

# Response to Company Feedback

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# Introduction

## Background

The Tobacco Transformation Index (the “Index”) is a tool to accelerate the transformation of the global tobacco industry and the reduction of harm caused by tobacco use. Specifically, the Index monitors tobacco companies’ activities with respect to:

1. Phasing out high-risk tobacco products;
2. Developing and responsibly offering reduced-risk alternatives to support current users to move away from high-risk products;
3. Preventing access and marketing of such alternatives to all non-smokers and non-users of high-risk products, especially youth;
4. Ensuring consistency of tobacco harm reduction activities across all markets of operation.

The Index will biennially rank the world’s 15 largest tobacco companies, which account for approximately 90% of global tobacco products volume sales, on their relative progress towards industry transformation. This ranking and supporting analyses aim to stimulate innovation and competition among companies, and to equip all stakeholders with valuable information for understanding and engaging with them to drive change.

The Index will be supplemented by country fact sheets profiling relevant regulation and related conditions in 36 markets, which account for approximately 85% of current global sales and consumption of tobacco products. The objective of the country fact sheets is to contextualize global company behavior within local market conditions, and in future iterations to analyze specific company activities in each market.

## Industry Consultation

Development of the Index began with extensive engagement with non-industry stakeholders. This was to ensure that these stakeholders could express their views openly and free from any concern about industry bias or influence. However, through a subsequent process, and in accordance with best practice demonstrated by other index initiatives, we approached the companies to inform them about the Index program, hear their feedback on proposed indicators, and invite them to share data to be evaluated by the Index.

An extensive list of contacts was assembled for each company by reviewing company websites and leveraging networks in the tobacco industry. Following the introductory email from the Foundation for a Smoke-Free World, Euromonitor International reached out to companies via an Index-specific email address ([tobaccotransformationindex@euromonitor.com](mailto:tobaccotransformationindex@euromonitor.com)). Each company received an introductory email and Preliminary Methodology (November 11), multiple follow-up emails (January 10, January 24), and phone calls to confirm addresses and receipt of the messages (January 27 – February 7). For companies located in non-English speaking countries,

Euromonitor International leveraged its network of in country researchers working on the project to reach out to companies via phone.

An additional consultancy was engaged to contact CNTC; however due to the evolving COVID-19 situation in China they were unable to fulfill their role. As such, Euromonitor International took over consultation with CNTC and only contacted the company in April 2020.

Half of the companies contacted replied to the invitation to engage on the Tobacco Transformation Index. Four companies have shared feedback on Index design, three of whom accepted further engagement via conference call. Each company had a separate call with the Index team to discuss the schedule for consultation; feedback on categories, subcategories, and indicators; and any specific questions about the Index program. All conference calls resulted in an open and productive discussion; companies shared inputs beyond the initial feedback and noted the collaborative and constructive spirit of the consultation. The company feedback process was facilitated by Euromonitor International on an individual basis, allowing for no interaction among companies. Given the strict principles of transparency and accountability, the Index team has communicated to tobacco companies that the timing, nature, and content of interactions with companies will be publicly disclosed. Consultation summaries were shared with participating companies after the conference calls and have been included in the Industry Consultation Summary.

Some of the companies that decided not to participate did relay some support for the cause of the Index while others shared concerns around the current vision and objective of the Index. Euromonitor International has offered to share subsequent material and requested opportunities to discuss in more detail, via conference call, to encourage future participation.

All companies whether participating or not will continue to receive follow-up emails and updated material such as the Preliminary Index Methodology, unless they have expressly asked to be excluded from this process.

## **Response to Industry Feedback**

This document consolidates and responds to written questions and comments the Index team received from companies. Company questions and comments are grouped by topic. The consolidated response covers several areas of interest, including product classification, Index design, and methodology. In the spirit of transparency that has guided all stakeholder engagements concerning the Index, this document was shared with all companies that provided feedback and is accessible to all stakeholders via the Index website.

Questions and comments are not attributed to any single company and could represent combined commentary from potentially several companies. While certain companies have voluntarily and independently provided feedback regarding the Index, this is not indicative of actual or intended coordination. The Index development process includes safeguards to ensure that data is not shared between competitors.

