

Submission to the Senate Foreign Affairs, Defence and Trade Committee

Subject: Criminal Code Amendment (Cluster Munitions Prohibition) Bill 2010

Executive Summary

The Australian Council of Superannuation Investors (“ACSI”) welcomes the move towards ratification of the *Convention on Cluster Munitions* (“CCM”) represented by the introduction of the *Criminal Code Amendment (Cluster Munitions Prohibition) Bill 2010* (“Bill”) into the Parliament.

ACSI represents the largest not-for profit superannuation funds in Australia and provides research and advice on governance issues that impact on their investments. ACSI represents the interests of 39 not-for profit superannuation funds that manage over \$300 billion of Australian retirement savings.

Cluster munitions have caused humanitarian suffering in every conflict they have been used in and leave behind a deadly legacy that disrupts the ability of communities to recover from conflicts when they finish.

Our interest in this issue arises as a consequence of having directly engaged with Australian financial institutions that have had to manage reputational issues as a consequence of assisting companies to produce components to an indiscriminate weapon that causes unacceptable humanitarian harm and the consequential reputational risk to investors in these financial institutions.

ACSI believes that providing direct or indirect financial assistance to cluster bomb producers goes against the spirit of the CCM. On this basis, ACSI requests that the Bill be amended in line with the Recommendation 2 of the Joint Standing Committee on Treaties in August 2009. Specifically, the Bill should be amended so as to prohibit the direct and indirect financing of companies involved in the production of cluster munitions.

Background

Currently the Bill would make it illegal for a person or bank to provide financial assistance to, or invest in a company that develops or produces cluster munitions, but only where that person or bank intends to assist, encourage or induce the development or production of cluster munitions by that company.

This drafting implies that financial assistance is illegal only if it is provided solely for the purpose of cluster bomb production and with recourse only to that activity. In other words, whilst direct financial assistance for cluster bomb production may be deemed illegal, indirect financial assistance to a company that produces cluster bombs will still be regarded as legal under this provision.

We are not aware that direct financing of such weapons actually exists. Nor do we believe that it is practically possible to restrict weapons producers from using corporate lending facilities towards producing cluster munitions or, for that matter, other controversial munitions such as anti-personnel landmines, depleted uranium ammunition and biological or chemical weapons. In fact, it is highly likely that weapons producers will increasingly shift to indirect financing of controversial munitions to avoid reputational damage. This presents a major loophole in the proposed legislation as most financing is indirect. Companies source financing through corporate loans, syndicated loans, rights issues, new equity and raisings through other securities and unless there is a mechanism to restrict weapons producers from using such financing towards the production of cluster munitions, the legislation will not be effective in complying with the spirit of the CCM.

In its 2009 report recommending that the Australian Government ratify the *Convention on Cluster Munitions* the Parliamentary Joint Standing Committee on Treaties recommended that the implementing law prevent “investment by Australian entities in the development or production of cluster munitions, either directly, or through the provision of funds to companies that may develop or produce cluster munitions”. The Bill before the Parliament falls well short of implementing this recommendation.

We note that the respective governments of New Zealand, Ireland, Luxembourg and Belgium have all introduced legislation to ban providing financing towards and investment in cluster munitions and the Governments of Lebanon, Mexico, Norway and Rwanda have all publicly stated that they interpret the CCM as prohibiting investments in cluster munitions producers.

Investments in cluster bomb producers

A cluster bomb (or munition) is a weapon containing multiple – often hundreds – of small explosive sub-munitions or bomblets. Cluster bombs are dropped from the air or fired from the ground and designed to break open in mid-air, releasing the bomblets over an area that can be the size of several football fields. This means they cannot discriminate between civilians and soldiers. Many of the bomblets fail to explode on impact and remain a threat to lives and livelihoods for decades after a conflict. While all weapons are dangerous, cluster bombs pose a particular threat to civilians for two reasons: they have a wide area of effect, and they consistently leave behind a large number of unexploded bomblets.

The Convention on Cluster Munitions (“CCM”) prohibits the use, production, stockpiling and trade of cluster bombs, sets deadlines for clearance and stockpile destruction, and contains innovative measures to assist victims. The CCM entered into force on 1st August 2010. Although the CCM does not explicitly prohibit financial investments, such investments can be interpreted as a form of “assistance”, which is prohibited under Article 1c of the Convention.

In a groundbreaking report produced by IKV Pax Christi (the Netherlands) and Netwerk Vlaanderen (Belgium) in October 2009, 146 financial institutions from 15 countries around the world have been identified that provide over US\$43 billion worth of investments and financial services to seven producers of cluster bombs. The findings were most recently updated in April 2010 in ‘Worldwide investments in cluster munitions: A shared responsibility’.

