

# TRANSFORMING **FINANCIAL** MARKETS FOR THE GOOD OF ALL

By: Rachel Melsom and Clare Payne

**Summary:** For the last 50 years, tobacco has been a key investment for many pension funds, insurers, investors and banks. However, investments are no longer viewed solely on financial return and the framework for review is being re-examined in a rapidly changing and transforming investment world. The negative impact of tobacco on health, human rights, environment, corporate governance, reputation, and the clear negative impact on the achievement of the Sustainable Development Goals (SDGs), has been highlighted through the increasing adoption of a framework driven approach, accelerating decisions to divest across the globe.

**Keywords:** Tobacco, Sustainable, Responsible, Framework, Investment

## Introduction

In the world of global business, the word disruption is usually associated with technology companies, maverick Chief Executive Officers (CEOs) and ‘unicorns’ (privately held start-ups valued at over \$1 billion/€0.8 billion). There are well known examples of new businesses with leaders who think differently, encouraging us to ride in the cars of strangers (Uber), sleep in their houses at night (Airbnb) and watch a whole season of your favourite show in one sitting (Netflix). Each of these ‘disruptive’ businesses have flourished in a world where finance is available to new ideas. Large investments of capital flow to businesses set to ‘transform’ our lives whilst providing a handsome return on investment along the way. But, why is it that so little innovative practice seems to flow to public health? The good news is that this is set to change and financial markets are transforming, for good.

## Questioning the status quo

Tobacco is one of the biggest issues of our time, something well understood by the global health community, but less so in the world of finance. This lack of understanding and the commonly held view that tobacco is an individual health choice issue rather than a global financial drain, has seen tobacco promotion and investment continue, facilitating product uptake at alarming rates in emerging nations.

The current reality, the status quo, is that many of us are ‘owners’ of tobacco companies through our investment portfolios, most commonly through compulsory or corporate pension structures. The largest tobacco companies have been considered a reliable investment, hence they are routinely included in default investment options, meaning that if someone does not explicitly ask for an exclusion, they

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### Box 1: The three questions

#### 1. Can the product that the company makes be used safely?

With respect to tobacco, the answer is an unequivocal 'no'. The only safe amount of tobacco for human consumption is zero. Even smoking an average of less than one cigarette per day increases the risk of death from lung cancer nine-fold compared to non-smokers.<sup>12</sup> When used precisely as intended, tobacco will result in the early death of two out of three smokers.<sup>13</sup> The evidence demonstrating the categorical and unconditional danger of smoking tobacco is irrefutable.

#### 2. Is there a UN Treaty regarding the issue?

For tobacco, the answer is 'yes'. There is the UN Tobacco Control Treaty, the WHO FCTC.<sup>14</sup>

#### 3. Can investors use engagement with the company as a tool to effect change?

As it pertains to tobacco, the answer is 'no'.

are likely to have tobacco stock in their investment portfolio. Countries have found themselves invested through Sovereign Wealth Funds, even when signed to the United Nations (UN) Tobacco Treaty (WHO Framework Convention on Tobacco Control, FCTC) that contains a provision prohibiting investment in tobacco companies.<sup>15</sup>

The global finance community has largely discouraged divestment (the removal) of any stocks, instead favouring a 'diversified' (i.e. all stocks) portfolio to minimise and spread financial risk. Due to this attitude towards divestment, even the use of the word divestment can meet resistance from the finance sector. Removing tobacco stocks has therefore required the introduction of a new thought process and framework for investment.

The rise of responsible investment combined with the increased pressure on businesses to reduce the negative impact of their products on society has accelerated us towards a transformation of financial markets. The new framework for investment that is emerging in global financial markets is seeing people's health prioritised like never before. There is still a long way to go; however, the case of tobacco gives hope that we may yet be able to address some of the biggest public health issues of our time.

### Challenging existing practices to develop a new framework for our time

Existing practices and rationales have had to be challenged in order to introduce a framework for investment that prioritises people's health alongside financial criteria.