## Feedback on Product Classification

### Company Feedback/Question

Companies inquired about the extent to which available research and existing consensus was utilized to determine product classifications.

- The classification of open vaping systems, closed vaping systems, heated tobacco products (HTPs) and snus as reduced-risk products was discussed, with the argument that it could lead to misrepresentation. Feedback quoted as supporting evidence the WHO's conclusion that, "Currently, there is no evidence to demonstrate that HTPs are less harmful than conventional tobacco products."
- Companies also mentioned that several countries had imposed bans on reduced-risk products. It was highlighted that an underlying factor supporting e-cigarette bans is the uptake of electronic products by youth.
- Concern was raised that the language and focus of the Index was centered on cigarettes, and it failed to capture a wide range of high-risk tobacco products such as bidi, cheroot, cigar, chuttah, hookah, pipe, chillum, hookli, dhumti, illicit cigarettes, gutkha, chewing tobacco, betel-quid, khaini, zarda, snuff, dokta, quimam, mishri, mawa, and pan masala.
- Additional feedback highlighted that there is considerable epidemiological analysis from the US illustrating that the use of moist snuff is less risky than cigarette smoking, but no epidemiological analysis of products that have been introduced in recent years, including vaping and heated tobacco products. As such, it was argued that moist snuff should be regarded as a reduced-risk product.

**Response.** The Index references Abrams et al, "Harm Minimization and Tobacco Control: Reframing Societal Views of Nicotine Use to Rapidly Save Lives," as an important source of scientific research used to identify a framework across the spectrum of high-risk and reduced-risk products (see Figure 1.).

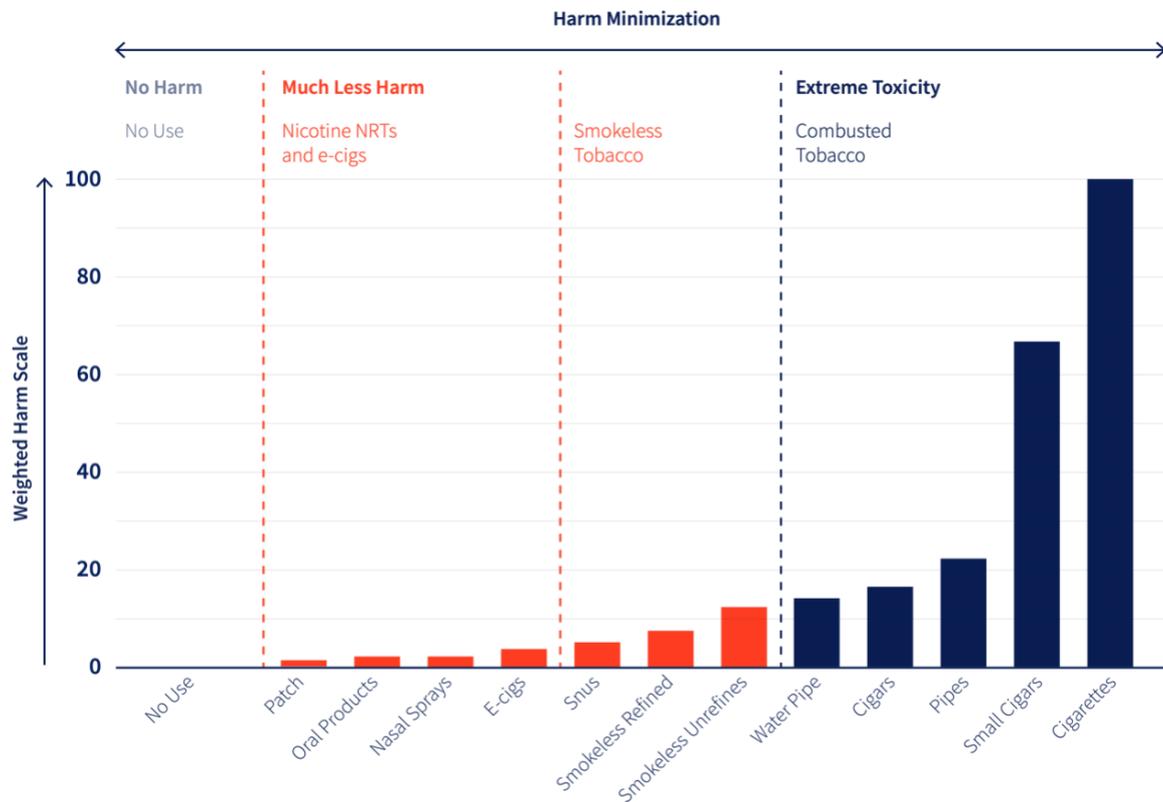
During the consultation process, stakeholders accepted Abrams et al as a useful framework; however, many suggested that, while the framework is representative in principle, the availability of even newer products and information means this picture was likely to be incomplete, or that the order of some of the products on the continuum could be rearranged slightly over time.

