

## RESEARCH GUIDELINES RED FLAG LIST

- **Definitions**

For our research we used the definition of cluster munitions and explosive submunitions in the *Convention on Cluster Munitions*:<sup>i</sup>

**Cluster munitions** means a conventional munition that is designed to disperse or release explosive submunitions each weighing less than 20 kilograms, and includes those explosive submunitions. It does not mean the following:

- a. A munition or submunition designed to dispense flares, smoke, pyrotechnics or chaff; or a munition designed exclusively for an air defence role;
- b. A munition or submunition designed to produce electrical or electronic effects;
- c. A munition that, in order to avoid indiscriminate area effects and the risks posed by unexploded submunitions, has all of the following characteristics:
  - i. Each munition contains fewer than ten explosive submunitions;
  - ii. Each explosive submunition weighs more than four kilograms;
  - iii. Each explosive submunition is designed to detect and engage a single target object;
  - iv. Each explosive submunition is equipped with an electronic self-destruction mechanism;
  - v. Each explosive submunition is equipped with an electronic self-deactivating feature;

**Explosive submunition** means a conventional munition that in order to perform its task is dispersed or released by a cluster munitions and is designed to function by detonating an explosive charge prior to, on or after impact;

We then define **producer of cluster munitions** as follows:

- Any company or group of companies that, itself or through a subsidiary, develops or produces cluster munitions and/or explosive submunitions according to the definition in the Convention on Cluster Munitions.
- Any company or group of companies that, itself or through a subsidiary, develops or produces key components for cluster munitions or explosive submunitions.

We consider a company or group of companies a cluster munitions producer when any part, however small, of its total turnover is derived from cluster munitions regardless of the nature of the company's other activities. We do so, because most cluster munitions are made by companies that also produce other defence and/or civil products. Companies can easily reallocate capital within the company or group of companies; profit from one production line can be invested in other production lines; money for general corporate purposes can be used for all the company's activities, etc. Focussing solely on the financing of cluster munitions is impossible and undesirable given the companies' financial structures. Moreover, even if a company only gets 1% of its turnover from cluster munitions, this 1% can represent a considerable amount of money and can mean the production of large amounts of cluster munitions.

- **Selection and research**

To research the financial links to cluster munitions producers, we first drew up a list of companies that produce cluster munitions. To identify these companies, research company Profundo, The Netherlands, called upon a variety of sources including reports by NGOs and exclusion lists maintained by financial institutions banning investment in cluster munitions,

information published by the companies themselves, contracts with the US government and, correspondence between the companies and investors. All producing companies on the Red Flag list were contacted to verify our data, and if additional information was provided, we included this in our report.

At this point, there is still a lack of official information in the public domain about the production of cluster munitions. This is the reason that this list is not exhaustive. From this list we then selected a short list, a *Red Flag List*, based on the following criteria:

- Certainty that the company manufactures cluster munitions, the evidence is available and clear.
- No evidence that the company will cease the manufacture of cluster munitions in the next 12 months.
- Clear evidence of production of cluster munitions in the last two years (meaning since January 2007), or involvement (even if this involvement is yet to be confirmed) in a planned production or development phase. This evidence is based on the abovementioned sources. In addition, we viewed marketing efforts (exhibitions, new product brochure, advertising on websites, etc.) in the previous year as evidence of ongoing involvement in cluster munitions production.
- Financial links to the company available through official information in the public domain. If financial links could not be found through the financial information available to us, we decided that a company would not be included in this report. It was for example more difficult to link state-owned companies to financial institutions. That is why the Red Flag List has only one state-owned company.

Using these criteria we narrowed our Red Flag List to eight companies: seven public and one state-owned. It is important to note that the list of companies used in this study is by no means an exhaustive list of cluster munitions producers.

## RESEARCH GUIDELINES HALL OF SHAME

- **Research**

We consider any kind of finance or investment link with a cluster munitions producer to be financial involvement with this producer.

We applied different thresholds to different companies for investment in shares and bonds. Due to the difference in the structure of shareholdings between companies<sup>1</sup> we chose a lower 0.1% limit for Hanwha Corporation, Poongsan, and Singapore Technologies and 1% for ATK, L-3 Communications, Lockheed, Roketsan and Textron.

