

INVESTMENT IN COMPANIES ASSOCIATED WITH NUCLEAR WEAPONS

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1 Purpose

- 1.1 The New Zealand Superannuation Fund holds a number of companies that, to one degree or another, are associated with nuclear weapons programmes. We reviewed the issue of investing in such companies to: a) establish if such investment breached our Responsible Investment (RI) Policy standards and b) determine our response if that were the case. This paper presents the findings of that review and our response as investors to this issue.

2 Background: the Guardian's RI Policy Guidelines

- 2.1 We have adopted a Responsible Investment Policy, Standards and Procedures and have established a framework to consider issues under the RI policy in three main steps:¹

Consistency with our mandate

- 2.2 Our investment decisions must be consistent with our 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.

We assess if investment in, or exclusion of, companies associated with nuclear weapons programmes is consistent with our mandate.

Consistency with international standards, New Zealand legislation and other Crown actions

- 2.3 Our RI Policy guidelines also consider whether the companies' activities are consistent with relevant international standards, New Zealand legislation, or other Crown actions.

Effectiveness of shareholder response

- 2.4 We consider the effectiveness of different shareholder responses where we establish that an investment breaches our RI Policy. The Guardians primarily seek to influence the practices of companies in their role as shareholders, through engagement and by exercising our voting rights. However, under certain circumstances, divestment and exclusion is considered.

¹ See Appendix 1 for the summary framework analysis

3 Definition of nuclear weapon

- 3.1 The Nuclear Non-Proliferation Treaty (NPT) and South Pacific Nuclear Free Treaty are enacted in New Zealand through the New Zealand Nuclear Free Zone, Disarmament, and Arms Control Act 1987 (NZ Nuclear Free Act) which places controls on nuclear explosive devices. For the purposes of this paper, we use the following definition from that Act:

“a nuclear explosive device is any nuclear weapon or other explosive device capable of releasing nuclear energy, irrespective of the purpose for which it could be used, whether assembled, partly assembled, or unassembled, but does not include the means of transport or delivery of such a weapon or device if separable from and not an indivisible part of it.”

4 Why review the issue of companies associated with nuclear weapons?

- 4.1 Nuclear weapons have been defined as weapons of mass destruction. The International Court of Justice’s (ICJ) opined that the threat and use of nuclear weapons would generally breach international humanitarian principles² based on the scale of the impact of the nuclear explosive device and its inability to discriminate between military and civilian targets..
- 4.2 Nearly all countries are signatories to the NPT. Under that agreement there are five official declared nuclear states: the United States, Russia, Britain, France and China who have agreed that, in exchange for other countries forgoing the development of nuclear weapons, the nuclear weapon states will pursue nuclear disarmament.

Given the high degree of international commitment to the NPT, this is a relevant issue to be considered under our RI policy.

5 Types of companies associated with the manufacture of nuclear weapons

- 5.1 The declared nuclear states still have nuclear weapons programmes and use products and services for these programmes from private sector companies. These companies are mainly in, but not limited to, the Aerospace and Defence Sector: however, the nature of their involvement varies.
- 5.2 We delineate between types of involvement in nuclear weapons-related programmes (by both governments and companies) as follows:
- A. Nuclear Explosive Devices:
 - i. Manufacture and testing of nuclear explosive devices;
 - ii. Simulated testing of nuclear explosive devices.
 - B. Nuclear weapons delivery and control systems, separable from the nuclear explosive devices e.g. missiles, (but not submarines and aircraft – see dual-use);
 - C. Nuclear bases: operation or management of military bases where nuclear weapons are deployed, maintained, refitted, stored or developed; and,
 - D. Dual use: dual use products and components including submarines and aircraft.

² ICJ Opinion 8 July 1996 No 96/23

- 5.3 Based on the information we have, the manufacture of nuclear explosive devices (Category A(i)) is limited to governments. Whilst not involved in that category, private sector companies are involved in the other categories. Establishing the degree of a company's involvement in any category of activity can be challenging. Based on our information, there are two publicly listed companies significantly involved in simulated testing (Category A(ii)). There are a handful of companies involved in Category B. Those companies are mainly large defense contractors and they have a material involvement in the manufacture of delivery and control systems for nuclear weapons. Category C companies have a significant responsibility in the running of nuclear bases, but take no part in the manufacture of nuclear explosive devices.
- 5.4 Category D companies may supply components to contractors involved in nuclear weapons programmes, but are not involved to a material extent. Category D products are often 'off-the-shelf' components and have other uses.

