds has more than doubled since 2014.
- Nuclear weapons-related investments have shown long-term under-performance and may further deteriorate as divestment gains momentum. Broader trends indicate sector downturn in the wake of prohibition by international treaty, even in non-signatory countries.
- The MSCI USA Ex Tobacco Ex Controversial Weapons Index has outperformed the MSCI USA Index over the past three years (see Appendix for data).
- Companies recommended for exclusion are international companies and represent a small portion of the overall investment landscape, limiting the fiduciary risk of divestment.

Regulatory Risk

- The ALP has committed to sign and ratify the TPNW when in government.
- By 2021, international law will comprehensively and categorically prohibit nuclear weapons and associated activities, including assistance for development, production, manufacture and stockpiling.
- States parties to the Treaty will be required to divest any government money – such as superannuation – from such nuclear weapons companies.

RECOMMENDATIONS

Our recommendation is to adopt a policy that:

1. Excludes all nuclear weapon associated companies:

- Whole companies, not only nuclear weapons related projects;
- Companies associated with nuclear weapons including through joint ventures;
- Companies regardless of their country of origin;
- Companies regardless of their country of operation.

2. Excludes all nuclear weapon associated activities:

- Development, testing, production, maintenance or trade of nuclear weapons related technology, parts, products or services;
- Delivery systems such as missiles that are specifically developed for nuclear tasks. It does not include delivery platforms such as bombers and submarines.

3. Applies the policy to all the institution's products and services. The institution applies the policy:

- For the entire group, including subsidiaries;
- In all markets;
- To all asset management classes – passive and active, internal and external;
- To all existing and future investments.

The following involvement categories are recommended for exclusion:

- Weapons - Nuclear Dual-Use Components
- Weapons - Nuclear Intended-Use Components
- Weapons - Nuclear Warheads & Missiles
- Weapons - Nuclear Weapons Support Services

The following companies are recommended for exclusion:

- Aecom (USA)
- Aerojet Rocketdyne (USA)
- Airbus (The Netherlands)
- BAE Systems (United Kingdom)
- Bechtel (USA)
- Boeing (USA)
- BWX Technologies (USA)
- Fluor (USA)
- General Dynamics (USA)
- Honeywell International (USA)
- Huntington Ingalls Industries (USA)
- Jacobs Engineering (USA)
- Larsen & Toubro (India)
- Lockheed Martin (USA)
- Northrop Grumman (USA)
- Safran (France)
- Serco (United Kingdom)
- Thales (France)



Quit Nukes is an initiative of the **Medical Association for Prevention of War** in association with the 2017 Nobel Peace Prize Laureate **International Campaign to Abolish Nuclear Weapons (Australia)**
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Quit Nukes applies definitions and criteria developed by **Don't Bank on the Bomb**, the only regularly published source of information on the private companies involved in the production of nuclear weapons and their financiers.
Visit dontbankonthebomb.com for more information.

APPENDIX

There are powerful humanitarian and ethical reasons as to why the worst of the weapons of mass destruction should be eliminated. But there are also material risks associated with ongoing investment in nuclear weapons. Funds need a broader and longer-term perspective than assuming a short-term profit from a single industry producing an illegal product that will have catastrophic outcomes with any use.

Research from Pace University (2019) shows indexes of stocks that screen out nuclear weapons largely track the overall economy, sometimes outperforming it.

The MSCI World ESG Screened Index, which excludes nuclear weapons, has largely tracked the MSCI World Index, marginally outperforming it since 2015. Data from several other investments that screen out companies with environmental, social and governance (ESG) concerns (including those associated with nuclear weapons) generally perform better in terms of risk and return, over various time periods (see Tables 1, 2 and 3).

Table 1: Performance of MSCI World and USA Indices Compared to the Same Indices Screened for Companies with Environment, Social and Governance (ESG) Concerns (including those Associated with Nuclear Weapons).

	3 YEARS			5 YEARS			SINCE 31 MAY 2012		
	Net Annualised Return (%)	Annualised Standard Deviation	Sharpe Ratio	Net Annualised Return (%)	Annualised Standard Deviation	Sharpe Ratio	Net Annualised Return (%)	Annualised Standard Deviation	Sharpe Ratio
MSCI WORLD INDEX (AS OF 31 MAY 2012)	9.00	10.88	0.71	5.62	11.40	0.45	10.38	No data	0.90
MSCI WORLD ESG SCREENED INDEX (AS OF 31 MAY 2012)	9.03	11.10	0.70	5.84	11.53	0.47	10.67	No data	0.92
MSCI USA INDEX (AS OF 31 MAY 2012)	11.10	11.73	0.83	8.91	11.77	0.70	12.78	No data	1.09
MSCI USA ESG SCREENED INDEX (AS OF 31 MAY 2012)	11.23	11.91	0.83	9.16	11.94	0.71	13.04	No data	1.10

Table 2: Performance of S&P500 Index Compared with S&P500 ESG Index (Screening Out Companies with ESG Concerns, including Nuclear Weapons).

	1 YEAR		3 YEARS		10 YEARS	
	Annualised Return (%)	Annualised Risk	Annualised Return (%)	Annualised Risk	Annualised Return (%)	Annualised Risk
S&P500	-4.38	17.00	9.26	13.00	8.49	13.22
S&P500 ESG	-3.95	17.09	9.44	13.02	8.47	13.18

Table 3: Risk and Reward Performance of Nuclear Weapons Producers Compared with Index of 59 Peer Industrial Firms, as of 31 May 2019

	3 YEARS		5 YEARS		10 YEARS	
	Risk (Standard Deviation)	Reward (Mean)	Risk (Standard Deviation)	Reward (Mean)	Risk (Standard Deviation)	Reward (Mean)
Benchmark Index of Peer Industrial Firms	16.58	13.21	15.36	10.49	17.00	20.30
Nuclear Weapons Producers	16.90	12.05	16.03	9.39	16.84	15.20

Source: Bolton, M (2019) Nuclear Weapons are Risky Business: Divestment as Financial Prudence for New York City's Retirement Systems. International Disarmament Institute Discussion Paper, December 2019.

<https://cpb-us-w2.wpmucdn.com/blogs.pace.edu/dist/0/195/files/2020/01/Nuclear-Weapons-are-a-Risky-Business-011620.pdf>