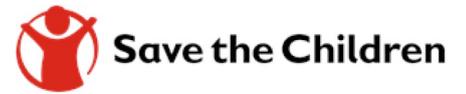


Agreement on International Responsible Investment in the Insurance Sector

**ESG INVESTMENT FRAMEWORK for the theme:
CONTROVERSIAL WEAPONS and THE TRADE IN
WEAPONS WITH HIGH-RISK COUNTRIES**

Version 2020



Ministerie van Buitenlandse Zaken



Ministerie van Financiën

Preamble to ESG theme-related frameworks

On 5 July 2018, the insurance companies affiliated with the Dutch Association of Insurers and the Dutch Association of Health Insurers concluded the Agreement on International Responsible Investment in the Insurance Sector¹ (hereinafter: the Agreement) with the Dutch government, NGOs and a trade union (hereinafter: the Parties). The purpose of the Agreement is to make a positive impact on themes relating to the environment, social conditions and governance (hereinafter: ESG²) and to strive to mitigate any adverse impacts. Insurers acknowledge their responsibility to act in accordance with international guidelines, specifically:

- UN Guiding Principles on Business and Human Rights (hereinafter: UNGPs). The UNGPs are the foremost international framework for human rights in the context of business;³
- OECD Guidelines for Multinational Enterprises (hereinafter: OECD Guidelines).⁴ The OECD Guidelines are one of the most important internationally recognised guidelines for International Responsible Business Conduct (IRBC). They address a wide range of issues, such as human rights, labour rights, the environment, corruption, taxation, health and safety.

Both of these frameworks form the basis for the provisions of the IRBC Agreement.

Based on these international guidelines, insurance companies are expected to define sector- and theme-specific investment policies. The Agreement documents this commitment. The policies define the ESG principles and standards that an insurer applies when investing in sectors and themes assessed as relevant and high-risk.⁵ Insurers are also expected to identify, prevent or limit the actual and potential adverse impact of their actions and explain how they deal with the risks. That applies as well to the insurer's own 'value chain' (for example businesses linked to the investee companies).

In the Agreement, the Parties have undertaken to seek out opportunities to improve the investment policy based on ESG themes, including those not or not conclusively covered by the international guidelines.⁶ This framework concerns the development and implementation of a responsible investment policy on the theme of **Controversial Weapons and the Trade in Weapons with high-risk countries**.

Due diligence

At the heart of any ESG theme-related framework are tools to assist in conducting due diligence on the investment portfolio.

The document *Responsible Business Conduct for Institutional Investors* is based on the OECD Guidelines (hereinafter: the Document).⁷ The Document describes the due diligence approaches available to institutional investors, including insurers. The *OECD Due Diligence Guidance for Responsible Business Conduct* offers a clear description of the steps involved in the due diligence

¹ Read the Agreement here: www.imvoconvenanten.nl/-/media/imvo/files/verzekeringssector/convenant-verzekeringssector.pdf. The English version can be found at <https://www.imvoconvenanten.nl/-/media/imvo/files/verzekeringssector/agreement-insurance-sector.pdf?la=en&hash=FB556D9429722E8F362B3B012310391A>

² These terms and the abbreviation are used internationally.

³ https://www.ohchr.org/documents/publications/GuidingprinciplesBusinessshr_eN.pdf

⁴ OECD Guidelines: <http://www.oecd.org/daf/inv/mne/48004323.pdf>

⁵ By relevant, we mean that the ESG theme applies to your investments. The Agreement does not provide a framework for determining when a subject is relevant for an insurer. That is up to the insurer itself to determine.

⁶ The Agreement establishes the themes: animal welfare, children's rights, climate change, land rights and controversial weapons and the trade in controversial weapons.

⁷ <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>

process.⁸ We look at this more closely in Section 4.

Disclaimer

The Parties have examined the options for each theme in this framework in accordance with international standards, treaties and initiatives. The framework should not be seen as an obligation imposed on insurers. Rather, the Parties regard this framework as a **tool/guidance** to help insurers embark on a theme-specific investment policy. The framework will be subject to an assessment every other year.

The Parties are, of course, prepared to engage in further discussions with the insurer if questions arise.

⁸ <https://mneguidelines.oecd.org/Oeso-Due-Diligence-Handreiking-voor-maatschappelijk-verantwoord-ondernemen.pdf>

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1. Introduction

A landmine exploding in an area where children are playing, or a regime using conventional weapons against its civilian population: these are examples of weapons being used in a manner that does not properly differentiate between civilians and military personnel or that continue to claim victims decades after the conflict has ended.

