

**To the Ministry of Finance**

**Recommendation**

**October 22<sup>nd</sup>, 2009**

# UNOFFICIAL ENGLISH TRANSLATION

## 1 Introduction

In its Government Whitepaper no. 20 (2008-2009), the Ministry of Finance proposed that tobacco companies should be excluded from the investment universe of the Government Pension Fund Global. The proposition was supported by Stortinget (the Parliament).

In line with this, the Ministry has changed the Fund's ethical guidelines to the effect that companies which produce tobacco are to be excluded from the Fund.

The Council on Ethics has reviewed the companies in the Fund which are classified as tobacco producers and thus subject to exclusion based on the new criterion. The Fund's investments in each company (in NOK) as of December 31<sup>st</sup>, 2009, are provided for each company.

Alliance One International Inc. (NOK 6 543 727)	ITC Ltd. (NOK 338 514 700)	Reynolds American Inc. (NOK 251 436 677)
Altria Group Inc. (NOK 916 297 967)	Japan Tobacco Inc. (NOK 1 469 905 318)	Souza Cruz SA (NOK 52 051 152)
British American Tobacco BHD (NOK 65 776 837)	KT&G Corp. (NOK 114 873 735)	Swedish Match AB (NOK 523 059 285)
British American Tobacco Plc. (NOK 4 777 801 401)	Lorillard Inc. (NOK 292 038 569)	Universal Corp VA (NOK 20 897 286)
Gudang Garam tbk pt (NOK 0)	Philip Morris Int. Inc. (NOK 3 335 098 781)	Vector Group Ltd. (NOK 14 899 151)
Imperial Tobacco Group Plc. (NOK 2 426 963 580)	Philip Morris Cr AS (NOK 19 019 853)	

The Council on Ethics recommends that these companies be excluded from the Fund.

The Council will examine whether there could be companies in the fund that produce tobacco but are not classified as tobacco producers. The Council may submit additional recommendations based on its findings.

## 2 Background

The Council has received a letter from the Ministry of Finance, dated September 30th, 2009, in which changes to the Fund's ethical guidelines and to the mandate of the Council are established. The changes entail that the Council is to submit recommendations on the exclusion of companies which produce tobacco.

In its letter, the Ministry writes that, as stated in the Government Whitepaper no. 20 (2008-2009), this new criterion for exclusion is based on the production of tobacco, not on the sale of tobacco products. Also, the criterion is limited to the production of tobacco products themselves, not to additives or ingredients used in the production of tobacco products.

The Council will therefore issue recommendations on companies which cultivate and process tobacco, and exclusion from the Fund will be recommended for all companies which manufacture products made from tobacco. Production of any form of tobacco product, regardless of its intended use, will form the basis for exclusion.

Cultivation of tobacco takes place partly in the United States, India, Brazil, China, and in several African countries. Tobacco is cultivated in large plantations, smaller farms and on small patches of land. So-called “leaf companies” purchase tobacco crop either directly from farmers or in local auctions where farmers sell their produce. The leaf companies process the tobacco and sell it on to tobacco companies, which produce various tobacco products for end consumers. Some tobacco companies also purchase tobacco crops directly from farmers or in local auctions, without the use of leaf companies.

The Council has used the classification of tobacco companies in the industry classification of the Fund’s reference indices as its starting point for this recommendation.

The industry classification is based on the type of business activity that is dominant for the companies’ turnover. The Fund’s reference index for equities is derived from the FTSE All Cap. FTSE classifies the companies in the index in different industries. In the industry “*Consumer Goods*”, “*Tobacco*” is defined as a separate sector. Companies classified in this sector will receive the bulk of their revenues from the tobacco industry. As for the bond investments, Barclays Global Aggregate is used as basis for the Fund’s reference index. Also here, companies with the bulk of their revenues from the tobacco industry are classified under “*Tobacco*”.

When using the classification of the index-providers to identify tobacco companies, there are two issues which should be particularly noted:

- Among the companies classified as tobacco companies, there may be companies which only produce additives or components for tobacco products, such as paper, filters etc., and not products made from tobacco. Such production does not form basis for exclusion from the Fund.
- There may be companies in the Fund which manufacture tobacco products without being classified in the indices under “*Tobacco*”. This could be companies with activities in tobacco production as well as other industries, and where the revenues from tobacco production does not make up the largest proportion. The Council will therefore introduce monitoring of the Fund’s portfolio with the aim of identifying such companies. Based on this, the Council may submit additional recommendations in the future.

### 3 The Council's previous assessments of companies in the tobacco industry

At its own initiative the Council has previously conducted surveys to assess the extent of child labour in the tobacco industry. Preliminary findings have indicated that the extent of health hazardous child labour in tobacco cultivation in some countries can be large. When it was clear that production of tobacco was to be introduced as an objective criterion for exclusion of companies from the Fund, further enquiries were halted as the companies in question would in any case be recommended for exclusion.

### 4 Tobacco companies in the Fund's portfolio

Based on the index providers' industry classification of companies in the Fund's portfolio and information on companies' web pages, the Council has identified the following companies with production which leads to exclusion under the revised guidelines. As the companies themselves clearly state that they manufacture tobacco products, the Council has not found it necessary to write to the companies in order to have this confirmed.

