



PHILIP MORRIS INTERNATIONAL

ANTI-DIVERSION GOVERNANCE COMMITTEE PROGRESS AND OUTLOOK REPORT

2017 - 2018



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

FOREWORD

By Alvise Giustiniani

Vice President Illicit Trade Prevention, Philip Morris International

When I look back at last year, I am pleased by the work that we—the team of the Anti-Diversion Governance Committee and the workgroup—have done to continue fighting against the diversion of our products.

This third edition of the progress report highlights the work of our affiliates to prevent the diversion of our products and to continue securing our supply chain.

We strongly believe in prevention in order to stay ahead of the game to avoid being overwhelmed as events transpire. Under the Anti-Diversion Governance Committee, we have redefined our strategy, moving to a risk-based approach. This report outlines the first positive results of focusing resources and controls where they are most needed.

Efficient anti-diversion plans are being implemented in a growing number of markets. I sincerely hope that readers will fully understand the challenges we faced as well as the efforts we have implemented across the regions.

In addition, we have widened the scope of the Anti-Diversion Governance Committee to smoke-free products, which are the fundamental pillars of PMI's vision. The

growing success of our products poses new challenges to us in our illicit trade prevention work. In order to provide a genuine and legitimate smoke-free experience for our consumers it is paramount to apply the same mindset and the same rigorous standards to the supply chain protection of our entire portfolio.

A wide palette of facts and experiences are represented on the following pages. We hope you find it both informative and useful.



WELCOME

For the optimal viewing experience, it is recommended that this report is viewed on a **laptop or desktop**. Viewed this way you can navigate to sections within the report by selecting items from the **Contents page**. You can also navigate back to the Contents page, map and Executive Summary by selecting the **icons** in the top right of each page. You can also interact with the map on **page 18** – you can select a flag to skip to more detailed information on that country.

Of course, you can view the report on any other device and you will still be able to scroll through, read the full report and access the external links provided within.



We will not condone, overlook, facilitate or support contraband or money laundering. We work with governments to stop illegal sales of our products. Our credibility in this area depends on us being alert to any activity or practice that might compromise our standards."

- Fiscal and trade section



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

INTRODUCTION

The Anti-Diversion Governance Committee, created in 2015, plays a key role in maintaining the highest standards possible in supply chain control. The committee reviewed the PMI global presence and classified markets into risk categories.


In 2017, we leveraged our experience and reviewed our supply chain controls approach. Based on our findings, we moved from a “one-size-fits-all” approach to a risk-based one, focusing our resources and controls where they are most needed. We based our risk analysis on several indicators and drivers such as outflows, price gaps with neighboring markets and the available seizures information, as well as other macro-economic indicators


from the World Bank (unemployment country rates) and Transparency International (corruption index).

The Anti-Diversion Governance Committee reviewed the global PMI presence and identified 27 higher-risk markets where additional controls and more regular checks were required. The Anti-Diversion Working Group supporting the committee reviewed the higher-risk markets’ anti-diversion plans to assess if the controls were adequate based on specific market risks.


Furthermore, we continuously monitor the evolution of risk drivers in “watch list markets,” in order to address any emerging issue related to supply chain controls.

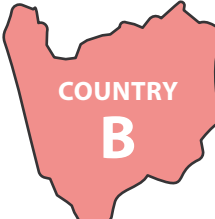
SUPPLY CHAIN CONTROLS: OUR RISK-BASED APPROACH

**LOW RISK**

**COUNTRY A**

- Simple distribution network
- High retail price
- Limited incentive to smuggle

**HIGH RISK**

**COUNTRY B**

- Complex distribution network
- Low retail price
- Profit opportunities to smuggle

WE ADAPT TOOLS TO SUIT RISK PROFILE

**VOLUME MONITORING**

**ORDER CONTROLS**

**ANTI-DIVERSION PLANS**

**TRACKING AND TRACING**

We reflect updated requirements in our internal Principles & Practices, Know Your Customer and Anti-Diversion by:

- 1
- Keeping standard controls for all markets, including Know Your Customer and Due Diligence practices, volume monitoring and a product seizure follow-up process.
- 2
- Further clarifying tracking and tracing requirements for all our products, including product coding and scanning to the first customer level. This is to complement existing legislation.
- 3
- Adding implementation of the Anti-Diversion plan and training under the responsibility of the market head of affiliate for higher-risk markets.