Given the feedback, the Index team has commissioned an independent literature review of the scientific research pertaining to the relative level of risk of tobacco product categories. The Index team acknowledges that a clearer reference to the underlying evidence related to reduced-risk products will enhance the Index's value and justify the boundaries between different levels of product risk. The body of scientific research in this area will develop over time and can be expected to inform future iterations of the Index.

Cigarettes are overwhelmingly the largest category within high-risk products, accounting for approximately 95% of volume sales globally. The categorization of high-risk and reduced-risk products

used by the Index is informed by the harm minimization continuum and can be found in the product definitions. Moist snuff is categorized as a reduced-risk product. The Index team will continue to revisit this categorization as more research becomes available.

**Figure 1 Products Along the Harm Minimization Continuum**



**Source:** Abrams DB, Glasser AM, Pearson JL, Villanti AC, Collins LK, Niaura RS. (2018). Harm Minimization and Tobacco Control: Reframing Societal Views of Nicotine Use to Rapidly Save Lives. *Annual Review of Public Health*. 2018 Apr 1;39:193-213.

Concerns over youth uptake have also been at the forefront of the public debate around reduced-risk products, and a key legislative focus. The Index acknowledges the importance of robust measures to prevent youth access to both high- and reduced-risk tobacco products, and it endeavors to measure company behavior in this regard. The Index holds that companies, while supporting current users in transitioning away from high-risk tobacco products, must mitigate potential unintended consequences of new alternatives, with a focus on avoiding non-smoker adoption and underage use, and an emphasis on clear health-risk communication and non-misleading advertising.

#### Company Feedback/Question

Company feedback on the product classification focused on the differentiation between US and European chewing tobacco and Asian style chewing tobacco. It was argued that US and European chewing tobacco should be classified as reduced-risk. It was also argued that the classification of

vaping products into “open systems” and “closed systems” is better than the classification into cartridges, e-liquids and single-use cig-a-like products.

**Response.** The Index team recognizes the difference in risk between US/European and Asian style chewing tobacco. This difference will be encompassed by the literature review to inform an appropriate level of risk classification. Gutkha, which is made in India and widely used throughout Asia, is classified as a high-risk product (product definitions can be found in the Preliminary Index Methodology).

Vaping products are currently classified as cartridges, e-liquids and single-use cig-a-like, rather than open systems and closed systems. Sales of devices will not be considered in the analysis of volume sales transition from high-risk to reduced-risk products.

## Feedback on Index Methodology

### Company Feedback/Question

Companies sought clarification on whether the same weighting criteria would apply to all companies and how it would account for companies already focused on reduced-risk products. It was also highlighted that the review process would have been easier if a preliminary view of weighting had been provided.

**Response.** Each technical category, subcategory and indicator is assigned a relative weight which represents its significance with regard to industry transformation. Each indicator has metrics against which the company's performance will be scored on a relative basis, depending on the performance and practices of the 15 tobacco companies. Details on the metrics for each indicator will be presented in the Methodology Report published in conjunction with release of the Index. Success in phasing out high-risk products and responsibly offering reduced-risk alternatives will be recognized.

The initial weightings are now available in the Preliminary Index Methodology document. We expect to receive additional feedback from stakeholders and companies.

