



GREENING DEFENCE: FRAMING THE STAKES FOR INDUSTRIAL AND MILITARY CAPABILITIES

Public Acceptability and ESG vs. Defence Exceptionalism: The European Defence Industry at a Crossroads

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February 2026



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The Armament Industry European Research Group (Ares Group) was created in 2016 by The French Institute for International and Strategic Affairs (IRIS), who coordinates the Group. The aim of the Ares Group, a high-level network of security and defence specialists across Europe, is to provide a forum to the European armament community, bringing together top defence industrial policy specialists, to encourage fresh strategic thinking in the field, develop innovative policy proposals and conduct studies for public and private actors.

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ABSTRACT

The rapid expansion of ESG (Environmental, Social and Governance) criteria in European finance has profoundly reshaped investment strategies over the past decade, often to the detriment of the defence sector. Long perceived as incompatible with responsible investment frameworks, defence industries have been subject to widespread exclusion policies, driven as much by reputational concerns as by simplified ethical narratives. However, the geopolitical shock triggered by the war in Ukraine has disrupted this paradigm, forcing policymakers and financial actors to reassess the strategic role of defence and the conditions of its financing.

This paper explores the growing tension between ESG compliance and defence exceptionalism in Europe. It argues that the current shift from exclusion to pragmatic re-engagement does not amount to a structural reconciliation between defence and sustainable finance, but rather reflects a temporary reweighting of risks under security pressure. Beyond regulatory adjustments, the long-term sustainability of Europe's defence technological and industrial base depends on its ability to credibly integrate ESG principles into its industrial, social and governance practices.

Rather than treating ESG as an external constraint, the paper shows how environmental performance, social policies and stronger governance can become levers of operational efficiency, talent attraction, investor confidence and societal legitimacy. Finally, it suggests that sustainable finance frameworks themselves may need to evolve to better reflect strategic realities, by recognising security as a foundational condition of long-term sustainability. In this perspective, a new pact between defence, finance and society is required to reconcile strategic autonomy, democratic accountability and sustainable development.

Keywords: European defence industry | ESG | sustainable finance | defence financing | public acceptability | security and sustainability | defence industrial policy | strategic autonomy

INTRODUCTION

In the wake of the 2008 crisis, financial institutions - banks, funds and other investors - have been pushing a respectability agenda that served to legitimize forms of risk-taking that ultimately threatened the stability of the economic system on which their fortunes relied. Socially responsible investment (SRI) thus became the new mantra of finance, leading to both an unprecedented spread of assets labelled in this way and an increase in the returns on these assets. Over the years, SRI has become more structured and widespread, and at the turn of the 2015-2020 period¹, environmental, social and governance (ESG) criteria have come to play an increasingly important role in the risk/return assessment of asset portfolios.

In a context marked by a sustained increase in defence spending across Europe, the question of public acceptability and the tension between ESG compliance and defence exceptionalism have become a central strategic issue, not only for policymakers but also for defence manufacturers themselves. Beyond environmental performance alone, the ability of the defence industry to secure long-term financing, attract talent and maintain societal legitimacy increasingly depends on how convincingly it engages with ESG frameworks rather than seeking exemption from them. Addressing these issues is therefore essential to any credible discussion on “greening defence”, as the sustainability of Europe’s military and industrial capabilities ultimately rests as much on public trust and financial access as on technological and operational performance.

INSIDE ESG: DEFINITIONS, SCOPE AND IMPLICATIONS

ESG criteria are a non-financial analysis framework for assessing a company's impact on society and the environment, as well as the quality of its governance. They are broken down into three fundamental pillars:

- **Environmental (E):** This pillar measures the company's impact on the environment. It includes factors such as contribution to climate change, consumption of natural resources, production of pollution and waste, and support for environmental improvement.
- **Social (S):** This pillar assesses the company's contribution to fairness and trust within society. It considers how the organisation responds to social trends by improving

¹ 2015 being the date of signature of the Paris Climate Agreements and 2020 being the date of the Covid-19 pandemic.

inclusion, diversity, mobility and well-being, while ensuring respect for human rights and standards against modern slavery in its supply chain.

- **Governance (G):** This pillar looks at systems for decision-making, reporting and ethical behaviour. It looks at the structure of the board of directors, the independence of directors and auditors, executive remuneration policies, as well as transparency and the fight against corruption.