Risk-based controls	Higher	Others
Significant Volume Customer Review (SVC)	Yearly	Every three years
Volume Monitoring	Monthly & monitoring indirect customers	Semiannual
Anti-Diversion Plan	Yearly	N/A
Anti-Diversion Training	Yearly	N/A

MOVING BEYOND OUR REQUIREMENTS

Some markets, such as Bulgaria, Paraguay, Russia, Ukraine and, globally, Duty Free, applied controls beyond our standard requirements and implemented aggregation at carton level or second-level tracking. Those markets did so to further secure their supply chain and address specific risks.



Back to Executive Summary



Back to Regional Highlights map

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

DESIGNING A SMOKE-FREE FUTURE

“Today, better options are available for men and women who smoke. For these billion people, it is our responsibility to ensure this moment of transformation does not pass them by.”

- CEO André Calantzopoulos, Concordia Annual Summit 2018

The objective of delivering a smoke-free future reinforces our commitment to protecting our consumers and their right to access genuine products with corresponding professional assistance.

We apply the highest standards to preventing diversion of our products, be it cigarettes or smoke-free products. This is fundamental to delivering on our vision of a smoke-free future to our consumers with genuine and legally sold products.

With smokers' growing interest in better alternatives to cigarettes, our innovation-driven smoke-free product portfolio is encountering growing success and facing intense competition. But there are also many illicit trade operators who try to take advantage of our brand assets and our breakthrough products by either infringing our intellectual property rights, including counterfeiting, or by diverting our products.

PMI has started a journey to adapt, grow capacity and build expertise in tackling challenges related to our new products. For example, stepping into the world of technology, we are facing additional complexities and challenges, particularly in e-commerce.

Under the guidance of the Anti-Diversion Governance Committee, we consistently monitor current and future risk drivers, which allows us to safeguard the commercialization of our smoke-free portfolio and, whenever necessary, we prompt specific controls.

“It is important that we embed a proactive risk-based anti-diversion strategy in our daily activities. Any form of illicit trade could undermine our efforts to build a smoke-free future.”

- Hannah Yun, VP Finance & Planning, East Asia & Australia

We are determined to bring our smoke-free products to smokers everywhere possible. We design our global expansion to meet demand in different geographies only through legitimate supply. Compliance with regulations coupled with enhanced supply chain controls are key elements to ensure that our consumers have continuous access to genuine products, professional assistance and warranties.

OUR COMMITMENT IN ACTION

The product diversion challenges we face are significant in magnitude and complexity—and we know there are no “silver bullet” solutions. Only a comprehensive and tailored approach including a set of actions such as Know Your Customer and Due Diligence practices, volume monitoring, capacity building and awareness programs for the organization can help us to act responsibly in our prevention efforts. Cooperation with law enforcement agencies remains a key component of our approach.

“At PMI, we do business with honesty, respect and fairness. We have publicly committed to these high standards. And this commitment includes managing our supply chain.”

- Mary Katherine Brink, VP and Chief Ethics & Compliance Officer

As diversion affects multiple countries, we must align our efforts by raising awareness in all impacted markets and collecting intelligence and insights, which will allow us to learn more about the evolving modus operandi of smugglers. This also helps ensure we are working with other relevant stakeholders in the supply chain who can play a key role in prevention—such as ocean carriers or airline companies.

In our last edition, we summarized the significant progress made to control our supply chain, thanks in part to our effective collaboration with authorities in markets such as Serbia, Poland, Ukraine and, globally, Duty Free. This year's report complements the previous edition with an overview of results achieved in 2017-2018 thanks to our risk-based approach and anti-diversion actions taken by the key “higher-risk” markets. It also emphasizes our relentless determination to protect our vision of a smoke-free future.



