Calvert

Defense Investing Through a Responsible Lens: Evolving Norms, Enduring Principles

INSIGHT | September 2026

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Historically excluded under responsible investment frameworks, the defense sector is being reexamined amid shifting geopolitical realities. As the global order shifts and responsible investing evolves, defense companies continue to find themselves at the intersection of ethical concerns and national security. Discover how new approaches are challenging prior norms and aligning responsible investing with evolving security considerations.

The Historical Approach to Defense in Responsible Investment

The defense sector has occupied a uniquely sensitive position within responsible investment frameworks due to its direct association with human harm and destruction. While energy and mining were often debated through lenses of transition or harm reduction, defense companies—particularly controversial weapons manufacturers—were frequently treated as categorical exclusions due to their indiscriminate impact and disproportionate harm. The prevailing view across sustainable finance markets, especially in Europe, was that capital allocation should avoid activities directly linked to military applications or potential violations of international humanitarian norms.

Typical weapons-specific exclusions under responsible investment frameworks are grounded in international conventions and non-proliferation treaties. Investors commonly screen for cluster munitions (Convention on Cluster Munitions, 2008), anti-personnel landmines (Ottawa Treaty, 1997), biological and chemical weapons (Biological Weapons Convention, 1972, and Chemical Weapons Convention, 1993) involvement out of their portfolios. Approaches toward nuclear weapons exclusions, however, remain fragmented across jurisdictions. While the Treaty on Prohibition on Nuclear Weapons (2017) explicitly prohibits "assistance", often interpreted to include financing activities, many nuclear armed countries have not ratified the treaty and continue to rely on nuclear deterrence under the Non-Proliferation Treaty framework.[1]

[1] Treaty on the Prohibition of Nuclear Weapons. United Nations, 2017.

Large asset owners have formalized both product-based and conduct-based exclusions. Under the guidelines of Norges Bank, companies could be excluded either for producing weapons that violate fundamental humanitarian principles or for selling arms to states engaged in serious and systematic violations of international law.[2] Similar approaches were reflected in ESG benchmark construction across Europe, embedding exclusions directly into index methodologies.

In addition to controversial weapons screens, many asset managers adopted broader conventional weapons exclusions. These were often implemented via revenue thresholds (e.g., excluding companies deriving more than a defined percentage of revenues from military equipment or services). As a result, major defense companies were frequently excluded from ESG-labelled portfolios through rules-based product or revenue screens.

This rules-based architecture sidelined the defense sector from mainstream discussions within the responsible investment community, and for many, defense became a domain of divestment rather than stewardship. In such an environment of structural exclusion, there was little need for nuanced, ESG-integrated frameworks for the defense sector.

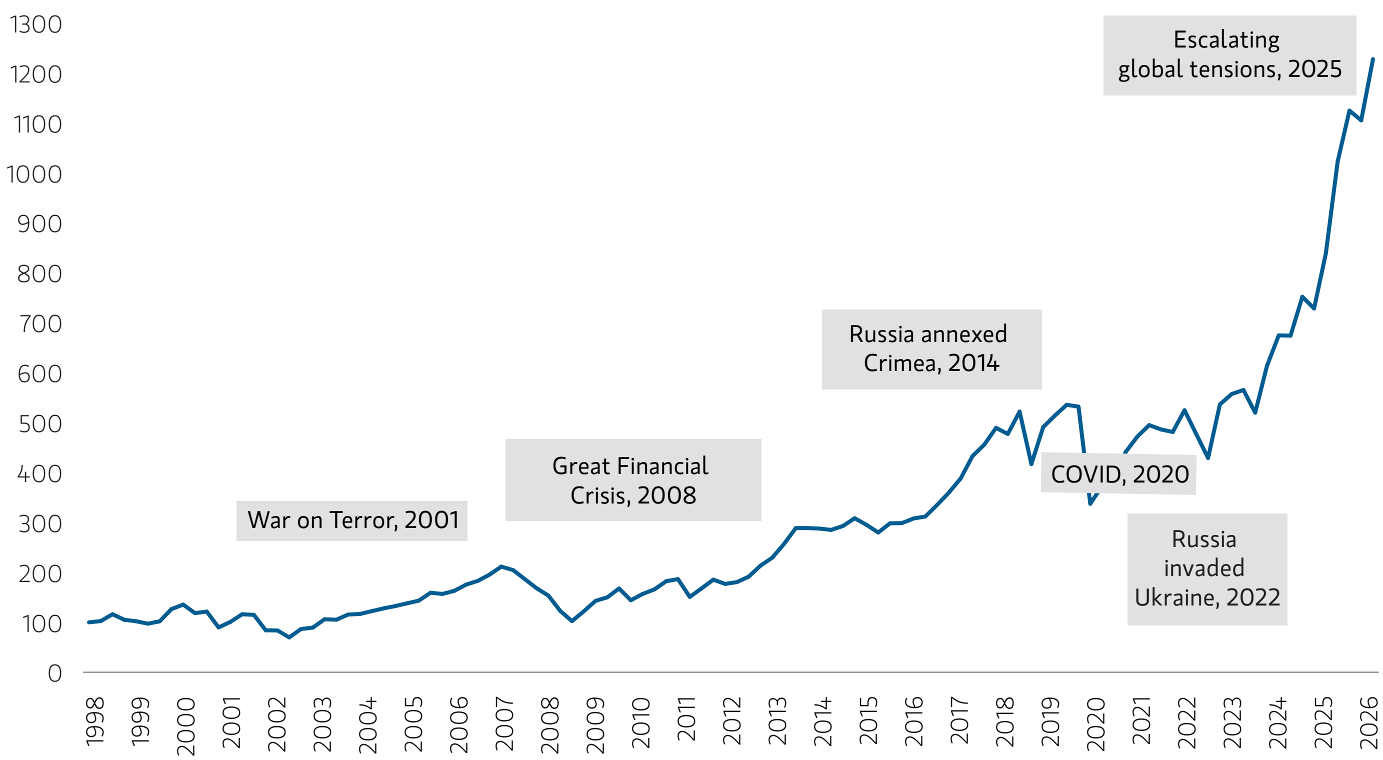
How Responsible Investors are Evolving their Approach