ESG criteria are a purely financial and risk management approach. The ESG score is therefore supposed to reduce long-term risk because it aims to assess a company's 'good governance' and, consequently, its solidity in the face of a changing and uncertain environment. It plays a part in assessing whether or not it is worth investing, alongside the expected returns on investment, which are more often than not shorter term.

DEFENCE INDUSTRIES: OVERLOOKED IN THE ESG EQUATION

Defence companies became the perceived “victims” of the rise of responsible finance, not because ESG frameworks explicitly targeted them, but because many financial actors found in ESG a convenient rationale to justify their reluctance to engage with the sector. From the perspective of investors concerned with reputation and risk exposure, defence activities appeared inherently difficult to reconcile with ESG principles. The reasoning was simple and reductive: weapons are used in war, and war kills. This shortcut allowed financial institutions to present exclusion as an ethical choice, while masking a far more complex set of considerations related to political sensitivity, regulatory uncertainty, capital intensity and long-term investment risk. Moreover, a faultline in this argument lies in the fact that it primarily concerns the use of weapons rather than the industrial processes, governance structures or management practices of defence companies themselves. Yet decisions regarding deployment, military operations and compliance with international humanitarian law — including potential violations of human rights — fall under the responsibility of States, either through the actions of their national armed forces or through the strict control of arms exports.

Finally, it is also important to note that investing in a strategic sector that is capital-intensive because it is innovative and high-tech, that exports to countries that are not always "ESG-compatible", that is massively dependent on the State as both client and regulator, and in a region where military spending has significantly reduced since the end of the Cold War, would logically appear to be riskier and less favourable to returns on investment than an ordinary investment.

Add to this the sector's negative reputation among citizens, who are not only savers (especially in Europe, where household savings are structurally high) but also customers and in some cases, employees of these same banks. This exposure has increased the sensitivity of banks to reputational risk, particularly in a context where NGOs have proven highly effective in shaping public narratives and exerting pressure on financial actors².

At the same time, and still in Europe, after 2015, a year marked by the adoption of a new global framework for sustainable development detailing 17 goals (SDGs) and the signing of the Paris Agreement, the European institutions drew up several texts aimed at ensuring the transposition of the commitments made. For example, in the October 2016 text recording the adoption by Europeans of the Paris Agreement³, the latter is listed in an appendix. Article 2(1)(c) specifies its objective as "Making finance flows consistent with a pathway towards low greenhouse-gas emissions and climate-resilient development."⁴

This ambition was explicitly enshrined in Regulation 2019/2088 of 27 November 2019 on Sustainable Finance Disclosure Regulation (SFDR)⁵ which came into force in 2021. The aim of this regulation was to harmonise and strengthen the sustainability of the financial sector, sustainability assessed by defining ESG criteria. It imposes transparency obligations on the way in which sustainability risks are taken into account, significant adverse impacts (SIAs)⁶, the classification of Article 6 / 8 / 9⁷ products and the definition of "sustainable investment". As

² Several civil society campaigns in Europe have explicitly targeted the financial sector's relationship with the defence industry. A network of values-based banks (Global Alliance for Banking on Values) issued a "Statement for Peace", urging mainstream financial institutions to divest from arms production and trade, on the grounds that this is incompatible with sustainable finance principles. Similarly, ethical finance advocates such as Banca Etica have publicly criticised EU initiatives that channel citizens' savings toward defence firms, framing such moves as a dangerous "financialisation of war". In parallel, organisations like Campaign Against Arms Trade and broader peace networks have produced reports and public pressure campaigns highlighting the complicity of banks in arms financing and calling for exclusionary investment policies.

See for example : <https://exitarms.org/node/12221> or <https://www.gabv.org/press-release/values-based-banks-reveal-the-global-financial-industrys-disturbing-role-in-financing-weapons-and-war/> or <https://www.european-microfinance.org/banca-etica-rearm-europe-is-a-dangerous-green-light-for-the-financialisation-of-war/>

³ Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change - <https://eur-lex.europa.eu/eli/dec/2016/1841/oj/eng>

⁴ United Nations Framework Convention on Climate Change (UNFCCC), Paris Agreement, 2015 - https://unfccc.int/sites/default/files/english_paris_agreement.pdf

⁵ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector - <https://eur-lex.europa.eu/eli/reg/2019/2088/oj/eng>

⁶ Under the SFDR, "Significant Adverse Impacts" (also referred to as "Principal Adverse Impacts", PAIs) designate the most material negative effects that investment decisions may have on sustainability factors, including environmental, social and human rights issues, as well as anti-corruption and anti-bribery matters. Financial market participants are required to disclose whether and how they consider these adverse impacts, based on a set of standardised indicators defined at EU level.