#### *Alliance One International Inc. (USA)*

This is an American leaf company. The company purchases tobacco in local markets, processes and sells it on to tobacco companies, mostly cigarette producers.<sup>1</sup>

#### *Altria Group Inc. (USA)*

The company owns 100% of the production company Philip Morris USA, which is the largest cigarette producer in the USA.<sup>2</sup> In 2009, Altria Group Inc. purchased UST Inc., which, through its wholly owned subsidiary US Smokeless Tobacco Company is the largest US producer of smokeless tobacco.<sup>3</sup>

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<sup>1</sup> "As a leading independent leaf tobacco merchant, Alliance One International provides worldwide service to the large cigarette manufacturers. Multinational manufacturers of consumer tobacco products rely on independent merchants such as Alliance One to supply the majority of their leaf. We purchase tobacco in more than 45 countries and serve manufacturers of cigarettes and other consumer tobacco products in over 90 countries.

*Alliance One proudly claims broad geographic processing capabilities, a diversified product offering, and an established customer base, which includes all of the major consumer tobacco product manufacturers. We select, purchase, process, pack, store, ship, and, in certain developing markets, provide agronomy expertise and financing for growing leaf tobacco."*

See company webpage: <http://www.aointl.com/au/>

<sup>2</sup> "Altria Group's operating companies include Philip Morris USA, U.S. Smokeless Tobacco Company, John Middleton and Ste. Michelle Wine Estates. Our tobacco company brand portfolios consist of successful and well-known brand names such as Marlboro, Copenhagen, Skoal and Black & Mild. Philip Morris USA is the largest tobacco company in the U.S. and has half of the U.S. cigarette market's retail share."

See company webpage: [http://www.altria.com/about\\_altria/1\\_0\\_aboutaltriaover.asp](http://www.altria.com/about_altria/1_0_aboutaltriaover.asp)

<sup>3</sup> "With Altria Group's acquisition of UST Inc., U.S. Smokeless Tobacco Company becomes a wholly-owned subsidiary of Altria Group, making Altria the owner of the premier tobacco companies in the United States. See company webpage: [http://www.altria.com/about\\_altria/1\\_6\\_4\\_USSmokelessStory.asp](http://www.altria.com/about_altria/1_6_4_USSmokelessStory.asp)

"U.S. Smokeless Tobacco Company is a wholly-owned subsidiary of Altria Group that manufactures and markets smokeless tobacco products.", see [http://www.altria.com/about\\_altria/1\\_2\\_5\\_ussmokelesstobacco.asp](http://www.altria.com/about_altria/1_2_5_ussmokelesstobacco.asp)

*British American Tobacco PLC (UK)*

The company's subsidiaries annually produce 715 billion cigarettes in 49 factories in 41 countries.<sup>4</sup>

*British American Tobacco BHD (Malaysia)*

The company is 50% owned by British American Tobacco PLC and produces cigarettes in Malaysia.<sup>5</sup>

*Gudang Garam TBK PT (Indonesia)*

The company is the largest cigarette producer in Indonesia, with an annual production of 70 billion cigarettes (2001).<sup>6</sup>

*ITC Ltd. (India)*

The company is the largest producer of cigarettes in India.<sup>7</sup>

*Japan Tobacco Inc. (Japan)*

The company manufactures cigarettes in Japan.<sup>8</sup>

*KT&G Corp. (South Korea)*

The company is the largest cigarette producer in South Korea.<sup>9</sup>

*Lorillard Inc. (USA)*

The company is the third largest cigarette producer in the USA.<sup>10</sup>

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<sup>4</sup> "Our subsidiary companies produce some 715 billion cigarettes through 49 cigarette factories in 41 countries. We are the only international tobacco group with a significant interest in tobacco leaf growing, working with thousands of farmers internationally."

See company webpage:

[http://www.bat.com/group/sites/uk\\_3mnfen.nsf/vwPagesWebLive/DO52ADCY?opendocument&SKN=1](http://www.bat.com/group/sites/uk_3mnfen.nsf/vwPagesWebLive/DO52ADCY?opendocument&SKN=1)

<sup>5</sup> Bloomberg: "BAT BHD manufactures, imports and sells cigarettes, pipe tobacco, cigars and luxury consumer products."

<sup>6</sup> "PT Gudang Garam Tbk is one of the leading cigarette producers that secures the largest market share in Indonesia, produced more than 70 billions sticks in the year 2001 and well-known as the high quality kretek cigarette producer."

See company webpage: <http://www.gudanggaramtbk.com/company/index.php?act=profile>

<sup>7</sup> "ITC is the market leader in cigarettes in India. With its wide range of invaluable brands, it has a leadership position in every segment of the market."

ITC's cigarettes are produced in its state-of-the-art factories at Bengaluru, Munger, Saharanpur and Kolkata."

See company webpage: [http://www.itcportal.com/sets/cigarette\\_frameset.htm](http://www.itcportal.com/sets/cigarette_frameset.htm)

<sup>8</sup> "The domestic tobacco business is positioned as the core source of profits for the JT Group Japan Tobacco International (JTI), the international tobacco division of JT, enjoys the fastest organic growth among all global tobacco manufacturers."

