

Investment for own account vs. investments on behalf of clients

Briefing paper by Profundo on why a financial institution should apply its cluster munitions policy to investments on behalf of its clients

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This fact sheet is based on the information in the Stop Explosive Investment Campaign Toolkit and Profundo's research experience for the 'Worldwide Investments in Cluster Munitions; a shared responsibility' report by Cluster Munition Coalition member PAX (the Netherlands).

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Introduction

Financial institutions, and in particular their asset managers or asset management subsidiaries, invest money received from their clients in various funds. This is called "investment on behalf of clients". Financial institutions often do not apply their responsible investment (RI) policies to investments on behalf of clients.

As this is a commonly seen loophole in financial institutions' cluster munitions policies, this briefing note explains what is generally meant by investment on behalf of clients. It furthermore explores the arguments that financial institutions give for not applying their policy to these types of investments. The paper will highlight a number of best practices to show that, contrary to what some financial institutions will argue, it is possible to apply cluster munitions exclusion across these investments. Finally, the note presents arguments campaigners can use when urging the financial institutions to expand their cluster munitions policies to investments on behalf of clients.

1 Definitions

Financial institutions provide various types of financial services to cluster munitions producers. The most important are commercial banking, investment banking and asset management.¹

Commercial Banking (Loans)

Commercial banking means offering loans individually or participating in the offering of loans with other banks to cluster munitions producers.

Investment Banking

Investment banking refers to the provision of advice and services to cluster munitions producers for raising capital through issuance of shares and bonds.

Asset Management

The asset management firms specialize in investing money in stock markets and bonds. They buy/sell shares and bonds of cluster munition producers in large quantities.

When we speak about “investment on behalf of clients” this relates to asset management activities. Below, we explain the difference between financial institutions’ investment on own account and investment on behalf of clients.

- **Investments on own account**

Financial institutions invest money in shares and bonds of companies. This can be done by purchasing individual stocks and bonds or through mutual funds. When a financial institution invests its own surplus money in shares and bonds, it is known as “investments on own account.” Since these investments require specialization, it is mostly done through the financial institution’s asset management subsidiary or division. The financial institution’s asset management department or subsidiary becomes the owner of those shares and bonds and hence they have full control on deciding where to invest or not to invest.

- **Investments on behalf of clients**

Through its asset management subsidiary or division, a financial institution can also offer investment services to clients. These clients could be institutional investors like pension funds, churches, insurance companies, but also individual investors (in which case the asset managers offering the solutions are often referred to as “retail services” or “wealth management”). When the asset management company invests its client’s money into shares and bonds this investment is called “investments on behalf of clients.” It can also offer solutions such as mutual fundsⁱ or index trackersⁱⁱ to its clients. The ultimate owner of the investments is the client.

2 Why is it important that a financial institution applies its cluster munitions policy to investments on behalf of clients?

When it comes to cluster munitions, we expect that a financial institution applies an exclusion policy across the entire group and across all investment activities. Financial institutions are often large groups that are composed of various subsidiaries, such as subsidiaries specialised in private banking, asset management, investment banking, private equity, etc. In case a financial institution consists of multiple subsidiaries within a group, the exclusion should not be limited to a part of the group or one subsidiary but should apply across the group and to all investment activities.

Since the main business of the asset management subsidiary or division of any financial institution is to offer investment solutions to the clients, the majority of the assets it manages is on behalf of its clients. In 2015, global assets under management (defined as assets professionally managed in exchange for a management fee) reached USD 71.4 trillion.² Were the financial institution not to extend its cluster munitions policy to such assets, this would in practice mean a large part of the investments it manages could be invested in producers of cluster munitions. Since the vast majority of AuM is on behalf of clients, this is where a cluster munitions exclusion policies makes a clear impact.

ⁱ A mutual fund is a pool of funds collected from various asset owners to be invested in a set of stocks, bonds, and other assets in order to achieve a higher price.

ⁱⁱ An index fund or index tracker is a type of mutual fund with a portfolio constructed to match or track the components of a market index. For more information see our background paper on index trackers.

3 Why do financial institutions make exceptions for investments on behalf of clients in their cluster munitions policies?

When financial institutions invests for own account, they have full control over the money and investments, and applying a cluster munitions exclusion policy is purely based on their own decision. When they are convinced about applying their principles and investment beliefs by means of certain strategies, such as exclusion, they will ensure that their money is not invested into companies that produce cluster munitions.

Most financial institutions will apply their cluster munitions policy to investment made on own account. However, we see that they often make exceptions for investments on behalf of clients. This section explores what arguments financial institutions often give for making those exceptions. It further provides counter arguments that campaigners can use in their engagement with financial institutions on this issue.

Financial institutions often argue that while they have a RI policy pertaining to cluster munitions, it does not apply to investments on behalf of clients. Often this means that clients could ask for a cluster munitions or other RI related criteria to be applied to its investments, but it is not standard practice. A financial institution will often argue that clients do not want their assets to be invested under the manager's cluster munitions policy and that the latter does not want to or cannot impose ethical choices on the clients. They further argue that the client has final control over its assets and as such that the decision lies with them.

In addition, asset managers also invest for their clients through discretionary mandates. A discretionary mandate is an agreed set of guidelines that a client gives to its asset manager that is required to follow the guidelines while investing the client's money, separate from the other funds managed by the asset manager. In case of discretionary mandates, the asset managers argue that it is difficult to ask the client to change their mandates to include cluster munitions exclusion.

