Exclusion of (nuclear) weapons and fossil fuel industries from Swiss Pension Funds

Rudolf Rechsteiner

President Ethos foundation
Divestment and active ownership

Movement for social responsible investment is growing. **Common subjects:**

– Carbon emissions
– Drugs, opioids, tobacco
– Nuclear, banned weapons or weapons in general
– Gambling, lotteries, pornography

• Norwegian State Fund as a pioneer
Ethos Foundation delivers Analysis and Engagement

Ethos is committed to
- promotion of sustainable investment activity
- stable economy and institutions that thrive long term

Ethos Services AG supplies
- Screening of listed companies
- Exercise of stock voting rights
- Engaging in dialogue with companies as part of engagement programs
- Demanding accountability and self-regulation from listed companies
Shareholder Impact?

- **Weak impact**
  - Capital allocation impact for big companies, indirect impacts

- **Stronger impact**
  - Talking at general Assemblies about the impact of products
  - Call directors to change products or delivery chain
  - Public dialog on things that newspaper do not report
  - Divestment and Capital cost impact regarding small companies

![Diagram: Framework outlining the components and mechanisms of investment impact](image)
Capital allocation impact rather weak

General Goal would be:
Higher cost for companies to finance contentious activities

But

– Big Companies do not have a shortage of funding

Therefore

– Divesting can be meaningful
  • For coordinated activities of investors resulting in a high market share of relevant financing
  • For small companies with restricted access to capital markets

– For contentious activities with perfect substitutes
  • Example: banning coal investments, pushing solar/wind/battery finance
US Stockholder Resolutions 2018

successful resolutions 2018

<table>
<thead>
<tr>
<th>Company</th>
<th>Issue</th>
<th>Percentage</th>
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<tr>
<td>STURM RUGER</td>
<td>(GUN VIOLENCE)</td>
<td>69%</td>
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<tr>
<td>AMERISOURCEBERGEN</td>
<td>(OPIOID RISKS)</td>
<td>62%*</td>
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<td>TYSON</td>
<td>(WATER)</td>
<td>61.6%*</td>
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<td>KINDER MORGAN</td>
<td>(CLIMATE CHANGE)</td>
<td>59.7%</td>
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<td>GENESEE &amp; WYOMING</td>
<td>(CLIMATE CHANGE)</td>
<td>57.2%</td>
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<td>MIDDLEBY</td>
<td>(SUSTAINABILITY/CLIMATE CHANGE)</td>
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<td>ANADARKO PETROLEUM</td>
<td>(CLIMATE CHANGE)</td>
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<td>RANGE RESOURCES</td>
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<td>50.25%</td>
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*majority of independent votes

Engagement of asset managers
climatic change and weapons mostly not an issue

- Professional Asset managers mostly did not support climate resolutions in 2017
The special case of weapons

- **Problems: Nuclear weapons not a free market product**
  - state companies and military agencies involved
  - Impact of pension funds is rather small
  - Purchase Power of states is goal oriented
- **But: Investment ban of weapons is popular**
  - Divesting can be more powerful for «neighbouring» technologies such as nuclear power plants
  - Divestment from nuclear weapons always should includ nuclear power stations
Definition of controversial weapons

Controversial weapons cause disproportionate harm and remain a threat long after a conflict has been resolved.

Different countries and institutions hold varying views based on these characteristics:

• **Indiscrimination**: the weapon is indiscriminate in nature, i.e. it does not distinguish between military and civilian targets;

• **Proportionality**: the weapon is considered to be excessively harmful, i.e. it causes an inordinate amount of pain and suffering relative to the anticipated military advantage; and/or

• **Illegality**: production and use is prohibited by international legal instruments.
  – i.e. cluster munitions, anti-personnel mines, and nuclear, biological and chemical weapons.
  – not subject to a ban: depleted uranium is also often considered among them.
  – Blinding laser weapons, incendiary weapons (those designed to cause burns), and weapons using non-detectable fragments, are not discussed as often, but are still considered controversial.
Main Goal

- Bench mark indexes should be free of companies violating international treaties
  - MSCI World or SMP 500
  - National Indexes such as DAX, SMI, Nasdaq
- Companies producing controversial weapons
  - should not exist
  - Should get no money from the stock market
Initiatives to delist controversial weapons producers from indexes