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

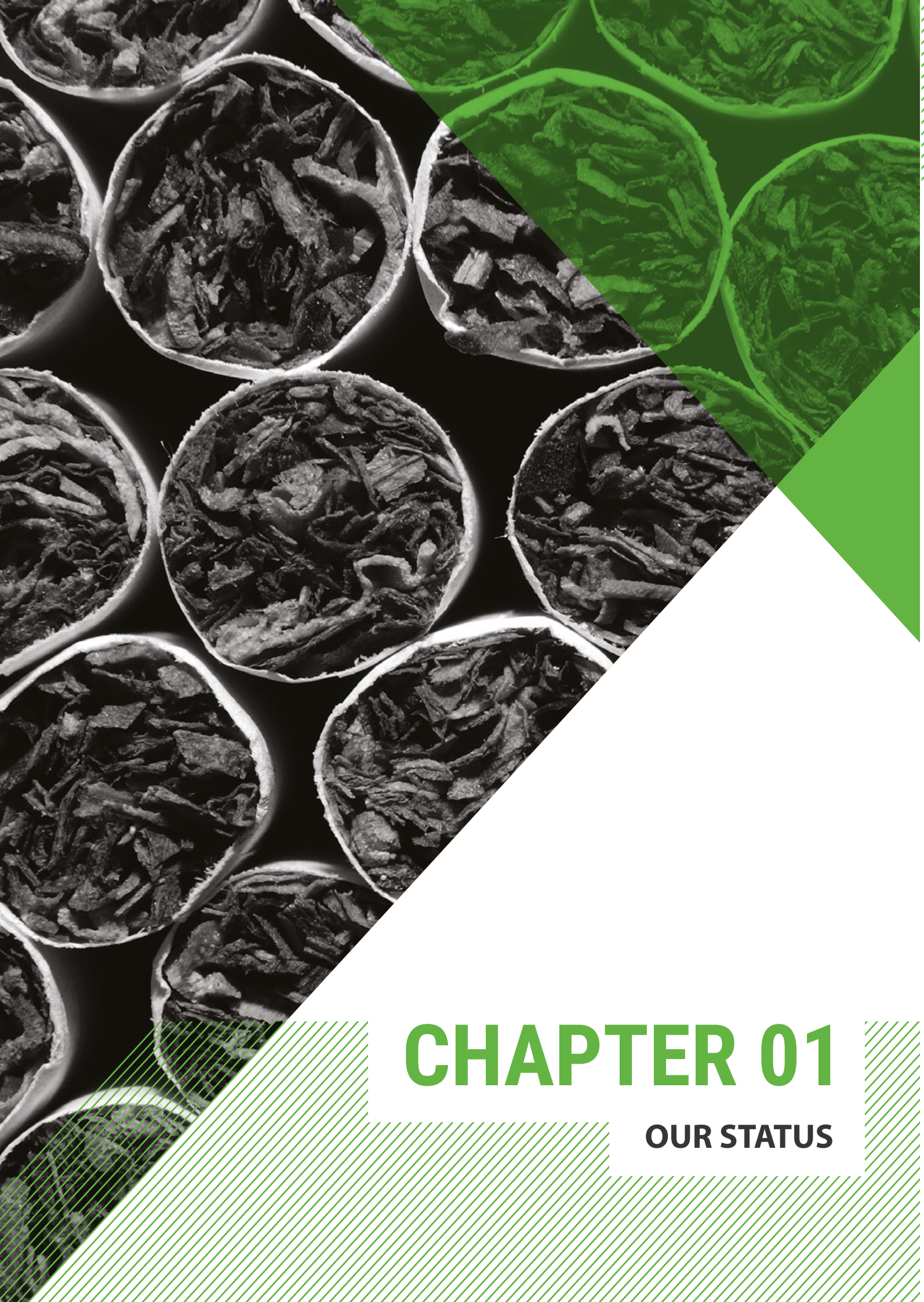
[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



GLOBAL NUMBERS

According to estimates, one out of 10 cigarettes smoked globally stems from the illicit trade. It is a major economic problem for governments, which are losing a potential \$40 billion to \$50 billion in tax revenue each year.

THE FIGURES...

In 2017, the share of illicit tobacco increased to 11 percent of total worldwide consumption—equal to **456 billion** cigarettes. The increase is mainly visible in the Middle East, Africa and Latin America, where Brazil accounts for a quarter of the incremental growth. This is partially compensated by the continuously decreasing illicit volume in China, Turkey and Western Europe. In 2017, in seven markets—Japan, Georgia, Belarus, South Korea, Paraguay, Myanmar and Qatar—the share of illicit trade accounted for **less than 1%** of the total local consumption.

A **5% increase** in illicit tobacco is forecast for the period of 2017 to 2022 due to pricing sensitivity,

mainly from a significant increase in major developing markets in Asia Pacific, in particular Australasia and Latin America. Additionally, the distant selling of illicit tobacco products is expected to grow as consumer habits change—e.g., buying products from virtual suppliers as well as ordering by mail will be more and more accepted. E-commerce already represents a major distribution channel for a large number of small-scale opportunists and quite a few criminal organizations. Global low-volume, high-frequency trade via online channels will be a major challenge for law enforcement in the future.

Euromonitor International – Illicit trade in Tobacco Products (November 12, 2018)



PMI has a zero-tolerance approach when it comes to illegal trade, and our work is a core pillar of our sustainability program.”