The geopolitical environment has shifted materially since 2022. Russia's invasion of Ukraine, rising U.S.–China strategic rivalry, conflict in the Middle East, escalating cyber threats, and renewed emphasis on NATO burden-sharing have elevated the role of defense capabilities in discussions of sovereignty and deterrence. Governments across Europe and Asia have increased defense budgets, while NATO allies have

DISPLAY 1

MSCI ACWI Aerospace & Defense Index Levels

1998-Q1 2026



Display 1 illustrates the performance of the MSCI ACWI Aerospace & Defense Index as a proxy for investor interest in the sector alongside major geopolitical developments. It is intended to provide market context rather than measure responsible investment flows.

Source: Bloomberg, Calvert, as of March 2026.

[2] Norges Bank Investment Management, Guidelines for Observation and Exclusion from the Government Pension Fund Global, as of November 2025.

jointly committed to a target of investing 5% of GDP in defense by 2035.[3]

In parallel, the EU Commission clarified that defense is not automatically incompatible with sustainability frameworks. European regulators signaled that investments supporting national security and democratic resilience may be consistent with sustainable objectives.[4]

The capital response has been measurable, the MSCI ACWI Aerospace & Defense Index has increased over 130% since Russia's invasion of Ukraine *(see Display 1).* Sustainability-oriented funds have followed suit, Barclays Research reported that European ESG funds increased defense exposure by 167% in dollar terms between December 2023 and June 2025.[5] Recent sustainable fund positioning shows that exposure to aerospace and defense has increased across many European Article 8 and Article 9 funds. In the first quarter of 2026, proportion of Article 8 funds with exposure to defense increased by 6 percent to 64%, while Article 9 fund exposure increased by 3 percent to 21%. Portfolios remain underweight relative to market benchmarks, suggesting a selective reassessment rather than wholesale removal of defense exclusions.[6]

The increase in investor interest across the spectrum rests on three interrelated themes. First, sovereignty: credible defense capacity is increasingly viewed as an important component for preserving democratic institutions and territorial integrity. Second, deterrence and stability: proponents argue that well-equipped defense forces reduce the probability of escalation by raising the cost of aggression. Third, resilience: supply chain vulnerabilities exposed during the war in Ukraine have highlighted the need for domestic industrial capacity in critical materials and advanced systems.

Importantly, while exclusions for controversial weapons remain widely accepted across responsible investment frameworks, investors are increasingly focusing less on whether defense exposure is acceptable and more on how it should be evaluated. This shift has created space for differentiated, materiality-driven approaches rather than blanket exclusions.

Calvert's Approach

Calvert's approach to Aerospace & Defense is principles-based and rooted in financial materiality rather than categorical exclusion. Our objective is to balance alignment with global norms and the pursuit of long-term shareholder value.

Business ethics is central to our evaluation. Given the opacity inherent in defense contracting—where a meaningful portion of revenues and business activities may be confidential—we assess the strength of ethics frameworks, favoring companies that maintain:

- **Strong internal accountability,** including clear disciplinary mechanisms and a culture that reinforces ethical behavior.
- **Meaningful transparency,** such as reporting misconduct-related metrics or whistleblower activity.
- **Integration of ethics into risk management,** supported by processes that proactively identify, mitigate and monitor potential ethical issues.