Weapons can be used by states for internal policing and to protect external borders. When they are abused, however, weapons can inflict great suffering on the civilian population, whether or not in violation of human rights or international humanitarian law. In addition, if not properly regulated, the trade in weapons can have an adverse impact on the security of states and their citizens. Weapons also play a role in human rights violations, for example when they are used by repressive regimes and armed groups. All this means that investing in the arms industry exposes insurers to ESG risks.

To properly assess such ESG risks, an insurer must consider two factors. First of all, it must determine whether an investee company is involved in the production of weapons that have been banned or are controversial owing to certain features. In this instance, the company's *product* constitutes the risk. Second, the insurer must ascertain whether an investee company is involved in supplying weapons (of any kind) to countries/end users that deploy them in an illicit manner. In this instance, it is the *conduct* of the company that constitutes the risk, i.e. engaging in the trade in weapons with a high ESG risk. Insurers must therefore always distinguish between controversial weapons (product) and the trade in weapons (conduct).

In summary, the framework indicates that involvement in both the production of controversial weapons and the supply of weapons to high-risk countries/destinations exposes the insurer to ESG risks. The ESG risks associated with the supply of weapons to non-controversial countries/destinations are lower.

2. Relevance for insurers

Businesses in the defence sector in Europe and the United States are mostly private companies. The larger ones are often listed companies. The Stockholm International Peace Research Institute (SIPRI) collects data on arms products and international arms transfers. Of the largest 20 companies investigated by SIPRI, 17 are based in the West and listed on the stock exchange.⁹

State-owned arms producers can also be found elsewhere in the world. Beyond the defence industry, other sectors may also be relevant. Examples include the IT sector, with AI potentially being used to develop autonomous weapons systems.

2.1 Sectors

The main sectors with investable assets in which weapons and the trade in weapons play a role are:

- Defence and Aerospace
- Industrial conglomerates
- Information technologies

⁹ See: <https://www.sipri.org/databases>

3. Frame of reference

The following international treaties and conventions offer a basis for determining the extent to which weapons are controversial and the trade in weapons poses a high risk.¹⁰

3.1 Frame of reference for weapons

The following treaties and conventions prohibit specific weapons systems or their proliferation:

- 1968 Nuclear Non-Proliferation Treaty (NPT) is meant to prevent the proliferation of nuclear weapons and to further the goal of achieving nuclear disarmament.¹¹
- 1972 Biological and Toxin Weapons Convention (BWC) prohibits the development, production and stockpiling of biological and toxin weapons and commits to their destruction.¹²
- 1992 Chemical Weapons Convention (CWC) prohibits the development, production and use of chemical weapons.¹³
- 1997 Mine Ban Convention prohibits the use, stockpiling, production and transfer of anti-personnel mines.¹⁴
- 2008 Convention on Cluster Munitions (CCM) prohibits the use, stockpiling, production and transfer of cluster munitions.¹⁵
- 2017 Treaty on the Prohibition of Nuclear Weapons prohibits participation in any nuclear weapon activities.¹⁶

The 1980 Convention on Certain Conventional Weapons (CCW) prohibits or restricts the use of weapons that cause unnecessary suffering to combatants and civilians, or that cannot distinguish between civilians and combatants.

3.1.1 Distinction between controversial and banned weapons

The common thread in the above treaties and conventions is that weapons must comply with all the requirements of international humanitarian law (IHL, also known as the 'law of war'). Those deploying weapons must be able to distinguish between combatants and non-combatants, and they must take the principles of proportionality and the precautionary approach into account. Long-term effects also play a role: by definition, weapon systems that have long-term effects, such as land mines and cluster munitions, make virtually no distinction between combatants and non-combatants.

In principle, the weapons specified in the foregoing treaties and conventions are *prohibited*.¹⁷ We refer to 'controversial weapons' when the relevant treaties or conventions have not been signed by all countries, and are therefore not *prohibited* under IHL. Weapons may also be classified as controversial because there are (as yet) no treaties or conventions regulating them.¹⁸

¹⁰ It is usually clear whether or not a military item is a weapons system. This is less obvious in the case of 'dual-use items': they have a legitimate civil use, but can also be used for military purposes. They include chemical products, vehicles or communication equipment. For practical reasons, we have chosen not to include dual-use items in this theme-related framework. For more information on such items, please refer to the Wassenaar Arrangement: <https://www.wassenaar.org>.