- Alvise Giustiniani, Vice President Illicit Trade Prevention

At PMI, we share our good practices and experience internally, helping other markets that face existing and new challenges. We understand that both external and internal collaboration are essential to maintain our positive momentum.

Since 2004, PMI has implemented key activities to fight illicit trade along with our “Three Knows” policies (Know Your Customer, Know Your Vendor and Know Your Payment), which form the cornerstone of our anti-diversion efforts to fight crime.

CHAPTER 01

OUR STATUS



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

ENFORCE ICONS

We have previously shared our **ENFORCE** tools¹, currently used in our markets. In addition, we continuously look for enhancements and target efficient implementation.

Enhanced Volume Monitoring - We continuously improve our volume monitoring approach into the supply chain, to increase our ability to detect unusual purchasing patterns that may reflect diversion somewhere down the supply chain.

Notifying Suspected Compliance Violations - With our Know Your Customer and third-party manufacturer policy, we require our employees to report any suspected diversions of products that occur in our supply chain.

Following Up Seizures - We diligently follow up when we are notified of seizures of our products. We inform our customers and ensure that the necessary actions are taken to secure our supply chain.

Order Controls Improvement - When there is a significant diversion risk, we monitor customer orders and ensure that they are commensurate with demand in the intended market.

Raising Awareness to Prevent Product Diversion - We raise awareness at the consumer level and cooperate with law enforcement agencies to highlight the risks associated with product smuggling.

Control Through Tracking and Tracing - We invest in product coding and scanning and continue to expand our capabilities to meet regulatory and PMI internal requirements.

Employee Training - Awareness of specific risks and actions needed are essential to align the entire organization behind our common goal. Therefore, our markets allocate resources and time to ensure that employees are aware of “why”, “what” and “how” they should act.

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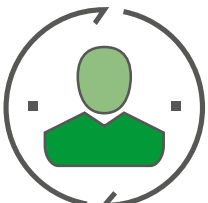
Control through T&T




Enhancing volume monitoring




Order controls improvement




Employee training




Raising awareness




Public private cooperation



Following up seizures




Notifying suspected compliance violations




Three Knows



Market visits



Cross-market cooperation



Smoke-free



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



The complex global nature of supply chains is also a weakness, as they are vulnerable to attack and abuse. Criminal enterprises can infiltrate the weakest point and try to replace legitimate ingredients or finished products with fakes and counterfeits, at the expense of consumers, governments, distributors and manufacturers. That's why it is vital to have a system to preserve the integrity of supply chains. Our experience is that effective tracking and tracing systems are a great way to do this."

- Alvisè Giustiniani, Vice President Illicit Trade Prevention

TRACKING AND TRACING

For over a decade, PMI has invested substantial resources in retaining strict controls over its supply chain to prevent illicit trade. One important element in our toolkit is tracking and tracing.

Tracking is the ability to monitor the forward movement of finished goods through the supply chain. Tracing is the ability to re-create the movement up to a certain point in the supply chain to help determine where the product was potentially diverted into illegal channels.

The PMI policy “**Know Your Customer and Anti-Diversion**” covers all tobacco products and defines that any affiliate and any related manufacturing entity is responsible for:

- » Coding of all packs, cartons and master cases - a unique code is applied to each packaging level at the time of production.
- » Scanning of all master cases when exiting factories, destined for export and to first customers in all PMI multi-customer markets.
- » Effective track-and-trace processes and protocols as an essential part of maintaining supply chain integrity.

Master case tracking is in place for 137 markets covering over 700 tracking locations:

Global Coverage		
Pack Coding	Carton Aggregation*	Pack Aggregation*
80%	80%	40%

*Aggregation: the virtual linking of a packaging unit to the next-level packaging unit (e.g., pack to carton, carton to master case)