Since there are so many shareholders in ATK, L-3 Communications, Lockheed Martin, Roketsan and Textron that have less than 1% of the shares, listing all of them was beyond the scope of this report. Therefore we made a pragmatic choice to apply the above mentioned thresholds.

Research institute Profundo, The Netherlands, provided the list of financial institutions which they derived from Stock exchange filings and other publications of the financial institutions and the CM producers, as well a commercial databases, filled with information supplied by financial institutions. Since these databases consists of information that is provided by the

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<sup>1</sup> The Asian companies seem to have a few large (local) shareholders and a group of foreign shareholders that hold a percentage of shares under 1%. That's why we've lowered the threshold for Hanwha, Poongsan and Singapore Technologies Engineering.

financial institutions directly, we trust that this information is correct and have not contacted all financial institutions in the Hall of Shame before publication of this report.

We included all credits and underwriting found since 1 January 2007. We provide the portfolio for investments in shares and bonds by August 2009, which is the date research company Profundo concluded their research on financial links to companies that produce cluster munitions.

We defined an investor as someone financially involved in a cluster munitions producer. The following factors are irrelevant to our definition: the investor's importance for the cluster munitions producer; the investment's importance for the investor's portfolio; the contribution of cluster munitions production to the company's total turnover; and the cluster munitions producer's other activities. We have chosen to do this because it is impossible for a financial institution to be sure that the financial services provided to a company are not used for the production of cluster munitions. It is common that weapon producers finance their cluster munitions facilities from their general corporate capital. So far, we have never come across a project intended specifically to finance cluster munitions facilities.

As mentioned above, the list in the Hall of Shame is not an exhaustive list of financial institutions investing in producers of cluster munitions. We apply different thresholds to different companies for investment in shares and bonds. Since the Red Flag List is not exhaustive, a financial institution might be investing in a producing company not included in our research. Transparency on what credits were given to whom is almost non-existing furthermore. It is therefore very hard to find out whether a financial institution has given a loan to a controversial company.

### **FOCUS: Public Pension Funds and Sovereign Wealth Funds**

Special attention is given to sovereign wealth funds (SWF) and public pension funds (PPF) in our research, since the importance of these investment funds is growing.

Sovereign wealth funds have existed since at least the 1950s, but their total size, worldwide, has increased dramatically over the past 10–15 years. According to the International Monetary Fund (IMF), sovereign funds probably held at most \$500 billion in 1990, while they controlled an estimated \$3 trillion in September 2007.<sup>ii</sup> International Financial Services, London (IFSL) estimated in March 2009 that assets under SWF management increased by 18% in 2008 to reach \$3.9 trillion. IFSL projections are that SWFs are likely to double from their current level to around \$8 trillion by 2015.<sup>iii</sup>

Pension funds are even bigger institutional investors. In 2007, the total assets of the world's largest 300 pension funds grew by over 14% to around US\$12 trillion. The size of this pool of assets has more than doubled over five years.<sup>iv</sup>

These funds are particularly interesting because most of them are state owned. This becomes even more important when the SWF's or PPF's home country has ratified the Convention on Cluster Munitions.

Moreover, SWFs and PPFs sometimes hold a substantial stake in the capital of companies. This gives them considerable voting power at the annual meeting, and sometimes even one or more seats on the board of directors.

- **Selection and research**

For our research we selected major SWFs and PPFs, targeting 15 funds, chosen for their importance and country of origin (to ensure a broad geographical spread).

Many of these funds are entrusted to managers. This makes it difficult to determine in which companies they have assets. Some funds are very transparent and publish a list with shares on their website (e.g. Alaska Permanent Fund, Ireland National Pensions Reserve Fund and Calpers). We have found information on assets for five of the funds, two of which own or manage assets in the companies on the Red Flag List. These five funds are described in our report.

These funds are only involved through asset management, since financing and investment banking are not part of their business operations.

We have listed all the shareholdings that we were able to document, including shareholdings under the 1% threshold. All other research criteria are equal to the research criteria used for the financial institutions in the Hall of Shame.