#### 1. An exception to the practice of 'engaging for change'

The concept of 'engagement', where investment professionals encourage companies to improve their practices (usually around environmental, social and governance matters) is now commonplace across the finance sector. Engagement is considered the preferred practice, allowing investors to influence companies to effect positive change. In the case of tobacco companies, however, engagement is futile, as the core product is the problem, and the only acceptable outcome is the cessation of the primary business – tobacco production.

Dr Vera Da Costa e Silva, Head of Secretariat of UN Tobacco Control Treaty, has stated, "*Engagement with the tobacco industry is contrary to the United Nations' systems, objectives, fundamental principles and values.*"<sup>16</sup> With no levers for change through positive influence, the case for divestment is strengthened.

#### 2. Understanding all the facts

It is over 50 years since the United States (US) Surgeon General announced the unequivocal link between poor health outcomes and tobacco use and yet the true extent of the devastation of tobacco is not well understood by the finance sector. The facts, the sheer numbers, tend to startle: seven million people will die prematurely this year<sup>17</sup> and one billion people this

century because of tobacco use.<sup>18</sup> This story and the implications beyond the share price must be told and understood by the finance sector in order for a new framework for investment to emerge.

#### 3. Challenging the accepted business model

Tobacco is a business, with health implications and associated human, societal and financial costs. The profitability of tobacco, however, is the outcome of a business model that internalises profits and externalises costs. This business model has allowed these companies to thrive in financial markets.

However, recent successful litigation has challenged the business model where the costs of tobacco are borne by society. The Court of Appeal of Quebec upheld the ruling for three large tobacco companies to pay C\$15.5 billion (€10.6 billion) in damages<sup>19</sup> – the largest award in Canada's history. The plaintiffs were Quebec smokers who argued that the companies did not properly warn their customers and failed in their general duty "not to cause injury to another person."<sup>20</sup> In May 2019, Brazil launched a case against two of the largest tobacco companies to recover the cost of treating tobacco related illnesses.<sup>21</sup> Cases such as these could see significant shifts in the valuations of tobacco companies and ultimately a questioning of the once accepted business model.

#### 4. Fiduciary duty beyond profit alone

A fiduciary duty is underpinned by a fiduciary relationship, which can be defined as a person having full trust and confidence in another to act in their interests rather than out of self-interest. Many financial services providers are subject to a statutory obligation to act in the 'best interests' of their clients. The term 'best interests' is one of continuing inquiry as trustees, directors and fiduciaries attempt to determine the extent of their responsibilities and whether 'best interests' implies more than the pursuit of purely financial benefit. According to the *Fiduciary Duty in the 21st Century Report*, which was published by the UN-backed organisation Principles for Responsible

Investment (PRI), “Fiduciary duty is not an obstacle to action on environmental, social and governance (ESG) factors”.<sup>7</sup>

The European Parliament and European Union (EU) Member States agreed in March 2019 on new rules on disclosure requirements related to sustainable investments and sustainability risks.<sup>8</sup> The UN Environment Programme Finance Initiative (UNEPFI) outlines that the new regulation will provide consistency across EU Member States by clarifying that duties require investors to consider financially material ESG factors in their investment decision-making. It also sets out how financial actors should inform beneficiaries about their compliance with the integration of ESG risks and opportunities. This will apply to private and occupational pension funds, insurance funds, portfolio management and investment advisors. This includes requirements to disclose the adverse impact of ESG matters. This would be the first regulatory-backed disclosure framework for sustainability impact of investment activity.<sup>9</sup>

This evolution of fiduciary duty has effectively removed a barrier to the divestment of tobacco stock from investment portfolios, allowing for a new investment framework to emerge.

### 5. Addressing tobacco to achieve a sustainable future

The Sustainable Development Goals (SDGs) were formally adopted by the UN General Assembly in September 2015, they officially came into force on 1 January 2016 and are increasingly adopted by the finance sector to guide and measure their activities. The SDGs have provided a valuable, constructive platform on which to base dialogue regarding tobacco-free investment.

