

RBC Vision Funds and cannabis

RBC Global Asset Management (RBC GAM) offers a number of different investment solutions for clients interested in socially responsible investing (SRI). Although all of RBC GAM's investment teams integrate environmental, social and governance (ESG) factors as part of their decision-making process, clients looking specifically for SRI-screened solutions can use RBC Vision Funds to meet their financial and values-based investment goals.

RBC GAM has been offering SRI funds for over 15 years and, last year, rebranded these funds under the RBC Vision Funds label. RBC Vision Funds fall into two categories: thematic funds (e.g., using a single exclusionary screen to minimize exposure to companies involved in fossil fuels) and broad-based, SRI-screened funds (e.g., using multiple screens to minimize exposure to more than one factor). The broad-based RBC Vision Funds use two methods to align portfolios with SRI principles: exclusionary screens and qualitative screens. Qualitative screening considers ESG practices in areas such as the environment, treatment of employees, product safety and corporate governance, and excludes companies that perform poorly in these areas. Exclusionary screens have historically excluded the following controversial sectors: alcohol, tobacco, weapons, gambling and adult entertainment.

Screens applied in RBC Vision Funds evolve over time and, recently, clients have been asking if and how RBC GAM plans to address the pending legalization of recreational cannabis in Canada in RBC Vision Funds.

Bill C-45

RBC GAM is committed to staying on top of trends and regulatory changes that shape the investment industry to best serve investors. One such change on the horizon is the imminent legalization of cannabis in Canada. Cannabis is currently classified as a Schedule II drug under the Controlled Drug and Substances Act; thus, possessing and selling cannabis for non-medical purposes is illegal

in Canada.¹ Bill C-45 was first introduced in April 2017 and proposed legal access to recreational cannabis in Canada.² On June 19, 2018, the Canadian Senate voted to pass Bill C-45, setting in motion the legal process of allowing Canadians aged 18 and above to possess, share, purchase and grow specific amounts of cannabis.³ Recreational cannabis will be legal in Canada starting October 17, 2018,⁴ and the provinces and territories are preparing regulations for retail sales.

Since its election in 2015, the current federal government has been clear in its intention to legalize recreational cannabis; therefore, investors have been expecting this to occur for some time now. Consequently, the cannabis industry has attracted significant capital. Investor interest has grown, demonstrated by the number of initial public offerings by cannabis companies and the growth of the Canadian Marijuana Index (trading stocks operating in the legal cannabis industry), which currently has a market capitalization of over \$27 billion⁵, up from approximately \$11 billion at the end of November 2017.⁶

RBC GAM's approach to cannabis and responsible investment

Responsible investors are faced with a decision about how to best treat cannabis companies in their portfolios. There is ongoing debate about the health effects (both negative and positive) of cannabis as well as whether the industry's net impact on society warrants its inclusion in the same category as alcohol or tobacco. The Government of Canada compares the Cannabis Act with the Tobacco Act as both cannabis and tobacco are considered public health issues, which both acts are meant to address. As with alcohol and tobacco, youth will have restricted access and there will be public education surrounding the health risks of cannabis use. Effectively, cannabis will face substantially the same regulatory regime as alcohol and tobacco. Guided by this regulatory approach, RBC GAM has decided to treat cannabis companies the same way it currently treats alcohol and tobacco issuers in RBC Vision Funds.

¹ <http://www.justice.gc.ca/eng/cj-jp/marijuana/law-loi.html>

² <http://www.parl.ca/LegisInfo/BillDetails.aspx?billId=8886269>

³ <https://www.canada.ca/en/services/health/campaigns/legalizing-strictly-regulating-cannabis-facts.html>

⁴ www.justice.gc.ca/eng/cj-jp/cannabis/

⁵ <http://marijuanaindex.com/stock-quotes/canadian-marijuana-index/>

⁶ https://www.investmentexecutive.com/inside-track_dustyn-lanz/responsible-investors-have-burning-questions-about-cannabis/

As such, an exclusionary cannabis screen will be applied to RBC Vision Funds that currently employ broad-based (i.e., not thematic) SRI exclusionary screens. This will include RBC Vision Bond Fund, RBC Vision Balanced Fund, RBC Vision Canadian Equity Fund and RBC Vision Global Equity Fund.

As with other exclusionary screens, RBC GAM applies the screen by looking at the percentage of revenue derived from the sale of the excluded good or service. Any company that derives more than 5% of its total revenue from direct involvement (i.e., growing and/or producing cannabis) or more than 10% of its total revenue from indirect involvement (i.e., selling cannabis or cannabis-related products, producing cannabis-related products or supplying specialized services or equipment to the cannabis industry) will be excluded for investment. This exclusionary screen, based on revenue thresholds, is applied in the same manner as RBC Vision Funds' alcohol and tobacco screens.

The treatment of recreational vs. medical cannabis

Unlike alcohol and tobacco, though, cannabis does have legitimate medical applications. This raises the question of whether medical cannabis-related revenue should be included in revenue threshold calculations. At this time, prior to legalization, all cannabis revenues are technically considered medical, but with legalization pending, revenue mixes are likely to shift. Overall, the industry is new, official legalization is still pending and it is difficult to determine if an exemption for medical cannabis is practical and warranted. There is uncertainty around the quality of data that will be available

and if a distinction can be made between revenue derived from recreational cannabis and revenue derived from medical cannabis. At the moment, a likely proportion of cannabis sales that are nominally medical are in reality recreational. A significant proportion of these sales would likely move to the legal recreational industry as it is established post-legalization.

As such, at this point, it seems prudent to wait and see how the industry develops, how contentious issues related to cannabis sales play out, how final legislation is implemented across provinces and territories as well as what kind of reporting and data will be provided by market participants. In the near future, it may be possible to definitively be able to distinguish between recreational and medical cannabis in terms of their eligibility for RBC Vision Funds, but given the current landscape RBC GAM will take a conservative approach and consider all cannabis-related revenue (recreational and medical) when calculating revenue thresholds for RBC Vision Funds. However, in the long term, RBC GAM intends not to include medical cannabis revenue in the calculation of RBC Vision Funds exclusion. RBC GAM will revisit the issue in a year's time to see if the quality of the data has improved to the point at which RBC GAM is comfortable excluding medical cannabis revenue from the calculation of the screen.

RBC GAM is committed to offering investment solutions that meet the needs of clients within an ever-evolving investment landscape and monitoring key ESG concerns is an important part of this commitment.

For more information on ESG factors in RBC Vision Funds and their investment principles, please visit www.rbcgam.com (Investment Solutions > Mutual Funds > Corporate Governance & Responsible Investing).

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