¹¹ <https://www.un.org/disarmament/wmd/nuclear/npt/>

¹² <https://www.un.org/disarmament/wmd/bio/>

¹³ <https://www.opcw.org/chemical-weapons-convention>

¹⁴ <https://www.un.org/disarmament/convarms/landmines/>

¹⁵ <https://www.un.org/disarmament/ccm/>

¹⁶ <https://www.un.org/disarmament/wmd/nuclear/tpnw/>

¹⁷ The CCW establishes 'prohibitions or restrictions on the use of certain conventional weapons'.

¹⁸ See Appendix 1 for more information.

3.2 Frame of reference for the trade in weapons

The following international treaties and agreements on the trade in weapons provide guidelines for states wishing to authorise exports of military items:

- *Arms Trade Treaty* (hereinafter: ATT) of 2014¹⁹: regulates the international trade in conventional arms. The Treaty requires the signatory states/parties to regulate the export of military items and to prevent illicit trade in military items. The Treaty further requires the signatory states/parties to assess, prior to authorisation of the export of military items, the potential that the items in question could be used to commit or facilitate a serious violation of international human rights law or international humanitarian law.
- *EU Council Common Position* of 2008²⁰: defines mandatory common rules for EU Member States governing the control of exports of military technology and equipment in accordance with eight Common Criteria:
 - Criterion 1: Respect for the international obligations and commitments of Member States, in particular the sanctions adopted by the UN Security Council or the European Union, agreements on non-proliferation and other subjects, as well as other international obligations;
 - Criterion 2: Respect for human rights in the country of final destination as well as respect by that country of international humanitarian law;
 - Criterion 3: Internal situation in the country of final destination, as a function of the existence of tensions or armed conflicts;
 - Criterion 4: Preservation of regional peace, security and stability;
 - Criterion 5: National security of the Member States and of territories whose external relations are the responsibility of a Member State, as well as that of friendly and allied countries;
 - Criterion 6: Behaviour of the buyer country with regard to the international community, as regards in particular its attitude to terrorism, the nature of its alliances and respect for international law;
 - Criterion 7: Existence of a risk that the military technology or equipment will be diverted within the buyer country or re-exported under undesirable conditions;
 - Criterion 8: Compatibility of the exports of the military technology or equipment with the technical and economic capacity of the recipient country, taking into account the desirability that states should meet their legitimate security and defence needs with the least diversion of human and economic resources for armament.
- *UN / EU arms embargos*: the UN and the EU can impose arms embargos on countries or non-state entities when acting by (qualified) majority. Embargoes can be either mandatory or non-mandatory. A state that complies with a (mandatory) arms embargo will not allow arms transfers to the country under embargo.²¹

¹⁹ <https://www.un.org/disarmament/convarms/att/>

²⁰ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32008E0944>

²¹ The EU sanctions map can be found here: <https://www.sanctionsmap.eu/#/main>

4. Due diligence

If an insurer is investing or considering investing in value chains relevant to weapons and the trade in weapons, the OECD Guidelines stipulate that it must undertake a due diligence process.

4.1 Embedding RBC measures in policy

If weapons and/or the trade in weapons are a significant factor in the insurer's investment portfolio, adequate policy measures should be adopted to manage the related ESG risks. Points of concern for institutional investors can be found in the 'Investor actions' text blocks in the Document.²²

4.2 Identifying investment criteria

It is advisable to work with specific investment criteria under this theme. The Parties have a number of suggestions in that respect.²³

4.2.1 Criteria for controversial weapons

Based on the frame of reference, the Parties recommend the following criteria for controversial and banned weapons. These criteria therefore concern the weapon itself, and not the user:

Suggested criteria	Operationalisation
Weapon systems should, by their very nature, permit a distinction to be made between combatants and non-combatants.	Identify manufacturers and suppliers of key components ²⁴
Weapon systems should, by their very nature, not preclude proportional deployment.	Identify manufacturers and suppliers of key components
Weapon systems should as far as possible avoid unnecessary injury or suffering.	Identify manufacturers and suppliers of key components
The long-term effects of weapon systems should be taken into account (e.g. unexploded or radioactive elements).	Identify producers and suppliers of key components
Arms manufacturers should not produce weapons banned under a UN convention.	Identify producers and suppliers of key components

4.2.2 Criteria for the trade in weapons with high-risk countries

Tackling insurer risks associated with the trade in military items involves looking at product use. Insurers must therefore consider who the product's end users are.²⁵ Insurers can use the following suggestions as criteria when drawing up their policy.