### Company Feedback/Question

It was suggested that Scandinavian countries should have been included in the scope of the Index given the success in transitioning smokers to reduced-risk products, notably snus.

**Response.** Countries have been identified considering three criteria:

- Largest countries by cigarette volume sales
- Largest countries by smoking population
- Representation of different world regions and low-medium income countries

While Scandinavian countries represent an interesting and important case study regarding tobacco industry transformation, current resources limit the selection to 36 countries identified according to the criteria described above. Future iterations of the Index may consider expanding the geographic scope to include more countries.

### Company Feedback/Question

It was argued that different attitudes and regulations in different countries would impact company activity, and therefore that scoring could be positively or negatively influenced by a given

company's geographic footprint. This is particularly relevant in markets where certain reduced-risk products are banned, such as India and Australia. It was also asked whether the Index would consider a company's migration to other industries as part of industry transformation.

**Response.** The Index team recognizes that the context in which companies operate varies significantly from country to country, and this affects individual companies' strategies, performance, and ultimate pathways to industry transformation. For this reason, the complementary country fact sheets will provide the local context in which the companies operate. This will include relevant regulation, the prevalence and influence of the tobacco industry, and the state of smoking and public health in each country. These fact sheets will enable stakeholders to contextualize each company's score.

It is also envisioned that, in future iterations, the Index will provide a ranking of the companies at the country level, in order to support full cross-comparability in terms of regulations and the state of smoking and public health.

The Index seeks transformation not only of individual tobacco companies but of the entire tobacco industry. It is therefore focused on how companies are (or are not) investing and managing to help bring this about. Therefore, the Index will not consider companies' interests in sectors other than tobacco.

#### **Company Feedback/Question**

Companies suggested that the notion of low-middle income countries (LMICs) and high-income countries (HICs) is difficult to establish and recognize. A recommendation was made to use OECD and non-OECD countries as the tiers to better map revenues.

**Response.** During the global consultation process, stakeholders strongly endorsed the Index's intention to differentiate between company behavior in low-middle income versus high-income countries. The Index has adopted World Bank definitions, as they are focused on consumer income, which affects purchasing choice between reduced-risk and high-risk products. In particular, the World Bank currently divides economies into four income groupings: low, lower-middle, upper-middle, and high. For the scope of the Index, two main income groups have been identified: LMIC (low-middle income country), which corresponds to low- and low-middle income groups as per the World Bank definitions: GNI per capita of USD12,375 or less; and HIC (high income country), which corresponds to upper-middle and high-income groups as per World Bank definitions: Gross National Income (GNI) per capita of USD12,376 or more.

## Feedback on Preliminary Index Design

Company feedback and corresponding responses from the Index team are organized by categories of measurement of the Index.

### Strategy and Management

#### Company Feedback/Question

Companies asked how exchange rate fluctuations would be incorporated, as many of the 15 tobacco companies sell products in countries other than their reporting currency.

**Response.** The Index will determine and use a single 2019 exchange rate to convert currency values for each year in US dollars. Differences in sales across countries and years therefore do not reflect currency fluctuations. Data requested will be in local currency, as the Index team will be centrally responsible for the conversion. Alternatively, if the company has converted sales using the reporting currency, they will be asked to supply the relevant conversion rates.

### Product Sales

#### Company Feedback/Question

Companies noted that different products under review come in different forms and concentrations, and thus that a common measurement criterion would have to be established to cross compare categories.

**Response.** In order to consider comparable volume sales figures, the Index team has developed an appropriate conversion rate for all the product categories under scope: a per cigarette stick equivalent. Detailed information on the process, considerations and proposed ratios for all product categories will be available alongside the Methodology Report published in conjunction with the final Index report.

#### Company Feedback/Question

Companies queried whether tracking product sales in the latest financial year for one indicator and capturing them in the last three years in another would analyze the same thing and therefore be repetitive.