6 Is investment in, or exclusion of, companies associated with nuclear weapons consistent with our mandate?

Best practice portfolio management

- 6.1 Our RI Policy incorporates relevant international standards and the activities of our peer funds as a benchmark for integrating RI into best-practice portfolio management.
- 6.2 It is governments rather than companies that own, control, and could potentially use nuclear weapons and therefore breach international humanitarian standards through this use. Any breach of standards by companies involved in nuclear weapons programmes would be indirect and dependent on their government clients' actions.
- 6.3 We found that exclusion of companies associated with nuclear weapons programmes is rare amongst peer funds. Of over 100 UN PRI asset owners, we identified only three international funds and one New Zealand peer as excluding some companies associated with nuclear weapons programmes.
- 6.4 Other fund managers use exclusions but these are generally limited to their specialist Socially Responsible Investment (SRI) products.

Maximising returns without undue risk to the Fund as a whole.

- 6.5 To ensure we comply with this part of our mandate under our RI policy, we need to consider whether divestment and exclusion will impact portfolio returns. Our analysis concludes that the exclusion of a small number of securities does not alter the portfolio's efficiency in any material manner, up to a limit.
- 6.6 We have already excluded tobacco and other stocks from the Fund. The combined effect of excluding companies involved in nuclear weapons programmes would be immaterial at the Fund level. However, continued exclusions, particularly of a growing number of the largest companies, could have a cumulative and potentially more material impact on the portfolio.

Avoiding prejudice to New Zealand's reputation as a responsible member of the world community

- 6.7 Investment in the companies involved in nuclear weapons programmes is commonplace and very few peer funds, including other Government funds, exclude such investments. On that basis it is difficult to see how the Fund's investment in such companies would prejudice New Zealand's reputation as a responsible member of the world community.

- 6.8 Category A(i) activities, are clearly illegal if carried out by a New Zealand citizen in New Zealand and inconsistent with New Zealand's obligations under international law, and would be inconsistent with our mandate. However, we have not identified any companies directly involved in the manufacture of nuclear explosive devices which appears to be confined to Government agencies.

Conclusion: Neither investment in or exclusion of companies associated with nuclear weapons programmes in Categories A(ii), B, C or D would be inconsistent with the Guardians' mandate.

Under our RI policy we may also consider international treaties, New Zealand law and other Crown actions.

7 Consistency with international standards, New Zealand legislation and Crown actions

NPT and New Zealand Nuclear Free Act

- 7.1 New Zealand's obligations under the NPT are implemented through the NZ Nuclear Free Act. Under this act:

"Persons ordinarily resident in New Zealand must not:

- (a) manufacture, acquire, or possess, or have control over, any nuclear explosive device; or
- (b) aid, abet, or procure any person to manufacture, acquire, possess, or have control over any nuclear explosive device (s5(1))
- (c) test any nuclear explosive device in the New Zealand Nuclear Free Zone (s7)."

- 7.2 The focus of the NZ Nuclear Free Act is on the nuclear explosive device. The definition of the nuclear explosive device specifically excludes delivery systems (see 3.1 above). Therefore, it would be illegal for a New Zealander to carry out Category A(i) activities in New Zealand as these are directly involved with the production of the nuclear warhead. To the best of our knowledge, nuclear explosive devices would only be manufactured in government facilities and not by companies. A(II) activities may not be illegal in NZ but are essential to the development of the nuclear explosive device.

- 7.3 The activities undertaken by companies in Category B and, as far as we can determine, most within Category D are associated with delivery systems such as missile programmes. We are not satisfied that such activities would be illegal under New Zealand law. Category C companies provide services to manage government facilities that maintain or store nuclear explosive devices but take no part in their actual production. Furthermore we consider such facilities to be under Government control.

8 Other Crown actions

- 8.1 Unlike the tobacco sector, where law and Crown actions were specifically targeted at the main business and practices of the sector itself. Crown actions in respect of nuclear weapons are primarily concerned with the actions of states, with additional controls on specific 'sensitive' products and services offered by companies.
- 8.2 Successive New Zealand Governments have promoted nuclear disarmament and New Zealand is playing a role in complex new international negotiations. New Zealand has a well-known international reputation as a nuclear-free state, including being a member of the New Agenda Coalition. New Zealand is also rare in having a Minister for Disarmament.