²² Pages 21 and 22: <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>

²³ The NGO Party wishes to emphasise that it regards these as minimum criteria for this theme (e.g. the normative lower limit).

²⁴ 'Key components' refers here to those components that contribute to the deadliness of the weapon.

²⁵ The question of the end user is, in fact, a generalisation of the possible 'deployment' of a weapon system. This is necessary because insurers will assess their risks by looking at specific companies and their customers (i.e. states) and not at the deployment of individual weapons that have been transferred, something that a government does consider explicitly when determining whether to authorise the export of arms.

Suggested criteria	Insurer-compiled list of high-risk countries ²⁶	Insurer-compiled list of companies that supply weapons to controversial regimes
Prohibition on the supply of military items to a state subject to a UN or EU embargo. ²⁷ The transaction must comply with international treaties and obligations.	See SIPRI list of arms embargoes ²⁸ or EU sanctions map. ²⁹	Based on the SIPRI Arms Transfers Database: scan weapons supplied to controversial regimes (step 2) and the links to companies (step 3). ³⁰
Prohibition on the supply of military items if there is a clear risk of human rights or international humanitarian law violations. ³¹	See Freedom House's Freedom in the World Index ³² and <i>The Economist</i> Democracy Index. ³³	
Prohibition on the supply of military items if there is a clear risk that those items will provoke, aggravate or prolong conflict. ³⁴	See Institute for Economics and Peace Global Peace Index. ³⁵ Uppsala Conflict Data Program. ³⁶	
Minimisation of the risk of corruption. ³⁷	See Transparency International's Government Defence Anti-Corruption Index. ³⁸	
Prohibition on the supply of military items to a failing or fragile state. ³⁹	See Fund for Peace's Fragile State Index. ⁴⁰	
Prohibition on the supply of military items to a state that devotes a disproportionate share of its public spending to military items, undermining its sustainable development. ⁴¹	Combine the SIPRI List on military spending ⁴² and the UNDP's Human Development Index. ⁴³	

4.3 Conducting a risk analysis

²⁶ Note: some insurers invest in government bonds only after verifying that the countries concerned meet their requirements. These requirements are often similar to those mentioned here and based on the same indices. It can be helpful to have such a policy and to screen government bonds in this phase of the due diligence process.

²⁷ Linked to arms embargoes, the ATT and Council Common Position Criterion 1.

²⁸ <https://www.sipri.org/databases/embargoes>

²⁹ See the User's Guide to the Council Common Position: <https://www.consilium.europa.eu/media/40659/st12189-en19.pdf>.

For more information about the Council Common Position, see the EEAS website:

https://eeas.europa.eu/headquarters/headquarters-homepage/8465/arms-export-control_en.

The Dutch government's website also offers additional information on Dutch legislation concerning the export of strategic goods: <https://www.government.nl/topics/export-controls-of-strategic-goods>.

³⁰ <https://www.sipri.org/databases/armstransfers>

³¹ Linked to ATT and Council Common Position Criterion 2, linked indirectly to Criteria 3, 4 and 6.

³² <https://freedomhouse.org/report/freedom-world/freedom-world-2019>

³³ <https://infographics.economist.com/2019/DemocracyIndex/>

³⁴ Linked to Council Common Position Criteria 3 and 4.

³⁵ <http://economicsandpeace.org/research/#measuring-peace>

³⁶ <https://www.pcr.uu.se/research/ucdp/>

³⁷ Linked to Council Common Position Criteria 7 and 8.

³⁸ <https://government.defenceindex.org/>

³⁹ Linked indirectly to Council Common Position Criteria 3, 8. The term 'fragile state' has not been conclusively defined. The Parties differ in their interpretation of this term.

⁴⁰ <https://fragilestatesindex.org/>

⁴¹ Linked indirectly to Council Common Position Criterion 8.

⁴² <https://www.sipri.org/databases/milex>

⁴³ <http://hdr.undp.org/en/2018-update>

Screening of the investment portfolio is based on self-determined criteria, the point being to identify the ESG risks to which the insurer is exposed. The insurer can then add these criteria to the ESG criteria, which are subsequently incorporated into the investment process.

4.4 Identifying and prioritising risks

Risks are prioritised based on the gravity (severity, scope and irreversibility) of the actual or potential adverse impact. By definition, the risk associated with the deployment of controversial weapons and the controversial trade in weapons is that civilians will suffer greatly, including serious bodily harm and death. There is also a significant risk of many other human rights being violated. It is the gravity of this potential adverse impact that is paramount when prioritising the risk.