**Response.** Including indicators capturing static 2019 data and evolution over the last three financial years will allow the Index to score both the static indicator as well as the company's rate of change. By scoring both indicators, the Index will address both the state of play in 2019 as well as the pace at which

companies are contributing to industry transformation. Success in phasing out high-risk products and responsibly offering reduced-risk alternatives is therefore based both on 2019 performance and the pace of transformation leading up to that performance.

#### **Company Feedback/Question**

Companies noted that only net revenues should be considered, with all taxes and duty removed. Furthermore, revenues should not incorporate sales of products not related to the tobacco industry. The importance of comparability was highlighted and, as such, it was recommended that reported sales be viewed through international accounting standards, such as US-GAAP.

**Response.** Only net value sales of high-risk and reduced-risk tobacco products will be considered. Net value sales refer to gross sales minus applicable sales returns, allowances, and discounts. Gross sales do not include cost of goods sold, operating expenses, excise tax expenses or other charges. Devices for consumption of e-liquids and heated tobacco will be part of the comprehensive analysis of companies but not considered in the Product Sales category score, in order to allow comparison of consumption volumes between high-risk and reduced-risk products. Other non-tobacco/nicotine product revenues are outside of the scope of the Index.

The Index team will clarify financial measures when requesting data from the companies but acknowledges that companies might use different accounting standards. Hence, net value sales figures will be collected in accordance with the accountancy practices of the jurisdiction in which the company is registered. Please also note that data shared directly by tobacco companies are only one aspect of a multi-faceted methodology that includes primary and secondary research, which will ensure that a robust process of checks and balances is adhered to, and a well-rounded and comparable analysis is delivered.

#### **Company Feedback/Question**

Companies suggested that volume sales indicators should be phrased as a “share of total nicotine volume sales” (not “share of total tobacco volume sales”) as current wording favors companies which are active in heated tobacco products and potentially discounts the efforts of those involved in vapor products and other non-tobacco RRP.

**Response.** The Index considers both tobacco and non-tobacco reduced-risk products. The language of the indicators has been revised and this is reflected in the Preliminary Index Methodology. For example, the indicator highlighted in the question above has been updated to ratio of volume sales of reduced-risk alternatives to those of high-risk tobacco products.

### Company Feedback/Question

Companies suggested that value sales should be removed, with a sole focus on volume, the rationale being that revenue is not relevant as it is dictated by the value of a brand, and a company will gain higher revenue from high-value brands. Further, a company with high-value brands could gain higher revenue from fewer sales than a company selling more of a lower value brand.

**Response.** Volume sales of high-risk products are the result of a company's commitment and actions towards industry transformation and its contribution to phasing out high-risk tobacco products. Therefore, it is recognized that volume sales have a higher importance compared to value sales, which are influenced by other aspects, such as pricing and the effects of taxation. This will be reflected in the indicator weighting. However, value sales indicate the reliance of a company on sales of high-risk products, which is useful context to understand its efforts towards industry transformation. The Index believes that companies that are less reliant on high-risk product revenues demonstrate greater progress toward transformation and, in turn, the capacity to make a greater impact on overall harm reduction.

### Company Feedback/Question

Companies highlighted that the Index does not consider the reasons for decline in high-risk product sales – i.e., whether this decline is driven by the tobacco manufacturer themselves or is simply the result of market forces.

**Response.** The Index recognizes that all companies that will be ranked do not have the same scope of market coverage and is, therefore, developing the country fact sheets to offer market context for individual markets and the companies active within them. While this context will not be incorporated into the scoring criteria, it will enable stakeholders to understand the forces contributing to a decline in high-risk product sales. The Index team recognizes the limitations of this approach and it is envisioned that future iterations of the Index will provide a ranking of the companies at country level, which will better mitigate this issue.

## Product Strategy

### Company Feedback/Question

The value of tracking the number of reduced-risk product categories was questioned, as it is likely to vary widely across the countries being studied due to regulations and to public health attitudes both to smoking and to tobacco harm reduction. An alternative indicator was suggested focused on “corporate intent,” as captured by the number of innovations brought to market. For example, a company which had placed a first-generation cig-a-like product on the market and not innovated further is likely to have less corporate intent with respect to tobacco harm reduction than one that has a demonstrable track record of innovation.

