

Addressing toxics in consumer products: A closer look at investor risks from toxic chemicals in the supply chain.

In the wake of high-profile toy and pet food recalls and growing public concern about toxics in consumer products, investors are advised to assess corporations' exposure to chemicals-related risks. A new wave of media reports and regulatory initiatives suggests that companies using toxic chemicals in products may be exposed to considerable regulatory, litigation, market exclusion and/or reputational risks. Conversely, demand for "safer products" is likely to increase as consumers become more aware of the environmental and health hazards that certain chemicals in products present, creating new opportunities for companies that take a proactive approach to chemical-related risks.

Regulatory and market exclusion risks

In Canada, toxic chemicals fall under the Canadian Environmental Protection Act, which contains a [list of toxic substances](#) that may be subjected to various preventive or control actions, including "virtual elimination" of persistent and bioaccumulative substances (respectively, substances that persist in the environment for long periods of time, or which concentrate in the tissues of living organisms, with concentration being amplified up the food chain).

Like in other developed countries, however, regulations in Canada were adopted when most of the chemicals in use today were already on the market. Existing chemicals were exempted from environmental and health testing requirements, leaving a major information gap on their environmental and health effects. To address this gap, many countries have taken steps to assess existing chemicals to determine risks and possible management strategies. The European Union's 2006 [Regulation on the Registration, Evaluation and Authorization of Chemicals \(REACH\)](#), for instance, requires chemicals manufacturers and importers to provide environmental and health data on thousands of existing chemicals by specified dates. REACH is expected to lead to bans on many chemicals, including substances used in consumer products.

In 2006, the Canadian government completed a review of 23,000 existing chemicals in order to prioritize substances for assessment and possible management options, including virtual elimination. About 4,000 potentially harmful chemicals were identified as requiring further study. Of these, some 200 were singled out as a "high priority," and a few have been targeted for regulation. In August 2008, for instance, the federal government announced its intention to ban the import and sale of polycarbonate baby bottles containing bisphenol-A, a "high priority" chemical associated with reproductive disorders. Similarly, in February 2008 Health Canada disclosed its plans to ban certain phthalates (a group of chemicals linked to reproductive disorders) in children's products. Phthalates are used to make plastics such as polyvinyl chloride (PVC) softer and more durable, and both the EU and the U.S. have adopted regulations banning the use of specified phthalates in children's products. Phthalates are also used as solvents in cosmetics and personal care products such as nail polish, hair sprays, deodorants and perfumes, and two are banned in cosmetics in the EU. Most recently, Canada announced its plan to restrict the use, import and sale of electronics containing DecaBDE, a toxic flame retardant.

In addition to excluding certain products from the marketplace, new proposed regulations would require companies in Canada to publicly disclose the chemicals they use or release, which would increase public awareness of chemicals-related risks. In June 2009, a [new bill](#) was passed in the Ontario legislature to require certain facilities using or releasing specified “substances of concern” to report on their use and release of those substances, and to adopt reduction plans.

Reputational risks

As exemplified by the toy industry, the use of toxic chemicals in products can present significant reputational risks to companies. Throughout 2007, 26 million toys were recalled by companies in the U.S. (up from 5 million in 2006) due to safety concerns. Such concerns were associated with the use of small loose parts, or the presence of lead and other toxic chemicals. The recalls caused alarm among parents and consumers and negatively affected toy sales in North America.

Following the recalls, major toy companies and retailers, including Toys “R” Us, Wal-mart and Mattel Inc., tightened their product safety requirements in efforts to restore consumer confidence. Despite its rapid response to the crisis, Mattel has faced significant problems as a result of the 2007 recalls, including considerable costs, lawsuits and a hit to its reputation. The recalls also affected Mattel’s share price, which underperformed the sector by approximately 35% in the second half of 2007, and suffered a 25% derating relative to peers (Henderson Global Investors/Goldman Sachs International, February 2009).

Investor responses

In response to growing public concern about toxics in consumer products, some investors in the U.S. have started to recognize the risks that toxic chemicals policies present to shareholder value. In 2008, shareholders filed 21 resolutions regarding toxic product risks, compared to three such resolutions in 2004. The 2008 resolutions addressed numerous chemicals and products of concern, including PVC in packaging and products such as toys and shower curtains, phthalates in toys, cosmetics and consumer care products, perfluorooctanoic acid (PFOA) in non-stick cookware and other products, and brominated flame retardants.

While investors in Canada have yet to engage with companies on toxic product risks, new regulations and increased public concern about toxics in consumer products indicate that Canadian companies may be facing considerable risks from toxic chemicals in products. As new information on the environmental and health effects of chemicals of concern (e.g., “high priority” chemicals under Canada’s chemical management plan) becomes available, the risks associated with new regulations, market exclusion, reputation and litigation are likely to increase for companies with chemicals issues in their supply chain.

Shareholders would be wise to start assessing company exposures to chemical safety-related risks, and to request relevant companies to develop appropriate chemicals-related policies and practices. Requests could include asking for information on the use of toxic chemicals in manufacturing processes, company systems to gather data from suppliers on potentially toxic chemicals in products, and toxicity reduction/substitution policies to ensure continued market access of company products.

Further readings:

Henderson Global Investors and Goldman Sachs International, *Chemical Safety in Consumer Product Industries*, SRI Briefing Paper (February 2009)

http://www.henderson.com/content/sri/publications/reports/productchemicalsafety_report.pdf

The Investor Environmental Health Network (IEHN), *Fiduciary Guide to Toxic Chemical Risk* (March 2007)

<http://www.iehn.org/filesalt/Fiduciary.pdf>

IEHN, *Beneath the Skin: Hidden Liabilities, Market Risk and Drivers of Change in the Cosmetics and Personal Care Products Industry* (February 2007) <http://www.iehn.org/filesalt/IEHNCosmeticsReportFin.pdf>