

# Peaceful, not Vulnerable: ESG Reporting should not weaken EU Defence Industry

Tomáš Bruner

Beginning in January 2024, large EU corporations have to gather and disclose ESG (environmental, social and governance) data about their activities. This obligation will gradually be expanded to include other companies. As a result, important actors in the defence industry could be either forced to publish sensitive information or be exposed to deteriorating access to capital. However, the ESG disclosures were meant neither to weaken the EU defence industry nor to make the EU vulnerable. This policy brief offers recommendations on how to avoid such unintended consequences.

As of January 2024, EU public-interest corporations<sup>1</sup> have to collect vast amounts of information on how sustainably they act. This information shall be made public annually, firstly in 2025 (non-financial (ESG) statements for 2024). Within three years, the same ESG reporting will become mandatory for all large EU-based firms,<sup>2</sup> large corporate groups,<sup>3</sup> and small and medium-size enterprises with publicly-traded stocks.

This ESG reporting, introduced by the EU directive abbreviated as “CSRD”,<sup>4</sup> makes no exception for the defence industry. It is required from significant armament companies such as Leonardo (Italy), Airbus (Netherlands/France), Rheinmetall AG (Germany) and Dassault Aviation (France) which are among the top 25 actors in the global defence industry.<sup>5</sup> Soon, it will be compulsory also for many smaller units in this economic sector.

<sup>4</sup> “Corporate Sustainability Reporting Directive” – EU Directive 2022/2464.

<sup>5</sup> Defence News. [Top 100 for 2023](#).

## About the author

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<sup>1</sup> Companies with publicly traded stocks, banks, or insurance undertakings that have more than 500 employees and exceed one of the following criteria: balance sheet total EUR 20,000,000 or net turnover exceeding EUR 40,000,000.

<sup>2</sup> Companies exceeding two of the following three criteria: more than 250 employees; balance sheet total EUR 20,000,000; net turnover EUR 40,000,000.

<sup>3</sup> Groups of firms that exceed the criteria listed in the previous footnote on a consolidated basis.

## Divulging Sensitive Information

The CSRD<sup>6</sup> requires, among other things, in-scope companies to trace and disclose:

- the adverse impacts of their operations, services, and products;
- the direct and indirect business relationships and suppliers that might influence the sustainability of their conduct; and
- the effects of their products on affected communities.

A strict reading of these vague rules might suggest that defence industry companies are to identify and disclose which armaments they produce, to whom they supply them, how likely they are to injure populations in the area of deployment, and who contributes to the production. Such divulged information might become a valuable source of open-source intelligence (OSINT) for foreign analysts. Moreover, ESG activists could press the companies to announce further details: for example, which strategic resources they import from which third countries. After all, the CSRD requires<sup>2</sup> disclosing information about the “value chain” of the company and the sustainability of the production units in it. At the end of the day, foreign analysts could form a vivid picture of the EU defence industry and its dependencies just by reading ESG reports.

## Discouraging of Investors

Surely, the EU did not create the CSRD to provide foreign military analysts with OSINT, but to provide EU investors with hints on how sustainable their investments are. In other words, the new non-financial (ESG) reporting should tell investors whether their money goes to, and revenues stem

from, ecological, ethical, and well-governed businesses. Unfortunately, this is where its second unintended consequence lies. The CSRD, together with other EU legislation, introduced a dichotomy between “sustainable” and “unsustainable” investment. Such distinction may divert private investors from financing the defence sector and thus limit the access of armament companies to capital, as the following two paragraphs specify.

The CSRD applies alongside the EU Taxonomy regulation.<sup>7</sup> The EU Taxonomy regulation provides criteria for environmentally-sustainable investing. The defence industry falls outside of these criteria.<sup>8</sup> Moreover, the Taxonomy regulation introduces its own reporting requirements for the same companies that are subjected to CSRD reporting. Under the Taxonomy regulation, companies must publish “how and to what extent the undertaking’s activities are associated with economic activities that qualify as environmentally sustainable.”<sup>9</sup> The practical meaning of this clause is simple. Neither the money that a bank lends to arms producers, nor the interest obtained from such a loan can be reported as sustainable. Similarly, institutional investors, such as insurance companies or asset managers, cannot label any financial reserve or fund assets invested into the defence industry as sustainable investments. Consequently, many financial institutions will exclude the defence industry from their investment portfolios rather than risk the disdain of their clients and their investors for such “unsustainable” spendings.<sup>10</sup> Similar reasoning may follow the adoption of the EU Social Taxonomy regulation which is planned in the forthcoming years.

<sup>6</sup> Art. 19a, para 2, letter f), point (ii), and para 3; Art. 29a, para 2 letter f), point (ii), and para 3

<sup>7</sup> Regulation (EU) 2020/852.