## **RESEARCH GUIDELINES HALL OF FAME**

To identify financial institutions with a policy on cluster munitions, we researched a variety of sources: NGO reports, screening agency information, financial institutions' reports and websites, worldwide campaigns and other official sources available in the public domain. We have chosen to limit our research to policies available in the public domain, since we believe that financial institutions should be accountable for their policy. We limited ourselves to policies that were available in Dutch and/or English. The Hall of Fame is far from comprehensive. We believe that the financial institutions listed are only a tip of the iceberg. For this research it was impossible to research the policies of all the financial institutions worldwide however. The Hall of Fame can be seen as an invitation to financial institutions that have a comprehensive policy to ban investment in cluster munitions to provide us with their policy and to publish it on their website in order for us to include them in either the Runners-up category or the Hall of Fame.

As the investment policy is usually stipulated by the banking group and as a banking group directly or indirectly supervises its subsidiaries, we have researched the policy of the group. We have contacted the financial institutions included in this list before publication to check our research findings and clarify their policy.

Financial institutions in the Hall of Fame must meet the following criteria:

- An investor must be transparent and accountable on its cluster munitions policy. This means that the investor itself has published the policy and/or a summary of it.
- Its policy must exclude investment in cluster munitions producers (recalling past investment and avoiding further investment).
- The policy must have an 'all-in' comprehensive scope:
  - no exception for any types of cluster munitions producers
  - no exception for any type of activities by cluster munitions producers
  - no exception for any type of financing or investment by the investor

We researched investments in the Red Flag companies for each financial institution in the Hall of Fame. This included shareholdings under the 1% threshold. We chose to do so because any involvement at all in a cluster munitions producer, after publication of a policy

not to do so, is evidence of poor implementation. When we found involvement of financial institutions in the Hall of Fame, we contacted the company to confront them with our findings. Financial institutions where we found this involvement without a legal reason preventing it from instant withdrawal, can not be part of the Hall of Fame.

## **RESEARCH GUIDELINES RUNNERS-UP**

To identify financial institutions with a policy on cluster munitions, we researched a variety of sources such as NGO reports, screening agency information, financial institutions' reports and websites, worldwide campaigns and other public sources. We were limited to policy statements available in English and/or Dutch and by access to information. This following list is therefore by no mean exhaustive. We welcome additions from those able to provide them.

As the investment policy is usually stipulated by the banking group and as a banking group directly or indirectly supervises its subsidiaries, we have researched the policy of the group.

Financial institutions have to meet the following criteria to be considered a runner-up:

- An investor must be transparent and accountable on its cluster munitions policy. This means that the investor itself has published the policy and/or a summary of the policy.
- The policy must exclude investment in cluster munitions producers (recalling past investment and restraining from further investment).

The Runners-up category lists financial institutions which meet the two criteria above. They differ from the Hall of Fame however, because they do not meet the following criteria:

- The policy must have an 'all-in' comprehensive scope:
- no exceptions for any types of cluster munitions producers,
- no exceptions for any type of activities by cluster munitions producers,
- no exceptions for any type of financing or investment by the investor,
- no breaches of this all-in comprehensive policy after the policy's publication or implementation date.

## **RESEARCH GUIDELINES COUNTRIES' BEST PRACTICES**

To be listed as a country banning investments, a country must either have officially stated that it considers investment to be part of the Convention on Cluster Munitions, or have proposed and/or passed legislation which bans investments. Proposed legislation does not need to be comprehensive, but it should meet the following criteria to be listed:

- The law proposal must be discussed in Parliament or another body with power to issue legislation.
- The law proposal should contain an explicit ban on investment in cluster munitions.

We were limited to policy statements available in English and/or Dutch.

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<sup>i</sup> Convention on Cluster Munitions. Article 2: Definitions. The Convention on Cluster Munitions is available at: [http://untreaty.un.org/English/Opening\\_Signature/english.pdf](http://untreaty.un.org/English/Opening_Signature/english.pdf)

<sup>ii</sup> Johnson, Simon (2007), The Rise of Sovereign Wealth Funds. In: Finance and Development, September 2007, Volume 44, Number 3.

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- iii Marko Maslakovic, Marko (2009), Sovereign Wealth Funds 2009. IFSL Research, March 2009, pp 1-2.
- iv Watson Wyatt Research (2009). Top pension funds reach 12 million. Global investment matters 2009.