Divestment of Tobacco Industry Holdings

Why Divestment Matters

While governments seek to improve the health of their citizens by implementing interventions to reduce tobacco consumption, the tobacco industry uses its economic might and lobbying prowess to delay, weaken, or forestall the introduction and enforcement of effective tobacco control measures.

To prevent tobacco industry interference in tobacco control policies, the World Health Organization Framework Convention on Tobacco Control (FCTC), a global health treaty, includes a set of measures to raise awareness of industry tactics and reduce the ability of tobacco companies to undermine tobacco control interventions. These eight measures constitute the Guidelines for implementation of FCTC Article 5.3 "on the protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry." Two of the eight key measures call for government bodies *not* to have any financial interest in the tobacco industry.

> Divest all holdings in tobacco companies by all government and quasi-governmental bodies, including those managing government or shared public investment portfolios.

Investing in tobacco companies creates a conflict-of-interest for government—between its responsibility to protect public health by driving down tobacco use and its desire to maximize returns on its investments by maximizing tobacco sales. Similarly institutions such as hospitals and universities, which receive public funding and serve a social purpose, have an ethical imperative *not* to invest in an industry that manufacturers and promotes a highly addictive product that kills half of its long-term users and is responsible for other social harms, including increased poverty and environmental degradation.

Investments in Tobacco Companies by Canadian Governments

	Canada Pension Plan Investment Board (CPPIB) As of 31 March 2014		Caisse du dépôt et de placement du Québec As of 31 Dec. 2013		B.C. Investment Management Corp. As of 31 March 2014 (unaudited)	
Tobacco Company	**Shares**	**Market Value CAD $**	**Shares**	**Market Value CAD $**	**Shares**	**Market Value CAD $**
Altria Group Inc	2,744,000	113,000,000	1,127,098	46,600,00	1,458,380	59,500,000
British American Tobacco Malaysia BHD	285,000	6,000,000	971,800	19,400,000	389,326	8,100,000
British American Tobacco PLC	238,000	15,000,000	2,798,747	172,200,000	1,578,108	89,900,000
Gudang Garam Tbk PT	960,000	5,000,000	107,500	500,000	934,600	3,400,000
Imperial Tobacco Group PLC	0	0	472,837	21,100,000	926,662	38,100,000
Japan Tobacco Inc	2,514,000	87,000,000	1,374,200	47,700,000	933,800	32,300,000
KT&G Corp	57,000	5,000,000	282,104	23,400,000	288,708	21,700,000
Lorillard Inc	669,000	40,000,000	237,142	14,200,000	386,730	20,800,000
Philip Morris International Inc	2,466,000	223,000,000	962,992	87,000,000	1,267,050	117,300,000
Reynolds American Inc	564,000	33,000,000	138,867	8,200,000	310,400	16,500,000
Souza Cruz SA	836,000	8,000,000	3,222,762	32,500,000	848,650	9,200,000
Swedish Match AB	859,000	21,000,000	108,597	3,900,000	157,824	5,400,000
TOTAL	**12,192,000**	**$556,000,000**	**11,804,646**	**$476,700,00**	**9,480,238**	**$422,200,000**

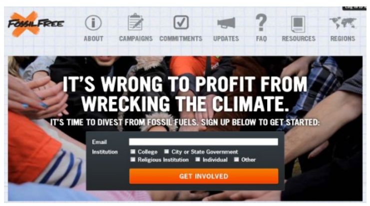
Harvard President Derek Bok explaining the rationale behind the university's divestment of its tobacco holdings: The decision "was motivated by a desire not to be associated as a shareholder with companies engaged in significant sales of products that create a substantial and unjustified risk of harm to other human beings."
(Letter by D. Bok,18 May 1990)

"U of T is looked to as a moral and ethical leader. Investing in the tobacco industry, whose products kill 50 per cent of long-term users and harm the health of countless others, does not uphold these high standards."
(EBUTT News Release, 16 Jan. 2007)

"The consensus regarding the moral imperative for institutions like Penn not to benefit financially from tobacco holdings is so broad that Penn now stands as the only institution among the nation's top 5 medical schools not to have a policy excludeing tobacco holdings from its investments."
(Ad hoc Committee on Tobacco Investment, U of Pennsylvania, Oct. 2013)