- 8.3 We consider that simulated testing of nuclear explosive devices (as provided by Category A (ii) companies) is inconsistent with New Zealand's strong stance on nuclear testing.
- 8.4 Through its actions the Crown appears to distinguish between its active promotion of disarmament, involving initiatives targeted at nation states and controls on nuclear explosive devices, and its commercial relationships with those companies associated with nuclear weapons programmes.

Defence relationships

- 8.5 The Ministry of Defence has a large procurement programme that includes purchase of arms and aircraft from some of the world's largest defence companies, including Boeing and Lockheed Martin. Both companies are involved in nuclear weapons programmes. Given the dominance of the aerospace and defence sector by a few key players, many of whom are also involved in nuclear weapons programmes, the New Zealand Defence Force may find it technically or commercially infeasible to exclude these potential suppliers.

Other Commercial relationships

- 8.6 Boeing has been a regular supplier to Air New Zealand. Air New Zealand is 81% owned by the New Zealand government. For example, Air New Zealand has contracts to purchase Boeing aircraft to the value of over NZ\$1 billion.

Conclusion: The Crown is an ardent advocate of nuclear disarmament in its international policy. However this position, which is aimed at nation states and establishing controls on specific products, can be distinguished from the Crown's commercial activities with companies who might be involved in other parts of their business in nuclear weapons programmes.

9 Conclusions

- 9.1 We invest the Fund in a number of companies that are involved in nuclear weapons programmes. The materiality of their involvement varies between categories, and companies.

Applying our established RI framework, we reached the following conclusions:

- Neither inclusion nor exclusion of such companies appears inconsistent with best-practice portfolio management.
- Divestment of such companies from the Fund would have an immaterial impact on portfolio efficiency. Neither divestment nor investment would be inconsistent with maximising returns without undue risk to the Fund as a whole.
- Neither investment nor divestment would be likely to prejudice New Zealand's reputation as a responsible member of the world community.
- Only Category A(i) activities would clearly be in breach of New Zealand law if New Zealanders undertook those activities within New Zealand.
- The Crown is an ardent advocate of nuclear disarmament at an international level with other governments. However, these activities which are aimed at nation states and establishing controls on specific products, can be distinguished from its commercial activities with companies who might be involved in nuclear weapons programmes..
- We consider Category A (ii) activities to be inconsistent with New Zealand's strong stance on nuclear testing and essential to the development of the nuclear explosive device.

10 Shareholder Actions

- 10.1 There are a number of shareholder responses other investors have taken to address the issue of investment in companies involved in nuclear weapons programmes. None seem to be influential in encouraging companies to exit services related to nuclear weapons.

No Policy

- Most investors have no specific position with regards to nuclear weapons programmes, even when they have a responsible investment policy in place.

Voting and Engagement

- We have not found examples where defence and armaments companies have ceased their involvement in this area in reaction to shareholder engagement or voting. Given the companies' relationships with their major customers (i.e. government defence departments), and the size of the contracts involved, it is unlikely that companies will refuse to bid for nuclear weapons related contracts, as a result of shareholder engagement. The most likely means of exit is through the sale of assets through the normal course of business.

Exclusion and Divestment

- Exclusion and divestment also appear to have little influence on a company's continued involvement in nuclear weapons. Government contracts are very likely to be more important to these companies than a few funds divesting from a small percentage of their shares.

Conclusion: Engagement with or divestment of companies involved with nuclear weapons manufacture appears unlikely to lead to them changing their business activities.

11 Decision

- 11.1 From our analysis we concluded that were any private sector companies identified as being involved in Category A(i) activities we would exclude them from the Fund's investment universe.
- 11.2 With respect to companies engaged in Category A (ii), successive Governments have taken a strong stance on eliminating nuclear testing. In addition, testing (simulated or real) is crucial to the development of a nuclear explosive device. We concluded that we would exclude such companies from the Fund's investment universe and divest from any current holdings.
- 11.3 We concluded that we should take no action in respect of companies in Categories B, C & D on the basis that continued investment in those companies is not contrary to our statutory obligations, nor inconsistent with the Crown's actions with respect to such companies.