See company webpage: [http://www.jt.com/about/division/tobacco\\_japan/index.html](http://www.jt.com/about/division/tobacco_japan/index.html)

<sup>9</sup> "While improving superior product quality and manufacturing capabilities by competing with foreign cigarette manufacturers operating their production bases in Korea, KT&G has dominated domestic market over 70% by developing and releasing new products marked by ceaseless technological innovations. Cigarette business will strengthen its role as Value Base for KT&G by investments focused on R&D, brands and marketing."

See company webpage: <http://www.ktng.com/>

<sup>10</sup> "Lorillard Inc. is the nation's third largest tobacco company. Lorillard Tobacco Company, the company's operating subsidiary, does business in all 50 states, the District of Columbia and Puerto Rico and other outlying U.S. possessions."

See company webpage: <http://www.lorillard.com/index.php?id=33>

*Philip Morris International Inc. (USA)*

The company is one of the world's largest cigarette producers. In 2008, the company held a 15% share of the international cigarette market outside of the USA.<sup>11</sup>

*Philip Morris CR AS (Czech Republic)*

This Czech company is 77% owned by Philip Morris International Inc. The company produces, distributes, markets and sells cigarettes and other tobacco products.

*Reynolds American Inc (USA)*

Reynolds American Inc is the holding company of R.J. Reynolds Tobacco Company, which is the second largest cigarette producer in the USA.<sup>12</sup>

*Souza Cruz SA (Brazil)*

The company produces cigarettes in Brazil.<sup>13</sup>

*Swedish Match AB (Sweden)*

The company produces smoke-free tobacco and other tobacco products at factories in 10 countries.<sup>14</sup>

*Universal Corporation VA (USA)*

This is an American leaf company. The company purchases tobacco in local markets, processes and sells it on to tobacco companies, mostly cigarette producers.<sup>15</sup>

*Vector Group Ltd (USA)*

Through its subsidiaries Liggett Group LLC and Vector Tobacco Inc, the company produces cigarettes in the USA.<sup>16</sup>

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<sup>11</sup> "Philip Morris International (PMI) is the leading international tobacco company, with products sold in approximately 160 countries. In 2008, we held an estimated 15.6% share of the international cigarette market outside of the USA. We own seven of the top 15 brands in the world and have a strong mix of international and local products that seek to appeal to a wide array of adult smokers. We are committed to providing our consumers with the highest-quality tobacco products." See selskapets hjemmeside:

[http://www.philipmorrisinternational.com/PMINTL/pages/eng/ourbus/About\\_us.asp](http://www.philipmorrisinternational.com/PMINTL/pages/eng/ourbus/About_us.asp)

<sup>12</sup> "The second-largest tobacco company in the United States, R.J. Reynolds Tobacco Company makes many of the nation's best selling cigarette brands [...]." See company webpage: <http://www.rjrt.com/aboutus.aspx>

<sup>13</sup> "The unchallenged leader on the Brazilian cigarette market, Souza Cruz is a subsidiary of British American Tobacco, the most international of the tobacco groups, whose brands are sold in 180 countries all over the world. [...] Cruz today works with the entire product cycle, from leaf-growing and processing tobacco through to manufacturing and distributing cigarettes." See company webpage:

[http://www.souzacruz.com.br/oneweb/sites/SOU\\_5SQE9E.nsf/vwllivelookupHomePage/HOME?opendocument](http://www.souzacruz.com.br/oneweb/sites/SOU_5SQE9E.nsf/vwllivelookupHomePage/HOME?opendocument)

<sup>14</sup> "Swedish Match produces and sells market-leading brands in smokefree tobacco products, cigars and lights products. The products are sold across the globe, with production units in 10 countries."

See company webpage: <http://www.swedishmatch.com/>

<sup>15</sup> "Universal's business includes selecting, buying, shipping, processing, packing, storing, and financing of leaf tobacco in tobacco growing countries for sale to, or for the account of, manufacturers of tobacco products throughout the world. Universal does not manufacture cigarettes or other consumer products. The Company's revenues are derived from sales of processed tobacco and from fees and commissions for specific services."

See company webpage: <http://www.universalscorp.com/>

<sup>16</sup> "Through our subsidiaries, Liggett Group LLC and Vector Tobacco Inc., we manufacture and market high quality cigarette products to adult smokers in the United States." See company webpage:

<http://www.vectorgroupltd.com/abtus.asp>

## 5 Recommendation

Based on the above, the Council on Ethics recommends that the companies

**Alliance One International Inc., Altria Group Inc., British American Tobacco BHD, British American Tobacco Plc., Gudang Garam tbk pt., Imperial Tobacco Group Plc., ITC Ltd., Japan Tobacco Inc., KT&G Corp, Lorillard Inc., Philip Morris International Inc., Philip Morris Cr AS., Reynolds American Inc., Souza Cruz SA, Swedish Match AB, Universal Corp VA, and Vector Group Ltd.**

be excluded from the Government Pension Fund Global.

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(sign.)

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