

Tobacco Divestment Research Study

*a report for
Physicians for a Smoke-Free Canada*

by

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Summary

With the rise of ethical investing in Canada, growing legions of investors are asking for more knowledge of where their money is invested. They want to know how their mutual funds invest their money, and the social and environmental consequences of those investments. And one of the most common social concerns expressed by investors surrounds tobacco. Given the knowledge of where their money is invested and the freedom to choose, a large proportion of Canadians would select investments outside the tobacco industry.

Physicians for a Smoke-Free Canada recognizes this and has come to aid of these investors. Inspired by the death and suffering they see firsthand, these doctors commissioned this report to identify tobacco companies around the world, and the major Canadian mutual funds that hold those investments. The aim is to inform investors of these tobacco investments and encourage them to choose investments which are tobacco-free.

In spite of serious litigation against the tobacco industry, growing information on the addictive nature of tobacco and rising concerns about the health and social costs of youthful cigarette smoking, tobacco companies continue to be a core holding among many of Canada's major mutual funds. In fact, more than half of the funds included in the study had some tobacco holdings in them.

Among the funds with tobacco holdings, the industry represents nearly two per cent of their portfolios, a significant proportion of their total investment. The total value of these holdings is estimated at more than \$1 billion.

The study contains some practical recommendations for investors of conscience who wish to avoid tobacco-related investments. Specifically, the study suggests that investors of conscience may wish to consider:

- Divesting of mutual funds holding tobacco-related companies;
- Urging their mutual funds to divest of these holdings in a timely way;
- Encouraging their funds to mount active shareholder campaigns against tobacco-related holdings companies, calling for these companies to spin off their tobacco operations.

These actions would send a powerful market signal to tobacco company executives that the time has come to plan for the phaseout of their industry.

Methodology

In the summer of 1998, Physicians for a Smoke-Free Canada contracted with Ellmen/Shaw Public Affairs to conduct a study of Canada's major mutual funds to determine how many and to what extent they held investments in tobacco companies. The aim was to identify tobacco-related investments among Canada's major mutual funds and to disseminate this information to the investing public.

Ellmen/Shaw undertook this project jointly with Michael Jantzi Research Associates and Kinder, Lydenberg, Domini & Co. Inc. Ellmen/Shaw Public Affairs is a consulting partnership specializing in research and public affairs for socially responsible companies, non-profits, co-operatives and advocacy organizations. MJRA is a leading Canadian company that tracks the social and environmental performance of Canadian companies. Boston-based KLD provides social research on US corporations.

Phase 1 of the study included the preparation of a "screen" to identify companies involved in the production of tobacco. This screen was then used to identify 114 companies worldwide involved in the production or marketing of tobacco. MJRA compiled this information from its own data as well as information supplied to it by KLD. A report on these Phase 1 activities is included with this study.

In Phase 2, Ellmen/Shaw Public Affairs selected 55 of Canada's major mutual funds to determine which of these funds had invested in the tobacco-related companies identified by MJRA and KLD. Funds with assets of more than \$1 billion on July 31, 1998 (as found in the August 20, 1998 *Globe and Mail Report on Mutual Funds*) were selected for the study.

The total value of these funds on July 31 was \$149.6 billion. While this is not a comprehensive list of mutual funds, Ellmen/Shaw estimates these funds comprise nearly half, or 47%, of the total assets of the Canadian mutual fund industry. This estimate is calculated by comparing the total assets of these funds with the total assets of all Investment Funds Institute of Canada (IFIC) funds on July 31, 1998 (\$320 billion).

Portfolios for these funds were obtained from mutual fund annual reports or financial statements found on the SEDAR database, the online database of company and mutual fund information maintained by Canadian securities commissions. SEDAR was chosen as the source of information since it is the official database of Canadian securities regulators. The database is located at <http://www.sedar.com>.

In some cases, annual reports or financial statements were not available on the SEDAR database. In these instances, Ellmen/Shaw obtained the reports from the mutual fund companies themselves.

If tobacco-related companies were found in the annual reports or financial statements, Ellmen/Shaw noted the company, size of holding and percentage of total portfolio the holding

represented on the report date. In a few cases, Ellmen/Shaw found a tobacco-related company in a mutual fund's annual report, but, according to a subsequent interim financial statement, the mutual fund dropped the holding. We have noted these cases in our study.