⁷ **Article 6** products refer to financial products that do not integrate sustainability considerations beyond the mandatory disclosure of sustainability risks, or that explicitly state that sustainability risks are not deemed relevant. **Article 8** products, referred to products that promote environmental and/or social characteristics, provided that the companies in which investments are made follow good governance practices. **Article 9** products have sustainable investment as their explicit objective and must demonstrate that their investments contribute to environmental or social objectives without significantly harming any of those objectives.

the Commission recently stated in a communication published in June 2025⁸ as part of the Defence Readiness Omnibus package⁹, the SFDR did not set any limitation, at least explicitly, to defence financing. However, the Principal Adverse Impact (PAI) entitled "Exposure to controversial weapons"¹⁰ (PAI14) or the mention of human rights in PAI 9 ("lack of Human Rights Policy"), may have led some investors to adopt particularly cautious interpretations of the framework, reflecting both the complexity of the defence sector and a desire to minimise perceived reputational and compliance risks.

FINANCING BARRIERS AND EXCLUSION: THE ESG SQUEEZE ON EUROPE'S DEFENCE INDUSTRY

Faced with this perceived incompatibility, the strategy most commonly adopted by investors seeking respectability has been that of exclusion. This consists of systematically excluding defence companies, or companies that generate more than a certain percentage of their sales in this sector, from investment portfolios. This approach has become the main tool for applying ESG principles to the sector. According to the Eurosif report, in 2018, 63.6% of investors in Europe excluded companies involved in the production of conventional weapons from their portfolios¹¹.

Many financial institutions have formalised these exclusion policies. Banks in Germany, Belgium, the Netherlands, Sweden and Finland have ceased all cooperation with companies generating only 5 to 10% of their revenues from defence activities. More specifically, the German banks BayernLB and LBBW have decided to cease all commercial relations with armoured vehicle manufacturers. Similarly, Norway's largest pension fund, Kommunal Landspensjonskasse (KLP), announced in 2019 that it would divest from companies such as Thales and Dassault Systèmes. The concept of "controversial weapons" has also been used to

⁸ European Commission Notice C(2025) 3800/3 on the application of the sustainable finance framework and the Corporate Sustainability Due Diligence Directive (CS3D) to the defence sector - https://defence-industry-space.ec.europa.eu/document/download/ac79ebc7-d2f1-4e7a-a79c-71a06a5fdbf8_en?filename=notice-application-sustainable-finance-framework-and-corporate-sustainability.pdf

⁹ European Commission, Defence Readiness Omnibus package, Simplification Proposal to Boost Industrial Readiness - https://defence-industry-space.ec.europa.eu/eu-defence-industry/defence-readiness-omnibus_en

¹⁰ The Commission's communication specifies that controversial weapons only concern weapons explicitly banned by treaties signed by Europeans, such as the Ottawa Convention (anti-personnel mines) and the Oslo Convention (cluster munitions), or those banning chemical or biological weapons, but in no case other equipment, not even nuclear weapons, since the Treaty banning nuclear weapons has not been signed by all European countries. This clarification was not included in the 2019 document.

¹¹ Eurosif, European SRI Study, October 2021 - <https://www.eurosif.org/wp-content/uploads/2021/10/European-SRI-2018-Study.pdf>

justify certain investment refusals and has been applied to categories broader than just prohibited equipment, such as dual-use nuclear or radiological products, for example.

This paradigm of exclusion, which seemed to have become the norm, was profoundly challenged by the geopolitical shock of 2022.

FROM EXCLUSION TO PRAGMATISM: HOW THE WAR IN UKRAINE RESHAPED DEFENCE FINANCING

The war in Ukraine contributed to change the situation. By boosting military spending and arms purchases, it called for increased investment in the defence technological and industrial bases (DTIB) to step up the production of arms and munitions, either to support Ukraine or to replenish stocks. On the financial side, this momentum ensured greater visibility of growth opportunities for defence companies, whose order books were filling up in a way not seen for decades.

