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RE: Tobacco report - Deutsche AM

SASB CN1 Sector Analyst Lynn Xia
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To SASB Comment Portal <comments@sasb.org>

From: Murray Birt [<mailto:Murray.Birt@db.com>]
Sent: Monday, January 15, 2018 05:41
To: Lynn Xia, SASB CN1 Sector Analyst <food_beverage@sasb.org>
Subject: RE: Tobacco report - Deutsche AM

Dear Lynn

Apologies for the large delay in responding. I was very glad to see that there was a short extension to the SASB consultation.

I would like to provide some comments on the Tobacco redline exposure draft, based on the Deutsche AM ESG research team's report.

Specifically:

Regarding the proposal to consolidate the marketing practices 2 metrics (TA08-24-01)

MSCI (Dec 2015) found that 65% of companies had marketing policies prohibiting youth marketing but only 50% had an audit mechanism to ensure compliance with marketing codes and to identify potential breaches...60% of companies face controversies related to their marketing practices

I suggest that companies should not just disclose their current marketing policies but also their audit and compliance mechanisms, non-conformance rates and associated corrective actions taken (including discipline for local staff/contractors who breach guidelines)

Regarding the accounting metric of disclosing fines (FB0301-03),

companies should disclose forward looking balance sheet provisions that are made for potential legal costs (not just fines paid). This is standard practice in the financial sector

As well, company internal legal costs are also substantial. SASB should consider require companies to

disclose their internal legal defence costs, as this is shareholder capital that could be redeployed elsewhere

I suggest that there is a need for a new type of disclosure: Tobacco regulation stress testing.

The materiality of this recommendation can be seen in how the industry's stock prices decline dramatically and only partially recovered after the FDA announced that they were considering new types of regulations including to reduce the addictive nature of tobacco.

Such a new type of disclosure could match the intent in the Task Force on Climate Related Financial Disclosure (TCFD)

Scenarios could include the impact of the World Health Assembly to reduce current tobacco use 30% by 2025 and analysis of the impact of all governments raising tobacco taxes to 75%+ of cigarette pack prices as well as potential impact from strengthening of other WHO recommended policies

Companies should be required to report on and stress-test potential losses from tobacco regulations

There is a need to develop disclosures regarding social and environmental standards for tobacco cultivation and processing. This was included in the provisional standards but not in the final exposure draft, apparently as there was no clear evidence of company cost savings.

I suggest this is the wrong standard by which use of this disclosure should be judged.

sustainable agricultural practices (including organics) have been found to improve yields and reduce environmental impacts across a range of crops particularly in emerging markets <https://ag4impact.org/publications/montpellier-panel-report2013/>(<https://ag4impact.org/publications/montpellier-panel-report2013/>) . While this (or other reports) is not tobacco specific, it should answer the concern that sustainable production can improve yields

Environmental and societal externalities are very large in the broad agricultural sector and institutional investors have several engagement initiatives (including through PRI) asking companies to improve their practices and policies. This shows investor interest, as the environmental externalities of agricultural production have material negative impacts on other aspects of an investors' holdings

As well, the UK Modern Slavery Act and California Transparency in Supply Chains Act require investors

(as listed companies) to publish steps taken to ensure supply chains are free from slavery. Schroders (Aug 2016) concluded that much tobacco production comes from countries with high modern slavery risks plus MSCI 2015 found only 20% of listed tobacco companies have programs to audit suppliers' code of conduct compliance. This demonstrates the need for improved disclosure of social practices in the tobacco supply chain, including how companies address and manage Green Tobacco Sickness

On environmental standards, a starting point could be the US Good Agricultural Practices GAP Connections initiative which could be applied to international tobacco production.

For instance percent of tobacco sourced from growers audited to U.S. Tobacco Good Agricultural Practices (GAP) program guidelines or an equivalent code of conduct

Suppliers' social and environmental responsibility audit compliance: (1) priority non-conformance rate and associated corrective action are and (2) other non-conformance rate and associated corrective action rate

Do other industries have disclosure regarding government policy lobbying? If so, then this should also apply to the tobacco industry

In July 2017, the Guardian published a series of articles regarding how multinational tobacco firms are using "intimidating tactics" to stop or dilute tobacco regulations in Africa

Investors have established expectations for corporate lobbying on climate policies, including that companies report on their lobbying activities (PRI April 2017)

There should be disclosure of how companies discuss tobacco policies with governments that respect commercial and trade law and countries' efforts to regulate to reduce tobacco's negative impacts, without using "intimidating" tactics. This seems to particularly needed given the asymmetry in resources and expertise between tobacco companies and emerging market governments.

I hope that these are helpful comments, please let me know if you have further questions

Thanks and Kind regards

Murray

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