In undertaking this research, Ellmen/Shaw attempted to obtain the most recent report available. Most of the information has been obtained from financial statements dated June 30, 1998 or annual reports effective Dec. 31, 1997. In a small number of funds, the information is from earlier reports; the oldest information used in the study is effective June 30, 1997. The fact that there are inconsistent report dates is due to a number of factors:

- 1) Mutual funds have differing year-ends. While most file annual reports effective Dec. 31, others have year-ends effective at other months of the year.
- 2) In some cases, annual reports were available on the database, but interim financial statements were not. Therefore, the information is taken from the annual report.
- 3) In a few cases involving particular mutual fund families, Ellmen/Shaw was unable to thoroughly search the database for the interim financial statements due to the volume of material available on these families. Again, in these cases, the information is taken from the annual report.
- 4) Finally, in some cases, interim financial statements were reproduced incompletely on the database, rendering them useless for the study. Again, in these cases, the information is taken from the annual report.

Because of these factors, Ellmen/Shaw cautions readers against assuming that any particular mutual fund currently holds any specific security. Readers are advised to contact the fund directly for an up-to-date portfolio list.

Major Findings

- 1) Of the 55 mutual funds studied, 32 or 58% directly or indirectly held securities identified as tobacco-related companies. This total includes three portfolio funds (which invest in units of other funds rather than in securities directly) that hold tobacco-related investments indirectly through other mutual funds. It also includes three funds identified as having tobacco-related holdings in 1997 that had been dropped from the portfolios as of June 30, 1998.
- 2) The total value of the tobacco-related investments among the funds under study is \$1.22 billion. This includes the 29 funds with direct tobacco-related holdings only to avoid double-counting the investments in the portfolio funds. The average value of tobacco-related holdings among the 29 funds is \$42.2 million, or 1.9% of their total portfolios.
- 3) The fund with the highest average tobacco-related holding is AGF International Value Fund at 5.85%. The lowest is Investors European Growth at 0.04%.
- 4) The most frequent tobacco-related company is, not surprisingly, Imasco, found in 17 of the 29 funds with direct tobacco-related investment. Of Canadian tobacco companies, Celanese was found in three funds; Rothmans was found in two. Of international tobacco companies, BAT was the most frequent tobacco investment found, identified in six funds.

Commentary

With the growth in values-based or ethical investing, a rising number of investors are demanding information on the composition of the mutual funds in which they own units. The growth of ethical mutual funds and ethical investing generally shows that there is a significant proportion of the investing public that wants to avoid certain companies or sectors. The tobacco industry has often been identified as a sector that investors of conscience wish to avoid.

In spite of this -- as well as well-documented health and social problems linked to smoking -- tobacco remains a commonly-held investment among major Canadian mutual funds.

In some cases, particularly among the international equity funds, the portfolio managers have decided to clearly invest in the tobacco industry, choosing tobacco manufacturers such as Gallaher, Dimon and UST. In other cases, the investments are in holding companies, such as BAT, Philip Morris or RJR Nabisco. However, these investments still represent significant participation in the tobacco industry. According to MJRA and KLD information contained in the study, tobacco products represent 62% of BAT's revenues, 53% of Philip Morris revenues and 49% of RJR Nabisco sales.

Imasco is a "core" stock among many funds included in the study. The manager of the London Life Canadian Equity Fund, for example, praised the company recently in the media, saying cash-rich Imasco "will rebound strongly once the market settles down." (*Despite change in managers, fund considered a safe haven*, Globe and Mail Report on Business, Oct. 15, 1998) In fiscal 1997, Imasco derived 26% of its revenues from Imperial Tobacco, its wholly-owned subsidiary. But the company also holds significant non-tobacco interests in the financial sector through Canada Trust, Canada's largest trust company. As well, it has large holdings in the retail industry and real estate.

However, it's not clear whether portfolio managers are investing in Imasco because of its tobacco holdings or because of its financial, retail and real estate interests. This is an important distinction for investors wishing to have a tobacco-free portfolio. While they may want to avoid Imperial Tobacco, these investors may also want to participate in Imasco's non-tobacco activities.

For such investors, it would be useful for Imasco to separate its tobacco-related operations from its non-tobacco activities. This would enable these investors to avoid Imasco's tobacco production while still permitting them to participate in the company's other operations.