At the same time, the war in Ukraine acted as a wake-up call, both for civil society¹² and for political decision-makers, to the need to boost arms production in Europe and, consequently, to make the defence sector more attractive to investors. The various European initiatives (the instrument for the reinforcement of the European defence industry through common procurement - EDIRPA, the European Defence Industry Programme - EDIP, the Regulation on supporting ammunition production - ASAP, etc.) are evidence of this, but they are also a guarantee for investors that the new opportunities should last over time. European preference, for example, reinforces the idea that European companies will increasingly be equipping European armies. This change was rapidly reflected in the weeks following the outbreak of war in Ukraine by a softening in the positions of certain financial players. To cite just one example, the Swedish bank SEB, which had adopted a policy of excluding defence companies, did an about-face and cancelled this ban in April 2022¹³. Then, on 16 June 2025, SEB updated its "Sector Policy on Arms and Defence" to fully adapt its policy to the "serious security situation in Europe" and allow business relations with defence/nuclear companies

¹² Daniel Debomy, "A devalued United States, a desire for European defence and consolidated support for Ukraine", Blogpost, Institut Jacques Delors, July 2025 - <https://institutdelors.eu/en/publications/a-devalued-united-states-a-desire-for-european-defence-and-consolidated-support-for-ukraine/>

¹³ Ed Ballard, "Sweden's SEB Changes Course on Defense Stocks as War Tests ESG Rules," *Wall Street Journal*, March 2, 2022 - <https://www.wsj.com/articles/swedens-seb-changes-course-on-defense-stocks-as-war-tests-esg-rules-11646253384>

based in a NATO country¹⁴. However, it should be noted that, in addition to the exclusion of “controversial weapons”, this bank also maintains the exclusion of nuclear weapons.¹⁵

The proposed amendment to the SFDR presented by the European Commission on 20 November 2025 follows the same logic with respect to defence¹⁶, explicitly aligning with the texts underpinning the European defence industrial strategy: « *The SFDR review builds on the guidance from the Commission on the application of the EU sustainable finance framework regarding the defence sector, presented in the European Defence Industrial Strategy and delivered through the June 2025 Defence Readiness Omnibus, [...] fully consistent with the Defence Readiness Roadmap 2030.* »¹⁷ The document also makes it clear that the framework has been revised with the concern of ensuring that capital can still flow to the defence sector: « *It is also aligned with efforts to boost the defence industry of the Union by ensuring that the sustainable finance framework does not prevent capital from being directed towards defence-related activities [...]* »¹⁸.

That said, even if the revised text no longer refers to *controversial weapons*, it nevertheless proposes to systematically prohibit investments related to “*prohibited weapons*”¹⁹ — a term that is admittedly less vague and more factual. Moreover, it maintains the same underlying logic for assessing what qualifies as “sustainable” investment and, consequently, continues to treat ESG criteria as fundamental components of that assessment. Therefore, assuming that the war in Ukraine has led to defence manufacturers being exempted from the responsibilities and constraints applying to other industrial sectors would be a serious misconception. And the resurgence of financial market interest in defence should not be confused with a fundamental alignment with ESG principles. Rather, it reflects a pragmatic and perhaps temporary reweighting of risk in the face of urgent security concerns. Fundamental reservations remain.

¹⁴ SEB Group, *Sector Policy on Arms and Defence for the SEB Group*, adopted June 5, 2025 - [https://webapp.sebgroup.com/mb/mblib.nsf/alldocsbyunid/A7C64D85BA120BAD12588130072B063/\\$FILE/Arms_Defence_2025.pdf](https://webapp.sebgroup.com/mb/mblib.nsf/alldocsbyunid/A7C64D85BA120BAD12588130072B063/$FILE/Arms_Defence_2025.pdf)

¹⁵ SEB Group, “SEB updates sector policy on arms and defence”, June 16, 2025 <https://sebgroup.com/press/news/2025/seb-updates-sector-policy-on-arms-and-defence>

¹⁶ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR), Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) and repealing Commission Delegated Regulation (EU) 2022/1288 - https://ec.europa.eu/finance/docs/law/251120-proposal-sfdr_en.pdf

¹⁷ *Ibid.* p.5

¹⁸ *Ibid.* p.16

¹⁹ ‘For the purposes of point (a), prohibited weapons shall mean anti-personnel mines, cluster munitions, biological and chemical weapons the use, possession, development, transfer, manufacture, and stockpiling of which is expressly prohibited by the international arms conventions to which the majority of Member States are parties, as listed in the Annex.’ European Commission ADDENDUM Commission Delegated Regulation of 3/11/2025 amending Delegated Regulation (EU) 2020/1818 as regards the definition of prohibited weapons C(2025) 3801 final/2 - https://www.europarl.europa.eu/doceo/document/B-10-2025-0502_EN.html

