

Raj Thamotheram
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Dear Raj

Re: SRSI and tobacco

Thank you for inviting me to the USS socially responsible and sustainable investment (SRSI) learning review seminar last Monday. We welcome USS's determination to engage with a difficult sector like tobacco. Though we have in-principle support for engagement, I urge great caution and formulation of a careful strategy. To that end, I thought it might be useful to set down some views.

In essence, we recognise two distinct SRSI investment approaches rooted in the perspectives of different stakeholders. First, investment strategies that meet the legitimate ethical preferences of *pension fund members*. These should include screening options. Second, strategies that are useful to a *campaigning organisation or wider society* in promoting change, for which shareholder action and engagement are the main options. At first sight these appear contradictory, but we support *both* approaches and we believe it is possible for USS and other large funds to do both.

Responding to members' ethical preferences - offering options to screen out tobacco

Our starting point is that individuals have a right to apply whatever criteria they deem important to the long-term management of their funds. Where their funds are managed for them, they ought to be offered options that would exclude businesses they simply want to have no part in – that is their prerogative. We accept that starting point and default should be the traditional fiduciary duty, but large funds could be disaggregated and offered with options to opt in to other management strategies that reflect the different values of the members. I understand the Pensions Trust already uses this approach, and I hope that USS will consider this option.

Fiduciary duty, risk and volatility

Only two years ago, British American Tobacco was trading at about one-third

of its value today. It was much easier then than it is today to see the downside of volatility and risk - political, regulatory, litigation, reputation – that beset the tobacco industry. However, there remains a good case for caution about holding tobacco stocks in the long term on purely financial and risk grounds.

Holding tobacco stock and engaging with tobacco companies

An advocacy organisation such as ASH has a different perspective to an individual pension holder. We favour a different investment approach for our purposes, while wishing to respect the ethical preferences of pension fund holders. From our campaigning perspective, if a fund holds no shares in a tobacco company it is completely irrelevant as a promoter of change in the tobacco sector. Funds that practice serious engagement are potentially more valuable to a campaign group pursuing societal objectives than funds that screen out the stock. But how does ‘potentially more valuable’ become *actually* more valuable?

Difficulty finding useful issues for engagement while protecting shareholder value

The difficulty we have with SRSI engagement strategies for tobacco, is finding issues for engagement for which it is possible to align investors’ interests with ours. Your approach to SRSI engagement is built on the idea that this should build shareholder value over the long term – an entirely respectable and plausible approach in many sectors. But from our perspective this represents a serious constraint in identifying issues for which we can find common cause. We are not limited by any concern for the financial welfare of BAT’s shareholders, whereas investors are.

Danger of counterproductive SRSI engagement

Furthermore, it is quite possible for SRSI engagement to make matters worse from our perspective. It would be possible to legitimise measures that appear to be progress, but which are actually defensive initiatives designed to head off public policy measures that the companies really would not like (and would destroy shareholder value while benefiting society). This most obviously applies to the tobacco companies’ marketing codes and their youth smoking prevention initiatives. In its engaging with tobacco companies, investors will need to ensure they do not become advocates for the health equivalent of ‘greenwash’. This may happen through naivety, but we are also concerned that SRSI strategists may be drawn towards such initiatives because of appearances, benefits to the companies and the gaining of SRSI ‘quick wins’, rather than because they are good for society.

Options for SRSI engagement on tobacco

Having raised these caveats, I do, however, still believe there is scope for a

meaningful investor engagement with the tobacco companies in three areas:

1. Smuggling and a managed retreat from the black market – and related corporate governance issues;
2. Product developments that would lead to less harm, including and especially an emphasis on ‘harm reduction’ through smokeless tobacco products;
3. Telling the truth and candour about its products and business *modus operandi*.

ASH does not seek to have tobacco companies diversify out of tobacco and we believe most change will come from the demand side, rather than the supply side. The number of tobacco users in the world is growing and likely to rise from 1.2 billion to 1.8 billion over the next twenty years in a ‘business as usual’ case. We wish to deal with the tobacco phenomenon as it is, and that means recognising that tobacco companies will be with us for the foreseeable future and that the way these companies operate will have an influence on public health outcomes.

Most of what ASH is trying to do will *destroy* shareholder value in most tobacco companies, and we make no apology for that. However, we do not seek confrontation for its own sake. Where we can identify common cause with investors, I am excited by the prospect of working with USS and other investors in meaningful SRSI engagement that helps to meet our overall aims of reducing disease and premature death.

Yours sincerely

Clive Bates
Director