Actions for Investors

This research report has taken a small step for investors of conscience in identifying major mutual funds that hold tobacco-related companies. For investors who wish to avoid tobacco involvement altogether, the choice is clear: divest of the mutual funds with such holdings.

For investors who wish to avoid tobacco involvement but are reluctant to divest, there are other options. It may be possible for these investors to write or telephone their mutual fund companies, asking them why they are holding investments in the tobacco industry and urging them to divest of tobacco-related companies in a timely way.

Furthermore, it may also be possible to begin discussions with portfolio managers of these mutual funds (as well as pension funds) to determine whether they can start an active shareholder campaign to urge tobacco holding companies to sell their tobacco-related operations. Such actions would involve Imasco in Canada, BAT in the UK and Philip Morris and RJR Nabsico in the US (as well as other companies). Such corporate breakups have already happened with American Brands spinning off Gallaher in 1996 and Kimberly Clark spinning off its tobacco-related paper business in 1995.

These actions would send important market signals to the executives of tobacco-related companies that the time has come to prepare for the long-term phase-out of the tobacco industry.

Appendix 1
Mutual Funds Selected for Study

<i>Name</i>	<i>Assets (\$m)</i>
AIC Diversified Canada	2168.1
Altamira Equity	1446.8
CIBC Canadian Equity	1147.4
Fidelity True North	1403.7
First Canadian Growth	1180.7
Investors Canadian Equity	3552.1
Investors Retirement Growth Port.	2487.1
Investors Retirement Mutual Fund	2924.6
Ivy Canadian	5573.9
London Life Canadian Equity	1379.3
MD Equity	1868.6
Royal Canadian Equity	3182.3
Spectrum United Canadian Equity	1556.1
Trimark Canadian	2053.2
Trimark RSP Equity	2499.3
Trimark Select Canadian Growth	4670.6
Universal Canadian Growth	1936.9
 <i>Cnd balanced</i>	
AGF Cnd Tactical Asset Allocation	1036.8
Canada Life Managed Fund S-35	1289.5
Canada Trust Balanced	1744.7
CIBC Balanced	1273.8
Dynamic Partners	1851.1
Fidelity Canadian Asset Allocation	3184.0
Global Strategy Income Plus	2177.7
Industrial Income Class A	2537.8
Investors Asset Allocation	1860.7
Investors Income Plus Portfolio	1574.5
Investors Mutual of Canada	1141.4
Investors Retirement Plus Portfolio	1874.0
Ivy Growth & Income	2524.0
London Life Diversified	2656.7
PH & N Balanced Pension Trust	2357.9
Royal Balanced	7588.0
Trimark Select Balanced	4580.3

Dividend Funds

AGF Dividend	2293.5
First Canadian Dividend Income	1279.5
Investors Dividend	4918.3
Royal Dividend	2211.8

Intl Equity

AGF International Value	2334.9
CI Global	1091.5
Fidelity International Portfolio	3909.3
Investors Global	1806.3
Investors NA Growth	1686.8
Ivy Foreign Equity	1180.2
MD Growth	3593.3
Templeton Growth	10679.8
Templeton Intl Stock	6079.9
Trimark Fund	3047.1
Trimark Select Growth	5852.7