FROM CONSTRAINT TO OPPORTUNITY: TURNING ESG INTO A PERFORMANCE LEVER FOR DEFENCE COMPANIES AND A MEANS OF GAINING ACCEPTANCE FROM CIVIL SOCIETY

This favourable momentum should therefore be seen as an opportunity for defence companies to proactively integrate ESG requirements into their industrial and governance strategies, not merely to comply with external constraints, but to strengthen their long-term resilience, credibility and access to capital. In that perspective, the defence industry can proactively reframe ESG criteria not as constraints, but as direct levers of operational performance, talent attraction, investor confidence and legitimacy in the eyes of civil society. As examples, each ESG's pillar offers concrete advantages that enable defence imperatives to be aligned with societal expectations and investor requirements:

- The sector's energy transition, for example, is not just a responsibility or a constraint. It is also a driver of innovation towards technologies that are not only cleaner but also contribute to greater strategic or operational autonomy²⁰. Energy efficiency, for example, translates into a major operational advantage: more fuel-efficient equipment means greater autonomy in the field and lighter logistics;
- On the social front, attracting and retaining talent is a crucial issue for a high-tech sector where technological leadership is a major asset for strategic superiority. Ambitious social policies - better working conditions, diversity, inclusion - are key factors of attractiveness, as shown by initiatives such as the "Women in Defence Charter" in the United Kingdom²¹ ;
- Finally, strengthening governance is essential if we are to win the confidence of investors over the long term. Greater transparency, robust anti-corruption measures and greater diversity on boards of directors are priority areas, especially as a study by Transparency International estimates that 62% of countries present a high risk of corruption in this area²² . Strengthening "European preference" in defence markets, where Member States' governance standards are among the highest in the world, could significantly reduce these risks.

Moreover, most defence companies operate on a dual-use basis, with technologies, skills and industrial processes serving both military and civilian markets. From this perspective, strong

²⁰ Europa Defence Agency, "Circularity in Defence Knowledge Platform" - <https://eda.europa.eu/what-we-do/eu-policies/if-ceed>

²¹ Ministry of Defence of the United Kingdom, Women in defence charter, updated 8 January 2026, <https://www.gov.uk/government/publications/women-in-defence-charter/women-in-defence-charter>

²² Transparency International, "62% of countries at high risk of defence and security corruption, index reveals", Press release, November 16, 2021 - <https://www.transparency.org/en/press/62-per-cent-countries-at-high-risk-of-defence-and-security-corruption>

ESG compliance can act as a catalyst rather than a constraint, facilitating spill-over effects between defence and civilian applications. Environmental performance, social standards and robust governance frameworks not only enhance the acceptability of defence activities but also ease the adaptation of military technologies for civilian use—and, conversely, the integration of civilian innovations into military systems. In this sense, ESG alignment can strengthen the virtuous cycle between defence and civilian industries, amplifying innovation, industrial resilience and long-term value creation.

CONCLUSION: TOWARDS A NEW PACT BETWEEN DEFENCE, FINANCE AND SOCIETY

The challenge facing the European defence industry is not a binary choice between public acceptability and exceptionalism, but the pursuit of an intelligent and sustainable convergence. The war in Ukraine has opened a window of opportunity, not a permanent exemption from the requirements of sustainable finance. For defence companies, the proactive integration of ESG principles is no longer optional, but a necessary condition to strengthen long-term competitiveness, secure durable access to capital and rebuild societal legitimacy.

Yet this effort cannot rest on industry alone. At the other end of the value chain, the sustainable finance framework itself may also need to evolve in order to fully reflect today's strategic realities. If sustainability is understood as the capacity of societies to endure, adapt and prosper over time, then security must be recognised as a fundamental precondition of sustainability. In this perspective, integrating security considerations into ESG frameworks would not dilute their ambition, but rather reinforce their internal coherence.

As defence budgets continue to rise across Europe, the stakes associated with transparency, accountability and societal legitimacy will only intensify. This new pact therefore calls for a shared responsibility: industry must commit to higher levels of transparency and governance; financial actors must move beyond simplistic exclusionary approaches towards more nuanced, risk-based assessments; and society must acknowledge that sustainable development cannot be achieved in the absence of credible security guarantees. Recognising security as a fourth pillar—alongside environmental, social and governance criteria—would help align sustainable finance with the strategic foundations upon which all long-term sustainability ultimately rests.

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