

Nest's approach to tobacco-free portfolios



September 2021

Overview

Nest Corporation has committed to being tobacco-free across our investment portfolios.

To do this, we have requested that all our fund managers cease investing in or financing companies that derive revenue from the production of tobacco (as defined below) within our portfolio. We are also regularly monitoring and reviewing our investment portfolios to ensure compliance with our tobacco-free approach.

With our tobacco-free approach, we aim to:

- › act upon investment research and other evidence on the tobacco sector's financial outlook and so improve members' financial outcomes over the long term
- › recognise and respond to strengthening regulation of this sector in the UK and internationally
- › apply the latest guidance on the role of fiduciaries in the UK¹
- › show responsibility and alignment with our members' likely values and interests, based on our surveys on members' views of responsible investment²

What we mean by tobacco-free

We are applying our tobacco-free approach to investments in shares or bonds issued by companies whose business is involved in the production of tobacco.

We define a tobacco investment as:

- › securities issued by companies that manufacture tobacco products, including subsidiaries and joint ventures
- › companies that derive 10% or more of their revenue from distribution of tobacco, supply of key products for tobacco manufacture or production, or the sale of tobacco

The approach does **not** apply to:

- › the rest of the supply chain, that is, companies that derive revenue from manufacturing or supplying products such as flavourings, filters, roll paper or packaging, or from the sale of tobacco, unless they derive 10% or more of their revenue from tobacco products

¹ Law Commission, Fiduciary duties of investment intermediaries (LAW COM no. 250, 2014), [lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries](https://www.gov.uk/government/projects/fiduciary-duties-of-investment-intermediaries)

² [nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/responsible-investment.html](https://www.nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/responsible-investment.html)

Why we decided to go tobacco-free

Nest has investigated and evaluated the merits of having tobacco-free investment portfolios. We have set out some high-level reasons for developing our approach:

- › Research has identified various issues associated with the manufacture and sale of tobacco which will have the effect of reducing future earnings and increasing the cost of capital for tobacco companies. We believe this increases the chance that shares in these companies will materially and systematically underperform the market over the next 10 to 20 years.
- › We believe the pressure on earnings will negatively impact the credit ratings of tobacco companies, and so will affect the performance of bonds issued by these companies.
- › Tobacco companies face significant commercial challenges from increasing regulation globally and risk of litigation, rising contingent liabilities and commitments, falling consumer demand and changing investor sentiment.
- › The UK government is a signatory to the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), which came into force in 2005 to protect present and future generations from the health, social, environmental and economic consequences of tobacco consumption and exposure. In particular, the treaty reaffirms 'the right of all people to the highest standard of health'³ and sets out the importance of measures to reduce demand for and supply of tobacco in fulfilling this.
- › Tobacco manufacture, use and exposure has large negative externalities which are imposed on societies, governments and businesses. There is a diminishing tolerance for these externalities, and governments around the world are now more stringently addressing them through regulation and other policies. This is likely to have an impact on the valuation of tobacco companies.
- › The tobacco industry has been identified as posing a severe and persistent environmental, social and governance (ESG) risk to the Nest scheme's investments. Due to the controversial nature of the industry, some companies have resorted to activities such as lobbying to reduce regulation on tobacco, bribery and corruption or marketing to children in order to continue to operate in some markets. We believe these activities are value destructive and immoral.
- › Uniquely, voting and engagement cannot be used to generate change in this sector. For many manufacturers and producers, tobacco is mostly a single-line business, and the manufacture of tobacco products cannot be changed to reduce the health risks associated with tobacco use. Therefore, there is no voting or engagement measure that can fully mitigate tobacco-related health risks.
- › However, the rest of the supply chain can more easily transition into other business activities. These companies can be engaged with to cease tobacco-related product output over time.
- › It is recognised that tobacco companies are moving into the production and distribution of electronic cigarettes and other so-called 'harm reduction' products. We do not view these products as sustainable or viable alternatives. E-cigarettes already face regulatory pressure and the WHO has advised countries to 'consider banning or restricting advertising, promotion and sponsorship'⁴ of them, in part because their long-term health effects are not yet properly understood.

How we are taking action

Our tobacco-free approach applies to 100% of Nest's investments including in the [Nest Retirement Date Funds](#) as well as [our other funds](#).

Nest will only use and appoint fund managers who have agreed not to invest our members' money in tobacco and have a clear and effective mechanism for monitoring their alignment with Nest's position.

We do not expect fund managers to have a firm-wide policy of excluding tobacco from their investments. We do however require our fund managers to agree to managing tobacco-free portfolios on our behalf and to remove tobacco from our investment strategy where they have not already done so.

³ www.who.int/fctc/cop/about

⁴ WHO FCTC, Decision: electronic nicotine delivery systems and electronic non-nicotine delivery systems (FCTC/COP6(9), 2014), [apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6\(9\)-en.pdf](https://apps.who.int/gb/fctc/PDF/cop6/FCTC_COP6(9)-en.pdf)

How we will stay tobacco-free

Nest's investment team will review the implementation of our tobacco-free approach annually and report these findings to the investment committee. This review will consider the investment case and outlook for tobacco as well as the suitability, adequacy and effectiveness of our implementation approach and ensure that we are complying with the objectives and thresholds we have set out.

We will monitor how our fund managers are implementing their own approach to screening companies. We have asked that they review the list of companies regularly and update us at least annually on their screening. We may share information across our fund managers in order to promote a closer alignment of approaches and to discuss any possible changes.

How we will choose funds

Our tobacco-free approach will also be applied in the procurement of new investment mandates and selection of new fund managers.

Going forward, where we do not choose to use a segregated account for our investments in an asset class, we will require potential new fund managers to provide a policy on tobacco exclusion. If they have no firm-wide policy in place, they will have to agree to exclude tobacco from any investment strategy that they would run on our behalf. If the manager is selected, this agreement will be written into the contract.

Where we choose to use a segregated account, we will instruct our fund managers to remove or exclude investments in tobacco in accordance with our tobacco-free approach under the terms of our investment management agreement with them.

Communicating our approach

Our tobacco-free approach is part of Nest's ongoing commitment to deliver the best possible financial outcomes for our scheme members over the long term.

Our commitment involves clearly and transparently communicating our strategies for achieving this to our members. This includes sharing this approach on our website.

We have also disclosed the names of the companies that have been removed from our investment universe on our website⁵.

As part of our commitment to the Tobacco-Free Finance Pledge⁶, we will raise awareness of our tobacco-free approach and engage with other pension funds looking to follow suit.

⁵ nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/responsible-investment/tobacco-divestment.html

⁶ unepfi.org/psi/tobacco-free-finance-pledge

Version Control

Version	Change	Date implemented
1	Document created	26 August 2020
2	Updated 'What we mean by tobacco free' section to reflect a more targeted approach in ensuring that only tobacco manufacturers and producers are in scope	10 September 2021

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