According to the report, the finance and banking industry has been complacent regarding its involvement in providing assistance to producers of cluster bombs. The following statistics, compiled from the report, highlight the extent of the problem:

- Investment banking services to companies producing cluster bombs (in millions): Bank of America (US\$873.25), JP Morgan Chase (US\$776.72), Goldman Sachs (US\$726.32), Deutsche Bank (US\$512.65), and HSBC (US\$447.33) provided the largest amount of investment banking services since May 2007.
- Loans to companies producing cluster bombs (in millions): Bank of America (US\$436.25), Citigroup (US\$321.25), Goldman Sachs (US\$250), Calyon (US\$155) and Barclays (US\$154.38) provided the largest amounts of loans since May 2007.
- Asset management: State Street, Capital Group, BlackRock, Temasek Holdings and Vanguard Group (investments in companies linked to cluster bomb production)

US based financial institutions make up most of the financial institutions involved with producers of cluster munitions.

As we have stated above, companies source financing through corporate loans, syndicated loans, rights issues, new equity and raisings through other securities and unless there is a mechanism in the Bill to restrict weapons producers from using such financing towards the production of cluster munitions, the legislation will not be effective. Unless this loophole is closed, it is highly likely that capital from Australian investors or Australian companies in unit trusts, superannuation funds and other forms will continue to be used indirectly in the production of cluster bombs around the world.

In the Estimates Transcript of the Legal and Constitutional Affairs Committee Senate session, dated Monday 18th October 2010, the case for limiting the Bill to prohibit conduct where there is a clear intention was discussed. It was argued that when Australian investors invest in a unit trust, they own shares in hundreds of different companies. It is possible that one of them may be involved in cluster bomb production but it may not be possible for the investors to know what each of the underlying companies are doing and it would be unreasonable to penalise them for holding a few units in a unit trust which may have an indirect exposure to a company producing cluster bombs.

We do not disagree with the above rationale. Individual investors in a unit trust cannot be held accountable for the operations of the companies in a unit trust. It is unlikely that they will be informed of the companies' operations in any great detail and, in any event, individual investors will rarely have the voting power to influence the corporate behaviour of the companies they invest in. On the other hand, the brokers, fund managers and investment banks who sell such unit trusts in Australia can ensure that they do not provide exposure to companies that breach the Bill. Similarly, the super funds can ensure that they do not expose their members to companies that breach the Criminal Code Amendment by excluding companies that are involved in cluster bomb production from their investment portfolios. Only by making such a restriction a legislative requirement can the Commonwealth ensure that Australian companies – banks, fund managers, brokers and other financial institutions – do not provide advertent or inadvertent assistance to cluster bomb producers.

We emphasise that the Bill should not be restricted to persons or companies who intend to assist, encourage or induce the development or production of cluster munitions because companies would rarely, if ever, solicit direct funding for the development or production of controversial weaponry and similarly, persons or companies would rarely provide such funding in the face of public scorn and controversy. On the other hand, it is extremely likely that companies will continue to use general corporate loans and equity towards producing cluster munitions and other controversial munitions that would not attract direct funding.

In order to comply with the spirit of the CCM and the recommendation of the Parliamentary Joint Standing Committee on Treaties, the Bill must restrict the ability of cluster bombs producers to secure any capital from Australian investors by making it illegal for Australian investors to provide financing to such companies.

We propose that the restriction applies to all Australian institutions regulated by ASIC or APRA. Under our proposal, these institutions will be prohibited from lending to companies that produce cluster bombs. In addition, the institutions will be prohibited in trading in securities or investing monies (their own or on behalf of their clients) in companies that produce cluster bombs. Finally, under our proposal, the Bill will contain a Schedule with a list of such companies that will be updated by the Commonwealth as required.

The above restriction is not a catch-all because we do not believe that private individuals, 'mums-and-dads' and members of unit trusts or super funds should be held liable under the Bill. Our proposed restriction focuses on financial institutions because they are the main source of capital for companies producing cluster bombs as per the report by Pax Christi and Netwerk Vlaanderen.

Recommendation

The proliferation of cluster weapons requires not only the co-operation of arms manufacturers, governments and civil society but also of the financial institutions that provide assistance to companies linked to the production of cluster bombs.

ACSI believes that the proposed legislation should prohibit financial assistance, either directly or through the provision of funds. If this does not occur Australian investors, through shares, unit trusts, loans or other financial instruments will still be able to invest in companies that produce cluster bombs. Therefore, by allowing Australian investors to lend to and invest in companies that produce cluster munitions, we believe that Australia will fail to abide by the spirit of the CCM.

On this basis, ACSI requests that the Bill be amended in line with Recommendation 2 of the Joint Standing Committee on Treaties in August 2009. Specifically, the Bill should be amended so as to prohibit the direct and indirect financing of companies involved in the production of cluster munitions by making it illegal for Australian institutions regulated by ASIC or APRA to provide financing to such companies.

We would be pleased to elaborate further on any of these issues should you require further information.

Yours sincerely

Ann Byrne

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Australian Council of Superannuation Investors

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