While it is easy to appreciate the importance of tobacco control in pursuit of SDG 3, ‘Good Health and Well-Being’, many in the finance sector are becoming aware that dramatic improvements in comprehensive tobacco control are vital for achievement of 13 of the 17 SDGs. One of the most recent high-profile decisions has been the European

Parliament vote in March 2019 paving the way for a ban on single use plastic, to reduce pollution in the oceans and to come into force by 2021, per SDG 14 ‘Life below water’.<sup>10</sup> What is less well known is that cigarette butts are the biggest manmade contaminant of the ocean and can take over a decade to decompose.<sup>10</sup>

SDG 17 calls for ‘Partnerships for the Goals’, which most clearly articulates the importance of cross-sector collaboration when addressing major global issues and is the philosophy that underpins the new investment framework.

### An investment framework specific to tobacco

With the preceding factors understood, a review framework of three questions provides a robust investment critique<sup>11</sup> for all products including tobacco (**see Box 1**):

When these questions and answers are considered collectively, a clear framework emerges. As such, applying an exclusion to investment in tobacco companies can be viewed as both a rational and pragmatic option for investment professionals.

Viewing this in conjunction with the financial impact of increased litigation, regulation, health awareness and decreasing social acceptability, it is clear that tobacco cannot be considered a sustainable investment.

### Financial markets are transforming, becoming an ally in the fight against tobacco

In the United States in 2019, one in four US dollars is invested under a socially responsible mandate,<sup>12</sup> and BlackRock’s CEO, Larry Fink, who manages one of the biggest investment management companies in the world, is calling for more.<sup>13</sup>

The removal of tobacco stocks from investment portfolios is an indication of financial markets that are transforming for health and societal well-being.

Momentum around tobacco-free investment has grown steadily in the last five years. In January 2018, ABP, the

world’s fifth largest pension fund, based in the Netherlands, announced a new policy excluding investment in tobacco<sup>14</sup> based on the framework detailed above. It was a signal of the year ahead with the Tobacco-Free Finance Pledge<sup>15</sup> led by Tobacco Free Portfolios and launched at the UN in New York during the General Assembly in September 2018.

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The initiative was sponsored by the French and Australian governments and supported in person by Dr Tedros Ghebreyesus, Director-General of the WHO, Dr Vera Luiza da Costa e Silva, Head of the Secretariat UN Tobacco Control Treaty, French and Dutch health ministers, and global finance leaders from across Europe, the US, Australia and Canada, all stood side-by-side in a public demonstration of the finance sector’s desire to play their part in helping to solve a global health issue of monumental proportions.<sup>16</sup>

Finance leaders are increasingly willing to use their power to contribute to addressing some of the most pressing issues of our time. Translating these issues into financial reality will be the key. If this transformation of financial markets continues, public health will be the beneficiary, at last.

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## Health, the economy & the G20

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**Freely available to download:** <https://www.hspm.org/g20/>

Governments of the world recognise health as a driver of economic and societal progress in the 2030 Agenda for Sustainable Development (SDG 3). In reality, health systems may face difficulties securing the necessary funding to deliver on their governments' commitments to move towards Universal Health Coverage. There are a number of reasons health systems do not always receive the funding they need, including legitimate concerns about efficiency and value for money in health care. It is also clear that health is not the only sector that matters when it comes to sustainable progress. Acknowledging all of this, it is equally as important to recognise the growing evidence that shows that health is a major contributor and key driver of strong economies and societal well-being.

This new series of country assessments (fiches), authored by national experts with the support of the Observatory, explores the significant part health systems play in the broader economy. The series draws on cross-country comparable data and country-specific analysis to explore how well the health

sector contributes to the economy in the G20 Member States and in the invited guest countries for 2019.

The series aims to make the contribution of health systems to the economy better understood, supporting both health ministers in their negotiations with their finance colleagues and other health advocates so that health systems receive a fair hearing. A compendium of the country assessments will be officially launched at the G20 Health Ministers' meeting in Japan in October 2019.