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

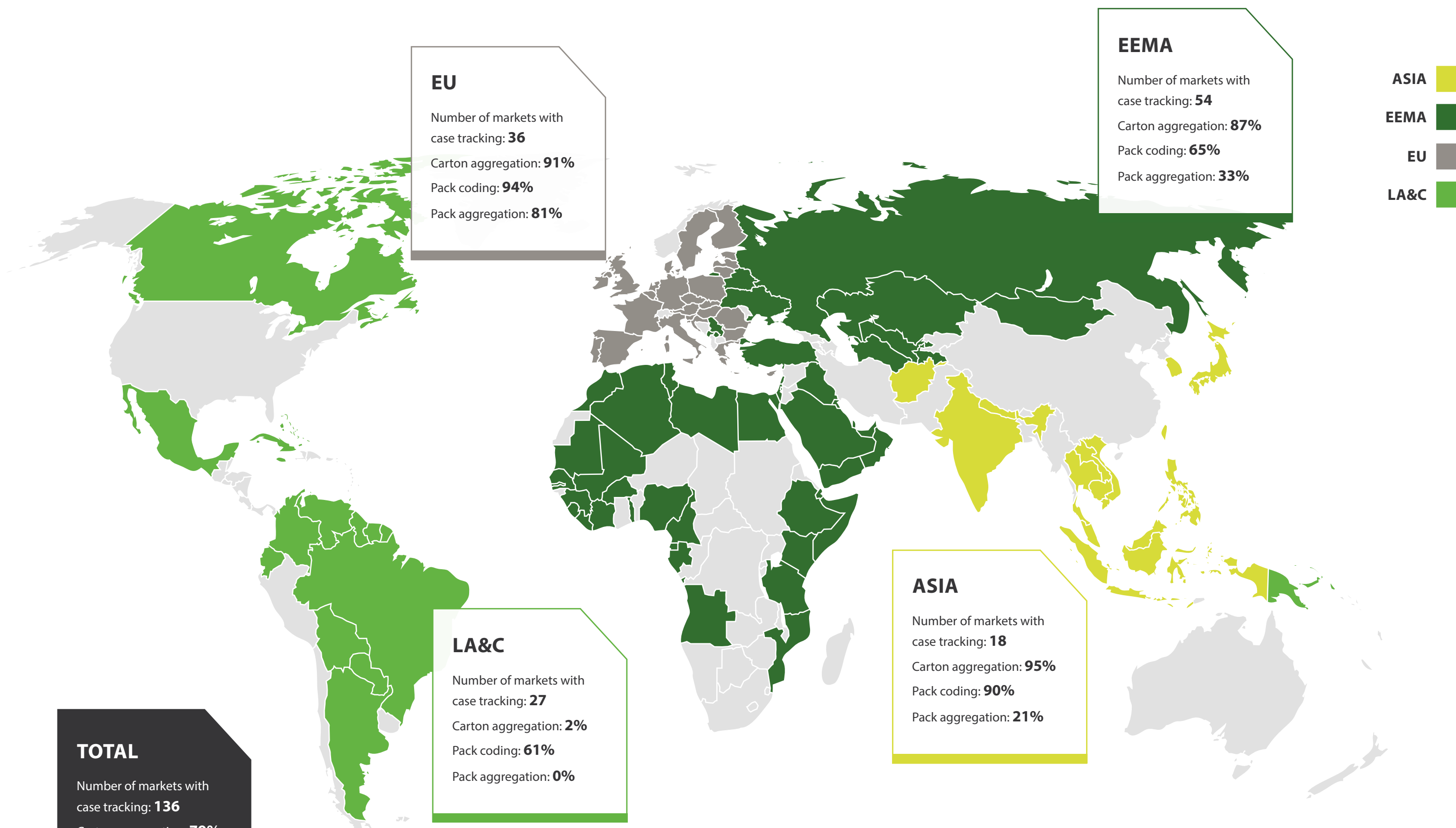
[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