Ethical Investing: A Growing Concern

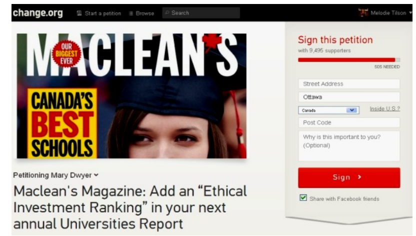
In recent years, the issue of ethical investing has become a hot topic, fuelled in part by concerns over global warming. A key pillar of the global grassroots climate change movement is pressuring public institutions—including municipal governments, post-secondary educational institutions, pension funds, and religious organizations—to divest their fossil fuel company stocks. The movement concluded that lasting change in energy policy would only be achieved by breaking the influence of wealthy fossil fuel companies on governments, thereby forcing the companies to change their practices.



While divestment initiatives ideally will orchestrate a decline in the share prices of the major offenders, divestment isn't primarily an economic strategy, "it's a moral and political one." (www.350.org)

Divestment campaigns have made the issue of ethical investing prime-time news and generated momentum for change. Post-secondary students have been recruited to launch initiatives aimed at getting the endowment fund of their university/college to divest its holdings in oil, gas, and coal-producing firms.

The campus initiatives were inspired by the anti-apartheid campaign in the 1980s, during which students used a variety of tactics, including hunger strikes, sit-ins, and the seizure of buildings, to pressure their institutions to divest their holdings in companies doing business in South Africa. While historians disagree on whether the campaign had much of an impact on the companies doing business in South Africa, it did garner considerable public attention, forcing prominent individuals to take a stand and ultimately influencing the politics of this divisive issue. (S Maturen, "To Stop Climate Change, Students Aim at College Portfolios," *The New York Times*,



Precedents in Divesting Tobacco Stock

The tobacco control movement has had limited success to date in achieving divestment of tobacco stock and has not been able to capitalize either on the momentum of the environmental movement's divestment campaign or on the fact that environmental groups publicly equate the fossil fuel industry to Big Tobacco and call for energy firms to be accorded the same status as tobacco companies—that of social pariah.

In Canada a few universities have publicly declared their policy of divesting their holdings in tobacco companies. The University of Lethbridge in Alberta was the first in 2006. The University of Toronto followed suit in 2007, in response to the divestment campaign by student group EBUTT (Education Bringing Youth Tobacco Truths), as did McGill University in Quebec.

In October 2011, the government of Alberta announced its intention to divest all $17.5M of its directly-managed tobacco stock held by the Alberta Heritage Savings Trust and public sector pension funds, declaring that it was a conflict-of-interest to sue tobacco companies for medicare costs incurred treating tobacco-caused disease while at the same time profiting from shares in those same companies. Although all other provincial/territorial governments have initiated similar cost-recovery lawsuits against tobacco companies, none has followed Alberta's lead and divested its tobacco holdings.

Globally, there are few significant precedents. The Norwegian government in 2010 divested its industry holdings worth $2B, in keeping with its new ethical investing guidelines. Following a campaign and a resultant spate of negative publicity, in 2013 the Australian government divested some $210M in tobacco stock held by its Future Fund.

No Easy Feat

Major Canadian institutions, including the pension plans of the federal and at least two provincial governments, continue to possess significant tobacco industry holdings, as shown in the table on page 1. (Other government pension plans do not publicly disclose a complete list of their investments.)

One reason it is so difficult to convince institutions to divest their tobacco stocks is that they remain highly profitable. A recent analysis by RBC found that Lorillard came in #3 among stocks with a price-to-earnings ratio of less than 16, behind only Apple and Cummins. Lorillard generated a 486% return on investment (ROI), 845% with reinvested dividends factored in. Joining Lorillard on the top twenty list are Reynolds American and Altria, with ROIs including reinvested dividends of 546% and 417%, respectively.

"Tobacco stocks have delivered long-term alpha: Some of the best returns provided by value stocks in the past decade came from the tobacco sector" (RBC Capital Markets Picture of the Week, Vol 15, 14 April 2014.)

It is important to note that this strong market performance came at a time when tobacco companies were facing significant litigation threats. Analysts attribute the "outperformance" of tobacco stocks to the companies' ability to continue increasing revenues despite decreasing volume sales, by cutting costs and increasing prices.

An additional challenge for the divestment movement is the fact that tobacco companies are now major players in the e-cigarette market, given that e-cigarettes are widely considered to be safer than cigarettes and may prove to be effective quit smoking aids.