US Equity

Fidelity Growth America	1767.5
Investors US Growth	1875.5

European Equity

Fidelity European Growth	2563.4
Investors European Growth	1794.0

Sector Equity

AIC Advantage	2947.5
AIC Advantage II	4361.6

Total **149558.6**

Appendix 2 -- Major Mutual Fund Tobacco Holdings

<i>Canadian Equity Funds</i>				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
AIC Diversified Canada 12/31/97	2168.1	N	1125.8	
Altamira Equity 12/31/97	1446.8	Y	1190.7	Celanese \$37.9 m (2.0%) Imasco \$14.1 m (0.7%)
CIBC Canadian Equity 12/31/97	1147.4	N	884.4	
Fidelity True North 06/30/98	1403.7	Y	1414.7	Imasco \$ 8.1 m (0.6%) Celanese \$ 5.6 m (0.4%)
First Canadian Growth 03/31/98	1180.7	Y	1214.0	Imasco \$29.6 m (2.4%)
Investors Canadian Equity ¹ 12/31/97	3552.1	Y	3759.0	Imasco \$24.8 m (0.65%) (dropped by June 30, 1998)
Investors Retirement Growth Portfolio ² 06/30/98	2487.1	Y (indirectly)	2631.7	\$21.6 m (estimated) 0.8% (estimated)
Investors Retirement Mutual Fund ³ 12/31/97	2924.6	Y	3026.9	Imasco \$19.9 m (0.7%) (dropped by June 30/98)
Ivy Canadian 06/30/98	5573.9	N	5655.6	
London Life Canadian Equity 12/31/97	1379.3	Y	1280.2	Imasco \$35.7 m (2.7%)
MD Equity 12/31/97	1868.6	N	1656.6	
Royal Canadian Equity 12/31/97	3182.3	Y	3129.4	Imasco \$33.6 m (1.1%) BAT (UK) \$ 0.7 m (.02%)
Trimark Canadian 06/30/98	2053.2	N	2205.6	
Trimark RSP Equity 06/30/98	2499.3	N	2736.0	
Trimark Select Canadian Growth 06/30/98	4670.6	N	5026.5	
Universal Canadian Growth 06/30/97	1936.9	N	971.8	

Canadian Balanced Funds				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
AGF Cnd Tactical Asset Allocation 06/30/98	1036.8	Y	1036.2	Imasco \$7.3 m (0.7%) Philip Morris US \$1.0 m (0.09%)
Canada Life Managed S-35 12/31/97	1289.5	Y	1186.0	Nabisco Holdings US \$2.4 m (0.2%)
Canada Trust Balanced 06/30/98	1744.7	N	1786.8	
CIBC Balanced 12/31/97	1273.8	Y	1018.8	Imasco bonds \$2.9 m (0.3%) Imasco \$3.0 m (0.3%) Dimon Inc US \$2.5 m (0.25%) Philip Morris US \$2.3 m (0.22%) BAT UK \$0.7 m (0.06%)
Dynamic Partners ⁴ 12/31/97	1851.1	Y	2002.2	Nabisco US \$9.3 m (0.5%) (dropped by June 30/98)
Fidelity Cnd Asset Allocation 06/30/98	3184.0	Y	3016.9	Imasco \$16.3 m (0.5%) Celanese \$8.8 m (0.3%) Universal US \$4.4 m (0.15%)
Industrial Income Class A 06/30/98	2537.8	N	2664.1	
Investors Asset Allocation 06/30/98	1860.7	Y	1899.5	Imasco \$30.5 m (1.6%)
Investors Income Plus Portfolio 06/30/98	1574.5	N	1593.8	
Investors Mutual of Canada 06/30/98	1141.4	N	1178.9	
Investors Retirement Plus Portfolio ⁵ 06/30/98	1874.0	Y (indirectly)	1935.9	\$7.9 m (estimated) 0.4% (estimated)
Ivy Growth & Income 06/30/97	2524.0	N	1138.0	
London Life Diversified ⁶ 12/31/97	2656.7	Y (indirectly)	2131.2	Imasco \$24.7 m (estimated) 1.16% (estimated)

<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
Philips, Hager and North Balanced Pension Trust (information unavailable as this is a fund for institutional investors)				
Royal Balanced 12/31/97	7588.0	Y	6512.6	Imasco \$38.1 m (0.6%) BAT UK \$ 1.95 m (0.03%)
Trimark Select Balanced 06/30/98	4580.3	N	4803.6	

<i>Sector Equities</i>				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
AIC Advantage 12/31/97	2947.5	N	1781.3	
AIC Advantage II 12/31/97	4580.3	N	3236.3	

<i>Dividend Funds</i>				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
AGF Dividend 06/30/98	2293.5	Y	2309.0	Imasco \$80.2 m (3.4%) Rothmans \$10.3 m (0.45%)
First Canadian Dividend 03/31/98	1279.5	Y	1228.0	Imasco \$31.3 m (2.5%) Rothmans \$19.6 m (1.6%)
Investors Dividend 06/30/98	4918.3	N	4389.5	
Royal Dividend 12/31/97	2211.8	Y	1558.0	Imasco \$14.1 m (0.9%)
Mutual Fund and Date of Report	Assets (\$millions July 31/98)	Tobacco Holdings (Y/N)	Assets on Report Date (\$ m)	Company, Size of Holding and Percentage of Total Portfolio on Report Date