• SSF Engagement Initiative
  – Open letter to index providers on controversial weapons exclusions
  – 166 asset managers representing **USD 6.8 trillion** in investor funds have demanded Index providers to remove controversial weapons from mainstream indices.
    • Members are heavy weight such as UBS, CS
  – weapons include cluster munitions, anti-personnel mines, biological and chemical weapons, as well as nuclear weapons which are produced for countries that have not signed the Treaty on Non-Proliferation of Nuclear Weapons
  – Weapons may cause indiscriminate or disproportionate harm. Their use is banned or restricted under international conventions.
Letter to global index providers: exclusion of controversial weapons producers from mainstream indices

166 signatories representing USD 8.8 trillions AuM

92 Swiss signatories – amongst them many pension funds

Dialogue with different index providers has started

OPEN LETTER TO GLOBAL INDEX PROVIDERS

We, the undersigned institutional investors, recognize emerging issues such as social, political and financial pressures to avoid investing in companies involved in the development, production and maintenance of controversial weapons. We wish to engender sustainable social and environmental performance in the index management process.

There is growing consensus among financial regulators, asset managers and investors to invest responsibly. Investing companies with any business in the production of controversial weapons is widely seen as ill-advised and incompatible with modern standards of corporate social responsibility (CSR) and environmental, social and governance (ESG) management. As a result, there is significant pressure on index providers to exclude companies involved in controversial weapons from mainstream indices.

Ethically responsible investors – most commonly of controversial weapons manufacturers – consider ESG and ethical issues under a portfolio of indices over long periods of time. The exclusion of controversial weapons is seen as a positive move towards sustainable investment practices.

We therefore call upon index providers to exclude companies involved in controversial weapons from mainstream indices, and to engage in dialogue with current and new signatories regarding their policies on Sustainable investment strategies.

Names of Co-Signatories (open for additional co-signatories until 28th February 2019)

Public announcement: 11 February 2019
Co-Signatories as of 31 January 2019

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<tr>
<th>Aargauerische Pensionskasse (APK)</th>
<th>Colonial First State</th>
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<td>ABN AMRO Bank N.V.</td>
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<td>Crédit Suisse Asset Management (Schweiz) AG</td>
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<td>Lenné Stromberg Ag</td>
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<td>Church Commissioners for England</td>
<td>Legal &amp; General Investment Management</td>
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<tr>
<td>CIEPP - Caisse des Entreprises de Prévoyance Professionnelle</td>
<td>Legato Capital Management, LLC</td>
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*LGT Capital Partners Ltd.* | *Profèlia Fondation de prévoyance* |
*Lombard Odier* | *Prospera Stiftung für die berufliche Vorsorge* |
*Luzerner Pensionskasse* | *Raiffeisen Switzerland* |
*Man Group plc* | *RAM Active Investments SA* |
*MAIF* | *Reposol B. F. P.* |
*Metalremont GmbH* | *Rentenaltereien - Fonds institutionnel* |
*Migros Bank AG* | *Rivaer Sammelstiftung* |
*Migros-Pensionskasse* | *Seguros RGA* |
*Millenium Investments, Inc.* | *Skandia* |
*Mirabaud Asset Management (Suisse) SA* | *Solothurnische Gebäudeversicherung* |
*Monevita Lebensversicherung* | *Sparbanken Vert* |
*MP Pension* | *Sparenvest S.A.* |
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*OLZ AG* | *Stonebrand Asset Management* |
*Orca Asset Management* | *Sustainable Value Investors* |
*Partners for Sustainability* | *Swiss Mobilier Asset Management AG* |
*Pension Protection Fund* | *Temps des hommes Schwyz* |
*Pensions-CASA 30* | *The Humanitarian Foundation CRS* |
*Pensionskasse Bühler AG Uzwil* | *The United Reformed Church Wassau Trust* |
*Pensionskasse Carlota* | *TPT Retirement Solutions* |
*Pensionskasse der Berufsbetreuenden* | *Tribe Impact Capital LLP* |
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*Pictet Alternative Advisors* | *VBV Pensionskasse AG* |
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*Pictet Wealth Management* | *Vision Super Poy Ltd* |
*PIKA AG* | *VZ Exportbank AG* |
*Pollard-Puchham Charitable Foundation* | *2Capital* |
*Prévoyance Santé Valais (PRESV)* | *Zürcher Kantonalbank* |
*prévoyance.ne* | |
Waht states can do
Swiss federal war material act