**Response.** The Index measures the number of reduced-risk product categories relative to the number of high-risk product categories as a mechanism to evaluate efforts to shift consumers away from high-risk tobacco products and responsibly offer reduced-risk alternatives to current smokers and high-risk tobacco users. A presence across a wider range of reduced-risk categories could indicate the intention to offer current smokers the breadth of choice when supporting them to transition away from high-risk products. Whether a company is a first mover or follower is not necessarily indicative of greater commitment, but rather company strategy. Companies that drive product innovation are also likely to have higher R&D and capital expenditure on reduced-risk products. This aspect will be captured in the Capital Allocation category.

#### **Company Feedback/Question**

- Concerns over competition law infringements led to some suggesting that pricing analysis be removed.
- It was suggested that using value sales and volume sales data shared by a company would allow the Index team to calculate an average price, thus not requiring company input on price.
- Specific questions were raised as to whether list price, maximum price or retail selling price including average discount were to be used.
- It was highlighted that the relative pricing of high-risk versus reduced-risk products does not consider the difference in cost structures of the category and does not include any consideration for markets with high levels of illicit trade, where there is unfair pricing competition for cigarettes.
- It was also stated that pricing movements will be dictated significantly by excise increases, given the low excise incidence of the reduced-risk products versus cigarettes.

**Response.** The Index team believes that accessibility and affordability of reduced-risk alternatives is key to transitioning existing tobacco consumers away from high-risk products. This has been highlighted across several stakeholder engagement sessions. As such, the price of a reduced-risk alternative should not necessarily create a barrier to transition. The Index team will be using a range of data inputs for the pricing indicators, including in-country data collected during store audits, average price derived from value and volume sales by category, and data shared by companies. This will ensure a robust triangulation of data to support a more accurate view of pricing.

Regarding the anti-trust/competition law concerns, the Index will not request or in any way attempt to assess future pricing strategies. Rather, it focuses solely on the lowest priced products by category in the period 2017-2019.

### **Company Feedback/Question**

“It is important to note that revenue recognition standards in certain jurisdictions require that certain ‘marketing-related costs’ be classified as a reduction to sales. In that regard, the classification of true marketing efforts may not be captured by this metric. In general, there is no obvious difference from a CSR perspective between ‘spending’ on an everyday low price or discounts. Also, certain marketing costs are incurred for regulatory purposes (e.g., changes to packaging and labeling). Should these costs be included in the marketing costs for purposes of this metric?”

It was noted that marketing costs will depend on the specific geographical footprint of each company and does not necessarily indicate whether a company is transforming or not. It was suggested that it is important to capture how much a company spends on marketing of reduced-risk products.

**Response.** The Index team acknowledges that capturing marketing spend effectively is a complicated process and depends on the manner in which companies report and share data. During the data request process, the Index team will specify the types of marketing expenses under scope and request the highest level of detail and clarification from participating companies. This insight will then enable the research team to identify if and how marketing costs can be measured to support or hinder industry transformation. In the case that the Index relies on publicly available data for marketing spend, there will be a clear indication of what is included in these costs for each company. The Index will also include analysis of marketing codes and evidence of reported fines and violations.

The objective of the indicators focusing on marketing costs is to identify whether a company continues to encourage consumption of its high-risk product portfolio by investing in marketing and promoting these products. In order to capture how companies have reallocated resources to reduced-risk products a new indicator – Ratio of marketing spend (including discounting) on reduced-risk alternatives to high-risk tobacco products – has been added. This indicator measures company investment in marketing reduced-risk alternatives to support current users to move away from high-risk products.

### **Company Feedback/Question**

Clarity was requested on whether within the product strategy category companies would be required to share information about each of their brands and SKUs.

**Response.** The Index is only looking to ascertain how many product categories a company is active in rather than collecting brand and SKU level data for each product category. A greater level of detail on what “product” and “brand” refer to will be provided alongside the official request for data, and the Index team will be available to answer questions and provide clarifications to this end throughout the data collection process.