<i>US Equities</i>				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
Fidelity Growth America 06/30/98	1767.5	N	1738.5	
Investors US Growth 12/31/97	1875.5	Y	1283.8	Philip Morris US \$56.5 m (3.1%) UST US \$42.7 m (2.3%)

<i>European Equity</i>				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
Fidelity European Growth 06/30/98	2563.4	Y	2328.0	BAT UK \$16.9 m (0.7%) Gallaher UK \$ 6.1 m (0.3%)
Investors European Growth 06/30/98	1794.0	Y	1683.6	Swedish Match Sweden \$0.82 m (0.04%)

<i>International Equities</i>				
<i>Mutual Fund and Date of Report</i>	<i>Assets (\$millions July 31/98)</i>	<i>Tobacco Holdings (Y/N)</i>	<i>Assets on Report Date (\$ m)</i>	<i>Company, Size of Holding and Percentage of Total Portfolio on Report Date</i>
AGF International Value 06/30/98	2334.9	Y	2201.6	Loews US \$29.7 m (1.3%) UST US \$16.6 m (0.75%) Philip Morris \$41.1 m (1.9%) BAT UK \$41.2 m (1.9%)
CI Global 06/30/98	1091.5	N	1045.1	
Fidelity International Portfolio 06/30/98	3909.3	Y	3517.4	Imasco \$1.1 m (0.03%) Rothmans of Pall Mall Malaysia \$0.6 m (0.02%) Gallaher UK \$4.8 m (0.1%) Universal US \$4.4 m (0.1%)
Investors Global 06/30/98	1806.3	Y	1799.6	Swedish Match Sweden \$8.8 m (0.5%) BAT UK \$15.6 m (0.9%) Philip Morris US \$49.7 m (2.8%)
Investors North American Growth 06/30/98	1686.8	Y	1757.0	Philip Morris US \$45.2 m (2.5%)
<i>Mutual Fund</i>	<i>Assets</i>	<i>Tobacco</i>	<i>Assets</i>	<i>Company, Size of Holding and</i>

<i>and Date of Report</i>	<i>(\$millions July 31/98)</i>	<i>Holdings (Y/N)</i>	<i>on Report Date (\$ m)</i>	<i>Percentage of Total Portfolio on Report Date</i>
Ivy Foreign Equity 06/30/98	1180.2	Y	668.4	Imperial Tobacco UK \$21.6 m (3.2%)
MD Growth 12/31/97	3593.3	N	2624.1	
Templeton Growth 04/30/98	10679.8	Y	11093.4	Eastman Chemical US \$49.2 m (0.4%)
Templeton International Stock 07/31/98	6079.9	N	6079.9	
Trimark Fund 06/30/98	3047.1	Y	3087.4	RJR Nabisco Holdings US \$82.3 m (2.7%)
Trimark Select Growth 06/30/98	5852.7	Y	5941.9	RJR Nabisco Holdings US \$157.4 m (2.6%)

Notes

- 1) *According to the interim financial statement dated June 30, 1998, Investors Canadian Equity Fund had dropped Imasco from the portfolio, leaving it without any tobacco-related holdings.*
- 2) *Investors Retirement Growth Portfolio is a portfolio fund comprised of other Investors Group funds. On 06/30/98, it is estimated that the fund indirectly contained 0.8% of tobacco investments through various holdings of the Investors Global Fund, which comprises 20% of the portfolio.*
- 3) *According to the interim financial statement dated June 30, 1998, Investors Retirement Mutual Fund had dropped Imasco from the portfolio, leaving it without any tobacco-related holdings.*
- 4) *According to the interim financial statement dated June 30, 1998, Dynamic Partners Fund had dropped Nabisco from the portfolio, leaving it without any tobacco-related holdings.*
- 5) *Investors Retirement Plus Portfolio is a portfolio fund comprised of other Investors Group funds. On 06/30/98, it is estimated that the fund indirectly contains 0.4% of tobacco investments through various holdings of the Investors Global Fund, which comprises 10% of the portfolio.*
- 6) *London Life Diversified is a portfolio fund comprised of other London Life Funds. On 12/31/97, London Life Canadian Equity comprised approximately 43% of the fund. This means that the 2.7% Imasco holding in London Life Canadian Equity represents about 1.16% of the Diversified Fund.*