



BRIEFING PAPER for SUPERANNUATION FUNDS AUGUST 2020

THE 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 EOFY 2021.

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 TPNW enters into force, international law will prohibit any assistance to anyone producing nuclear weapons.
- As illustrated by Covid 19, predicted low frequency catastrophic events do occur. Nuclear war is an accident waiting to happen - be it by human or technical error, extremists, hackers or erratic leadership.
- Like tobacco, nuclear weapons kill millions of people. The subsequent "nuclear winter" would lead to a decade long global famine putting a further 2 billion lives at risk.

CURRENT STATUS

- Most superannuation funds do not have comprehensive policies in place to exclude nuclear weapons companies.
- 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.

KEY CONSIDERATIONS

Reputational risk

- Investments in nuclear weapons companies do not meet community standards. In Australia 79% of people agree that the government should sign and ratify the UN nuclear ban treaty (IPSOS 11/18), while 69% agreed or strongly agreed that their superannuation fund should not invest in nuclear weapons companies, and only 7% disagreed. (IPSOS 8/19).
- PRI signatories claiming to 'avoid harm' may be misrepresenting investors' exposure to armaments.
- Interests of members and beneficiaries in the future are a key responsibility of trustees.

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.
- In Japan, 16 banks (including 3 mega banks MUFG Bank, Mizuho Bank and Sumitomo Mitsui Banking Corp) have flagged ceasing investment in nuclear weapons companies.
- 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 since its inception in 2012. (see Appendix for data).
- Companies recommended for exclusion are international companies and represent a very small proportion of Australian fund portfolios, limiting material risk.

Regulatory risk

- 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 nuclear weapons companies.
- Stress testing for a nuclear event scenario (not unlike stress testing for a pandemic) forms part of due diligence requirements, as all portfolios are exposed to the negative impacts of a nuclear event while nuclear weapons continue exist.
- Over 80 federal parliamentarians have pledged support for the treaty, and the federal Opposition has a policy to sign and ratify the treaty.

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 28 companies are recommended for exclusion:

Aecom (USA)
Aerojet Rocketdyne (USA)
Airbus Group (The Netherlands)
BAE Systems (United Kingdom)
Bechtel (USA)
Bharat Dynamics Limited (India)
Boeing (USA)
BWX Technologies (USA)
Charles Stark Draper Laboratory (USA)
Constructions Industrielles de la Méditerranée (CNIM) (France)
Fluor (USA)
General Dynamics (USA)
Honeywell International (USA)
Huntington Ingalls Industries (USA)
Jacobs Engineering (USA)
Larsen & Toubro (India)
Leidos (USA)
Leonardo (Italy)
Lockheed Martin (USA)
Moog (USA)
Northrop Grumman (USA)
Raytheon (USA)
Safran (France)
Serco (United Kingdom)
Textron (USA)
Thales (France)
United Technologies Corporation (United States)
Walchandnagar Industries (India)



Quit Nukes is an initiative of the Medical Association for Prevention of War in association with the 2017 Nobel Peace Prize Laureate, the International Campaign to Abolish Nuclear Weapons (Australia).

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>