4.5 Implementing policy to minimise impact and to mitigate identified risks

Depending on the screening results and how they are interpreted, the insurer may:

1. actively adapt its voting behaviour accordingly;
2. engage with the companies concerned;
3. exclude the companies concerned.

By **voting (1)** at shareholders' meetings, the insurer can influence the policy of companies in which weapons and the trade in weapons are a factor. The insurer must, of course, decide on its own voting behaviour, which can range from voting against management decisions to introducing or supporting resolutions aimed at improving policy and practices associated with weapons and the trade in weapons.

Engagement (2) on weapons and the trade in weapons involves the insurer entering into a dialogue with investee companies that do not comply with the insurer's policy. The aim is for the company to make structural improvements. Generally speaking, engagement on this particular ESG theme is more difficult than engagement on other themes. There are a few successful examples of engagement with companies that have a large civilian component.

There are many different ways to achieve effective engagement:

- develop engagement activities independently;
- join an existing engagement provider;
- join an engagement alliance or network, for example PRI.⁴⁴

In engagement, it is advisable to work with as many like-minded (institutional) investors as possible with regard to one and the same company. The greater the investment capital they represent, the more leverage they will have on the company in question. For more information, see the Document.⁴⁵

Examples of engagement questions:

- Is the company committed to upholding international human rights standards?
- Does the company assess whether new products can be deployed in accordance with international humanitarian law?
- Does the company have a proper due diligence policy to prevent the military items it sells from being implicated in human rights violations?
- Does the company identify and assess the impact of its products and services before, during and after transfer to the customer?
- Is the company taking steps to combat adverse impacts on human rights? What does the company do to compensate communities and individuals for adverse impacts?
- Is the company transparent about damage that transgresses the current frameworks, for

⁴⁴ <https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment>

⁴⁵ See Box 7 on page 27: <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>

example international humanitarian law?

If engagement fails to deliver satisfactory results within a reasonable period of time, or if a company turns out to be involved in practices that are already on the insurer's exclusion list, the company may be **excluded (3)** from investment.

4.6 Measures aimed at preventing and/or mitigating actual and potential adverse impacts

The purpose of due diligence is to identify and prevent risks, but it is still possible for an investee company to have an adverse impact with regard to weapons and the trade in weapons.

Insurers usually hold a minority stake in investee companies and are therefore unlikely to have 'contributed to' an adverse impact arising from weapons or the trade in weapons (the term used in the OECD Guidelines). Nevertheless, in most cases it is possible to establish that an insurer's investment is 'directly linked' to the adverse impact caused by a company (again, the term used in the OECD Guidelines). In that latter case, the insurer is expected to use leverage to persuade the company to take appropriate action. For more information, see the Document.⁴⁶

4.7 Monitoring risks and the results of the mitigation strategy

The due diligence policy should be monitored at regular intervals. It is advisable to pay particular attention to:

- the way in which the established criteria for weapons and the trade in weapons have been effectively applied when screening investments for theme-related risks and the choices to which this has led;
- progress on and results of the chosen engagement and/or mitigation strategy addressing weapons and the trade in weapons.

⁴⁶ See Figure 1, 'Addressing adverse impacts under the OECD Guidelines for Multinational Enterprises' on page 35: <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>

5. Accountability and reporting

The OECD Guidelines require the insurer to report publicly on its due diligence policy and associated results at regular intervals, preferably annually. The OECD Guidelines describe this as:

- knowing: tracking the insurer's performance against its own investment policy;
- showing: publicly communicating the same. The Document sums up the procedures for this step.⁴⁷

The insurer identifies the most appropriate indicators for reporting on its efforts to address weapons and the trade in weapons in its investment policy. The insurer itself is responsible for selecting relevant indicators (taxonomy) for tracking its performance against its policy.

An insurer can also report on engagement with or exclusion of companies, thereby sending other investors, the companies in question and its own customers an important signal.

When an insurer invests through a fund, it can ask the (external) asset manager to provide taxonomy-related information on the impact of its investments on issues associated with weapons and the trade in weapons. The insurer can then use this for accountability and reporting purposes.

This section will be elaborated in more detail over the term of the Agreement (see Section 5 of the Agreement).

⁴⁷ See 'Investor actions' on page 43: <https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf>.