Defense companies are more susceptible to controversies due to the deliberate opacity of business practices and activities. Yet, when issues do arise, leading companies respond in a prompt and credible manner. For instance, some leading firms disclose the frequency of corrective action arising from breaches in the ethics code.

Where appropriate, direct engagement is central to our overall evaluation. Through dialogue with companies, we assess whether frameworks are practiced in daily operations rather than existing solely on paper.

In 2025, we introduced a Customer Risk KPI in our analysis, flagging issuers with elevated sales exposure to jurisdictions ranking poorly on the Transparency International's Government Defense Integrity Index. As foreign military sales grow and companies have more diversified operational and sales footprints, we seek to acknowledge the elevated risks companies may face in regions with heightened bribery and corruption risk. Given the sensitive and long-duration nature of defense

[3] NATO Public Reports and national budget announcements (2023–2025).

[4] European Commission. Commission Notice - On the application of the sustainable finance framework and the Corporate Sustainability Due Diligence Directive to the defence sector. 2025.

[5] Barclays Research, European ESG Fund Defense Exposure Trends, 2025.

[6] Morgan Stanley Research. Defence in Sustainability: 1Q26 Fund Positioning.

[7] The Customer Risk KPI aligns with the Sustainability Accounting Standards Board's (SASB) recommended disclosure framework for the Aerospace & Defense industry. The SASB functions under the standard-setting architecture of the IFRS Foundation, with a focus on establishing industry-specific standards for material sustainability disclosures.

DISPLAY 2

Calvert's Controversial-Weapons Assessment Framework

INHERENTLY DESTRUCTIVE COMPONENTS & LIFECYCLE SUPPORT	DUAL-USE PLATFORMS	SUPPORT, MAINTENANCE & INFRASTRUCTURE RELATED TO DUAL-USE PLATFORMS
Flagged as Controversial Weapons Involvement	Not Automatically Flagged	Not Controversial Weapons Involvement
Nuclear Warheads, Biological/ Chemical Weapons, Cluster Munitions, Landmines etc.	An example is a submarine with nuclear weapons deployment capabilities. While some submarines can deploy nuclear weapons, they are fundamentally dual-use platforms that also perform a broad range of non-nuclear missions, including intelligence, surveillance and maritime security	Maintenance & Logistics, Propulsion & Sensors, Training & Support

procurement, companies rely on trusted relationships with government customers. Allegations of bribery or corruption can undermine procurement credibility, disrupt contract renewals and impair a company's ability to compete for future security programs.

Additionally, we continue to rely on our controversial weapons assessment as an additional risk flag. Crucially, we do not rely on this flag alone as a means for exclusion, but rather an indicator that the company faces elevated social and governance risks owing to potential outsized negative harm to civilians and the heightened geopolitical sensitivity that comes with possessing such capabilities.

Responsible Investors can have wide-ranging definitions of what constitutes controversial weapons involvement. Notably, we have **adopted a narrow definition** to include only the production of destructive components such as nuclear warheads or fissile material. We **do not penalize dual-use components or delivery systems** absent direct involvement in the prohibited element *(see Display 2)*. Definitions of controversial weapons vary across responsible investment standards, and interpretations often differ. Calvert's approach reflects both the ethical implications of weapon systems and the practical challenges of an overly expansive exclusionary criteria.

How Research Translates to Implementation

We adopt a nuanced and holistic assessment of each company across multiple dimensions of ethical risk. Companies flagged for involvement in controversial weapons may still be included in our investment universe where they demonstrate robust ethical risk frameworks, leadership in responsible conduct and limited exposure to controversies. In contrast, companies with weaker controls, more frequent or severe controversies, or direct involvement in controversial weapons are subject to heightened scrutiny.

We maintain a high eligibility threshold, creating a deliberately narrow universe of investable companies.

Ongoing refinements to our assessment of evolving operational and sales footprints have enhanced our ability to identify risk, rather than broadly expanding exposure.

Our ultimate view of the sector is pragmatic and risk-aware. Defense is neither categorically excluded nor uncritically embraced. In a world marked by heightened geopolitical conflict, responsible investment requires selectivity, transparency and rigorous governance assessment. By maintaining a principles-based, materiality-driven framework, Calvert seeks to ensure that any defense exposure aligns with our values and supports long-term shareholder outcomes.

Risk Considerations

There is no assurance that a Portfolio will achieve its investment objective.

Portfolios are subject to **market risk**, which is the possibility that the market values of securities owned by the Portfolio will decline and that the value of Portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. **ESG Strategies** that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance.

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gem. § 53b KWG). **Denmark:** MSIM FMIL (Copenhagen Branch), Gorrissen Federspiel, Axel Towers, Axeltorv2, 1609 Copenhagen V, Denmark.

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RO 5420149 Exp. 09/30/2028 09/11/2026 26Q20336 LTR