## Capital Allocation

### Company Feedback/Question

Companies argued that a more effective analysis of the impact of capital allocation on tobacco industry transformation would be a comparison of the investment in high-risk versus reduced-risk products. It was also mentioned that “a simple measure of spend, headcount, and new product development could be supplemented with R&D output related to demonstrating an intent to determine the reduced-risk potential of each of the reduced-risk product categories, which could include peer-reviewed scientific publications and presentations at scientific conferences.”

It was also noted that an organic/pro forma view should be considered for company data within the capital allocation category.

**Response.** The indicators for Capital Allocation were revised so that comparable expenditure on reduced-risk products is evaluated. Ratios have been introduced that capture spend on high-risk versus reduced-risk products for both R&D and capital expenditure. These indicators measure company performance in structurally shifting from high-risk to reduced-risk products. The Index team recognizes that R&D output, such as the publication of scientific research in peer reviewed publications, could offer an additional view on R&D that is not solely cost-focused and, as such, will be considered for future iterations of the Index. The Index will use pro forma results depending on the reporting structure of the companies under review.

## Supply Chain Transition

### Company Feedback/Question

An additional indicator was suggested that would assess the commitment and progress of a company in identifying alternative uses for tobacco. For tobacco farmers in many parts of the world there is not another crop that will bring in the same levels of revenue and, therefore, livelihoods that tobacco does.

It was suggested that rather than focusing solely on reducing farmers’ dependence on tobacco, the Index should also assess efforts to identify high-revenue alternative uses and associated markets for tobacco.

**Response.** Indicators for Supply Chain Transformation evaluate a company’s commitment to ensuring that members of the tobacco supply chain are not left behind as the company undergoes transformation away from high-risk tobacco products, and any programs it has implemented to this end. This could encompass a range of initiatives, including support in finding alternative crops or alternative uses of the same crop.

## Others

### Company Feedback/Question

An important aspect of reduced-risk product categories is likely to be the development of consensus product standards, especially for emerging technologies such as vaping and heated tobacco products. Demonstration of contributions to national and international product standards for reduced-risk products could be a useful indicator of corporate intent.

**Response.** Although difficult to quantify, these actions will be covered within the Lobbying and Advocacy category if publicly disclosed by the company. Future iterations of the Index will look to further incorporate companies' contribution to developing product standards for the evolving reduce-risk product market.

### Company Feedback/Question

One company suggested the inclusion of an indicator capturing companies' commitment to combat illicit trade.

**Response.** Although the Index recognizes how the presence of illicit trade might impede the ultimate elimination of high-risk tobacco products, companies' actions aiming to tackle illicit trade are not captured by the first version of the Index.

### Company Feedback/Question

Additional indicators were suggested:

- % of countries in which a company operates and where reduced-risk products are allowed.
- % of countries where reduced-risk products are allowed in which the company commercializes reduced-risk products.
- Number of countries where reduced-risk products generate more than 10% of company revenue.
- Number of countries where reduced-risk products generate more than 50% of company revenue.

**Response.** The Index considers industry transformation a global endeavor and intends to highlight geographic discrepancies or inconsistencies in the efforts made by tobacco companies toward this objective. Furthermore, the Index does not aim to measure commercial success or investment in reduced-risk products but instead the efforts made by companies to shift away from combustible and high-risk tobacco products.

# Appendix

## Glossary

**High-medium income country (HMIC)** – as defined by the World Bank (as of 1 July 2019), a country with a national income per person (GNI per capita) of USD12,376 or more in 2018.

**High-risk products** – combustible or other high-risk nicotine products, which includes cigarettes, cigars, cigarillos, smoking tobacco, and bidis, as well as traditional smokeless tobacco, such as gutkha.

**Low-medium income country (LMIC)** – as defined by the World Bank (as of 1 July 2019), a country with a national income per person (GNI per capita) of up to USD12,375 in 2018.

**Reduced-risk products (RRP)** – nicotine products that are considered to be less harmful than combustible cigarettes and/or other traditional products. Products that are potentially reduced-risk include vapor products (including open and closed vaping systems and heated tobacco), snus, NRT products, and non-tobacco nicotine pouches.