<sup>8</sup> For the reasons for this see Causevic, A. et. al. Quo vadis sustainable finance: Why defensive weapons should never be classified as an ESG investment. Journal of Sustainable Finance & Investment. October 19, 2022.

<sup>9</sup> Taxonomy regulation, art. 8, para 1.

<sup>10</sup> As did the US asset manager Candriam. Statement available [here](#).

As a result, it will become harder for an armament company to get a loan, insurance, or obtain additional capital from new investors.<sup>11</sup>

In a nutshell, the legislative dualism “sustainable” vs “unsustainable” makes private investments in the defence industry less attractive, as it implicitly “lumps together in one category the suppliers of European armed forces with unlawful or morally questionable business practices”.<sup>12</sup> This comes at a time when the defence industry is complaining about a long-standing lack of investment which continues “to limit the ability to invest in modern capabilities and compete efficiently with other global powers.”<sup>13</sup> Even the European Defence Agency, which falls under the authority of the Council of the European Union, recently acknowledged that access to finance is becoming an issue for the European defence industry.<sup>14</sup>



### Recommendations

The following recommendations for ESG reporting companies, investors, and supervisory authorities should help to avert the above-mentioned negative trends, misinterpretations, and unintended consequences of ESG reporting:

**1. Reporting companies can, and should, prepare ESG disclosures without detailed or sensitive information.** Their investors, and activists, have no right to demand such information, and the supervisors have no right to sanction the absence of such information in ESG reports. ESG reporting can, and should, be aggregated and generalized. Even though the rules are vague and allow for various interpretations, there is no clause in the CSRD that would force companies to disclose details about a specific supplier, purchaser, piece of armament or its expected area of deployment. Moreover, the delegated regulation implementing the CSRD,<sup>15</sup> which was published just a few weeks ago, states that officially-classified information is exempted from the reporting. A similar exception applies to sensitive information that could endanger the security of natural persons or legal entities.

**2. Investors should avoid the mind-trap that an unsustainable investment is always a bad choice – detrimental, non-ethical, or illegal.** The ESG regulation does not ban any type of investment and the shortcut “unsustainable” should not be used for naming and shaming per se. Investments that must not be legally labelled as sustainable can still bring benefits for society or become vital for EU interests, especially investments in the defence industry, which can additionally result in interesting revenues, while still making sure that no firms with controversial weapons are funded or that the products flow to a belligerent party that frequently violates human rights or humanitarian law.<sup>16</sup> In particular, banks, asset managers and insurance companies should bear these facts in mind and not hastily exclude defence industry companies from

<sup>11</sup> Including retail investors. Also EU [Regulation 2019/2088](#) (also abbreviated as the SFDR or Disclosure) expects that investment into the armament industry must not be labelled as sustainable when sold to individuals, because it does not fulfil the “no significant harm” criterion.

<sup>12</sup> ASD. [ASD Considerations on Sustainability and the European Defence Industry](#). Position Paper, 6 October 2021.

<sup>13</sup> ASD. [Facts and Figures 2023](#).

<sup>14</sup> EDA. [Strengthening the EDITIB'S access to finance and its ability to contribute to peace, stability, and sustainability in Europe](#). November 14, 2023.

<sup>15</sup> Commission delegated regulation (EU) 2023/2772, ESRS 1 General Requirements, section 7.7.

<sup>16</sup> Both of these facts would indeed have to be disclosed under the SFDR, in the template table for reporting the principal adverse impacts of investment.

**3. Armament companies should emphasize in their ESG reports all the facts ensuring that their conduct is not unethical.** Most of the EU defence industry companies that fully adhere to international sanction regimes and arms trade regimes, do not develop or produce controversial weapons banned by international treaties and do not supply weapons to belligerent parties oppressing human rights or violating humanitarian law. As long as these guarantees are true, they should be stressed in ESG reporting to reassure (potential) investors that they do not put money into sin stocks, although their investment is not legally speaking “sustainable”.

**4. Supervisory authorities should oversee ESG reporting in the defence industry area reasonably, and keep the above points in mind.** After all, the concept of “sustainability” is still developing. In upcoming years, the EU will probably adopt the Social Taxonomy regulation, detailing the criteria for socially-sustainable activities. Although an early draft of this regulation<sup>17</sup> expected the defence industry to be unsustainable, this all might, and perhaps should, change, given the above points.<sup>18</sup> EU ESG reporting should disclose information on how peaceful, not how vulnerable, the EU is.

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<sup>17</sup> See the [Draft report on Social Taxonomy](#) from 2021.

<sup>18</sup> See, e.g., Bindman, P. [Why ESG funds are full of weapons](#). *Capitalmonitor*.