• The Swiss Federal Act on War Material (WMA, Feb 2013) includes provisions on financing in the context of war materials prohibited in Switzerland,
  – i.e. nuclear, biological and chemical weapons,
  – anti-personnel mines and cluster munitions.
  – It prohibits the direct financing of the development, manufacture or acquisition of prohibited war materials (Article 8b WMA).
• Direct financing refers to the direct granting of credits, loans, or endowments or comparable financial advantages, in order to pay or advance costs and expenditures that are associated with the development, manufacture or acquisition of prohibited war materials.
  – indirect financing of prohibited war materials is banned only if intended to circumvent the ban on direct financing (Article 8c).
  – This should change!
  – few states’ parties have expressed the view, that Convention does not prohibit the financing of cluster munition production and else.
Resistance and impediments to weapon divestments

• Divestment from weapons is a value question
  – Some providers of index products don’t share these values
  – Asset manager fear, performance could drop below benchmark indices
  – Some exclude controversial weapons but restrictions do not carry meaningful impact
    • Only “some” controversial weapons manufacturers (i.e. Pakistan, North Korea etc.)
    • Controversial weapons a too small part of mixed company activity
    • Exclusion of companies from countries only who did not sign the non-proliferation treaty

• Exclusion of coal companies and weapon companies from non-signature countries of non-proliferation treaty is preferred strategy for some pension funds

• Financial institutions across Europe seem to apply a more extensive approach, whereas US-based companies do not appear to apply restrictions to the defense industry – or at least they do not publicize them.
Conclusion on controversial weapons

• Biggest impact could be derived from barring contentious weapons companies from main investor indices
• Weapons are a value question for investors
  – Common sense could be to avoid all investment in legally restricted weapons or
  – Avoid weapons that can be acquired by private actors or terrorists
• Weapons is a «state affair»
  – International treaties and state bans have a dominating impact
  – private divestment strategies are complementary
Different situation with fossil fuels

- Fossil fuel is a risk position
- Climate challenge, taxes and emission tradings and reneweable with performance impact
- Divestment can have an impact for small exploration and production companies of shale oil.
Climate risk: atmospheric carbon concentrations in uncharted territory

CO₂ Konzentration der letzten 800'000 Jahre

Climate risk: atmospheric carbon concentrations in uncharted territory

+35%
Summer temperatures in Switzerland 1864-1990 and 1991-2018

Temperatur Juni-Juli-August 1864-2018 (°C)

(Figuren von C. Schär ETHZ, Daten Meteo Schweiz)
Wind and Solar power on an exponential path worldwide: a world share of 6% now, 100% by 2050 possible (including hydro)

Global Wind Energie TWh
9 doublings since 1985

Globale Photovoltaic Power (TWh)
10 doublings since 1996

Daten GWEC, Wind Power Monthly, BP World Energy Statistics
Wind- and solar cheaper than gas, coal, nuclear

Levelized Cost of Energy Comparison—Historical Alternative Energy LCOE Declines

In light of material declines in the pricing of system components (e.g., panels, inverters, turbines, etc.) and improvements in efficiency, among other factors, wind and utility-scale solar PV have seen dramatic historical LCOE declines; however, over the past several years the rate of such LCOE declines have started to flatten.

Unsubsidized Wind LCOE

Unsubsidized Solar PV LCOE

Source: Lazard synthesis.

(1) Represents the average percentage decrease of the high end and low end of the LCOE range.
(2) Represents the average compounded annual rate of decline of the high end and low end of the LCOE range.
Ahead: A real shake out of fossil and nuclear fueled power generation – a risk for investors
climate destabilisation is not an «environmental» problem

• Goal:
  – Preservation of the foundations of economic activity
  – Biodiversity, agriculture, food security
  – Preservation of settlement areas
  – Maintaining productivity and returns

• Pension security is at risk
  – Weather extremes reduce productivity
  – business losses
  – Damage to products, capital and services, non-amortizable investments

• Real estate losses,
  – rising insurance premiums,
  – Rising prices reduce purchasing power of pensions
  – Economic risks and opportunities
  – Prohibition or price increase of climate-damaging goods

• Growth of new technologies,
  – damage containment
  – New Investment opportunities
Final remarks

• Responsible investment and responsible stock holder engagement
  – creates communications platforms
  – Forces asset managers to take side in questions beyond profit
  – Can move capital toward or away from certain topics
  – Herd behaviour can be a force within investor community

• Main tasks are political and should be resolved by parliaments and governments
  – incentives and disincentives, sanctions
  – Pension fund capital can be helpful
  – Development is a revolution, but on an incremental path.