Counter arguments:

- Financial institutions will argue that they do not want to impose ethical choices on their client. However, since most financial institutions do not disclose these choices or are transparent about which companies they invest in, it is impossible for clients to make an informed decision.
- If a financial institution adopts a policy that prohibits investments in producers of cluster munitions, that means they recognize that these weapons cause humanitarian suffering and are unacceptable. Profiting from selling or offering investment in cluster munitions producers on behalf of clients, would simply be inconsistent and ethically questionable.
- If an asset manager takes a decision to invest in a company, it should always act in a responsible way. Similarly, if a financial institutions decides not to invest in a company, these choices need to be applied to the entire portfolio irrespective of investments on own account and investments on behalf of clients. Even if the client does not ask for a RI product or more specifically for the exclusion of cluster munitions producers, there is nothing that can stop an asset manager from staying committed to RI and extend its policy to every investment product that it offers to its clients.

- Similarly, the financial institutions can stay committed to their cluster munitions exclusion policy also while executing discretionary mandates. They could convince their clients of the risks associated with such investments and that they need to abide by their exclusion policy.

Best practices

There is a growing number of financial institutions who exclude investments in cluster munitions producers. For them, there is no exception in applying their policy to investments on own account and investments on behalf of clients when it comes to cluster munitions exclusion.

Examples are:

APG is a Dutch asset manager, managing assets worth EUR 443 billion for 4.5 million participants in several Dutch pension funds (including ABP, BPF Bouw and SPW). APG has developed RI policy that considers all the ESG factors for all the investments on behalf of its clients. The RI policy is also applied across all investment products and asset classes. It has developed a set of exclusion list which prohibits investing in companies which are involved in the manufacture of landmines, cluster bombs, chemical or biological weapons, or nuclear weapons made in violation of the Nuclear Non-Proliferation Treaty.³

The British Co-operative Bank offers a wide range of banking products. In accordance with its Ethical Policy, the Co-operative Bank will not finance any company that manufactures, sells or directly exports cluster munitions or exports strategic parts or services for cluster munitions. The policy applies to all investments and all asset categories of The Co-operative Bank, including those on behalf of clients.⁴

PGGM is a Dutch pension administrator that provides services in pension administration, communication, board advisement and asset management for 2.8 million participants. PGGM's responsible investment policy is also extended to its investments on behalf of its clients. For example, regarding exclusions, it states "PGGM wants to avoid making investments that are not appropriate for us or our clients. That is why we do not invest in controversial weapons or in the production of tobacco."⁵

Storebrand Group (Norway) is a leading player in the Nordic market for long-term savings and insurance. It has also established asset management activities and offers life and health insurance products in Sweden. Storebrand Group has barred cluster munitions producers from its investment portfolios. Storebrand Group applies its exclusion policy to all asset management activities, including to investments on behalf of clients. Storebrand uses an exclusion list that excludes companies involved in controversial weapons. This category includes cluster munitions, anti-personnel mines and nuclear weapons.⁶

These examples show that it is very well possible to apply a cluster munition exclusion policy to investment on behalf of clients.

As outlined above, financial institutions have a responsibility to apply their cluster munitions policy across investment on behalf of clients. However, when you speak to such a client – an institutional investor such as a pension fund, for example - you can stress that they have a responsibility too. After all, every investor has to play their part to ensure that no money goes to companies that are involved in the production of cluster munitions. Here are a few arguments you can use:

- Asset owners are expected to develop their own RI policy and ask their asset managers for investment options that are in line with their RI policy.
- They could also give discretionary mandates to the asset managers that are in line with their cluster munitions exclusion policy.
- Asset owners could consciously look for asset managers that integrate RI and cluster munitions exclusion in the investment process and offer a wide range of products.

4 Conclusion

To conclude, financial institutions have a responsibility to apply their cluster munitions policy across all their investments, including those made on behalf of clients. The arguments given by financial institutions for not applying their cluster munition policy to assets managed on behalf of clients can never negate the implications of providing capital to producers of cluster munitions. If an asset manager is committed, it can enforce its exclusion policy to its clients without any exceptions. The best practices and arguments provided in this paper show: if it can be done, it should be done.

References

- 1 'Worldwide Investments in Cluster Munitions; a shared responsibility', 16 June 2016, available at www.stopexplosiveinvestments.org/report.
- 2 Statista (2016), "Global assets under management from 2007 to 2015 (in trillion U.S. dollars)", online: <https://www.statista.com/statistics/323928/global-assets-under-management/>, viewed in March 2017.
- 3 APG (2015, August), *Responsible Investing APG – Annual Report 2014*, p. 6 and 7.
- 4 'Worldwide Investments in Cluster Munitions; a shared responsibility', June 2016, p. 152. Available at www.stopexplosiveinvestments.org/report.
- 5 PGGM (2016), "PGGM – What we do – Asset Management – Exclusions", online: <https://www.pggm.nl/english/what-we-do/exclusions/Pages/default.aspx>, viewed in March 2017.
- 6 'Worldwide Investments in Cluster Munitions; a shared responsibility', June 2016, p. 160. Available at www.stopexplosiveinvestments.org/report.