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In Depth: What’s in a Name? 'Defense Stocks' Highlight the Challenges for Asset Managers in Navigating Sustainability Taxonomies as They Characterize Investments as ESG-Compliant

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It is hardly news that ESG investing is a significant aspect of the asset management industry. According to Barron’s, $400 billion was invested in U.S. mutual funds and assets that have an ESG orientation in 2021. However, it remains a challenge for issuers, asset managers, regulators and other industry participants to determine whether a particular business, industry, or product promotes or is harmful to ESG considerations. The Russian invasion of Ukraine shines a spotlight on this larger issue due to shifting attitudes about “defense stocks” – *i.e.*, stock in weapons and ammunition manufacturers and other companies in the defense industry. The defense industry does not immediately come to mind when thinking about ESG issues.

The notion that a particular business or product can give rise to tension between the environmental and social aspects of ESG, or raise disputes about whether it is sustainable or socially beneficial at all, is not limited to the defense industry. For instance, in the United States, there have been significant investor complaints and confusion, as well as regulatory scrutiny surrounding the question of what constitutes a “sustainable” company. Thus, while there are any number of examples, the defense industry provides a useful lens through which to examine the challenges for the asset management industry in classifying investments as sustainable or not.

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