- ASIA
- EEMA
- EU
- LA&C

TRACKING AND TRACING

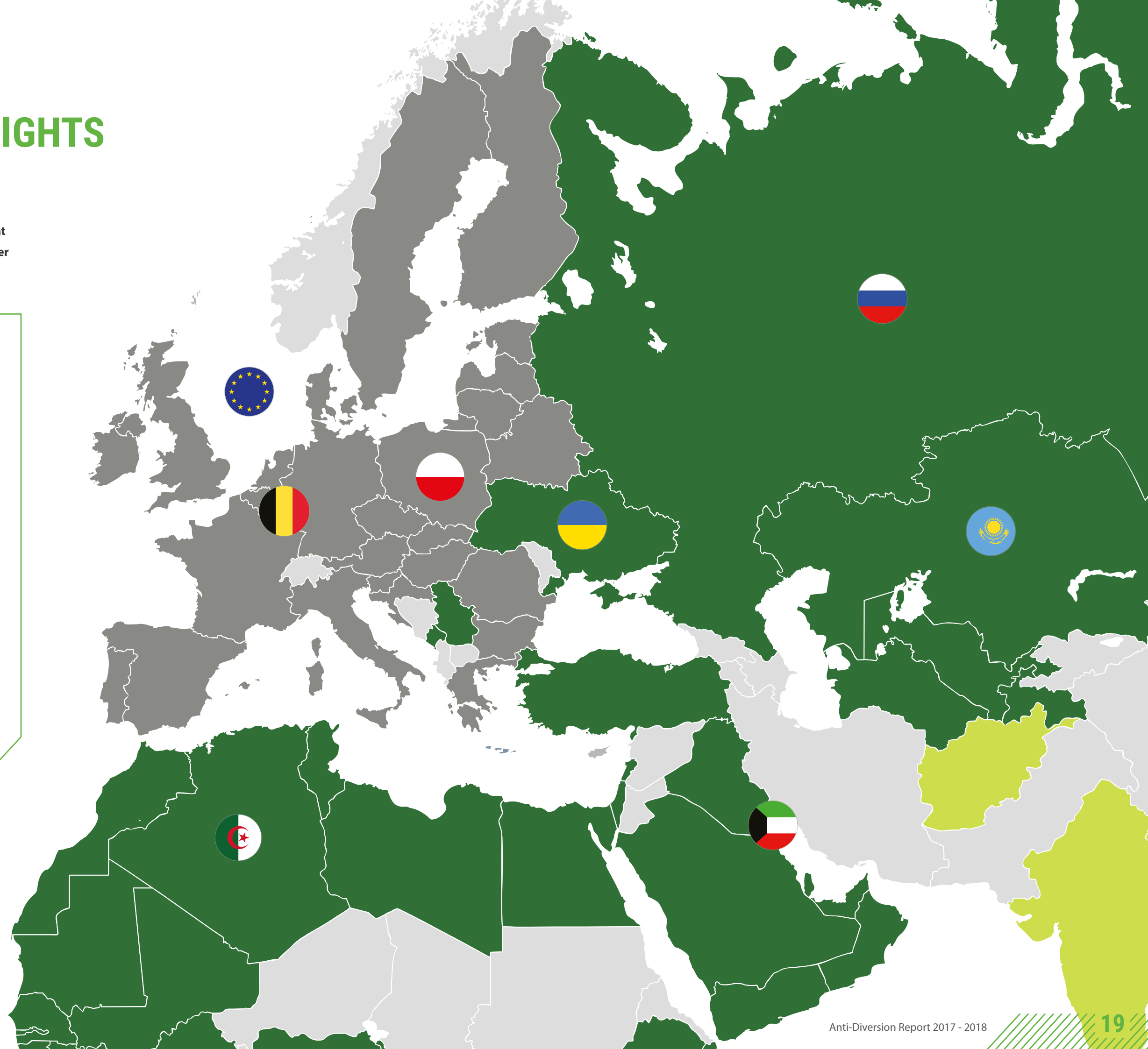
- [Foreword](#)
- [Introduction](#)
- [Designing a Smoke-Free Future](#)
- [Our Commitment in Action](#)
- CHAPTER 01: OUR STATUS**
 - [Global Numbers](#)
 - [ENFORCE Icons](#)
 - [Tracking and Tracing](#)
 - [Regional Highlights](#)
 - [Preparing to Meet the EU Tobacco Products Directive Requirements](#)
 - [Memorandum of Understanding - Status & Objectives](#)
 - [Anti-Counterfeiting Protocol](#)
 - [Protecting a Smoke-Free Future](#)
- CHAPTER 02: HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)**
 - [Benefits of a Risk-Based Approach](#)
 - [Risk-Based Approach - Sharing our Learnings](#)
 - [Executive Summary](#)
 - [Sharing our Learnings](#)
 - [Algeria](#)
 - [Ukraine](#)
 - [Belgium](#)
 - [Poland](#)
 - [Kuwait](#)
 - [EU](#)
 - [Russia, Ukraine & Kazakhstan](#)
 - [Conclusion](#)

REGIONAL HIGHLIGHTS

If you click on a flag on the map, you'll be taken to a case study that explores in more detail our anti-diversion efforts in that country/region. When in that case study, select the map icon in the top-right corner of the page to return to the map.

KEY

-  ALGERIA
-  UKRAINE
-  BELGIUM
-  POLAND
-  KUWAIT
-  EU
-  RUSSIA
-  KAZAKHSTAN



[Back to
Executive
Summary](#)



[Back to
Regional
Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

**(SHARING REGIONS AND
MARKET LEARNINGS)**

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

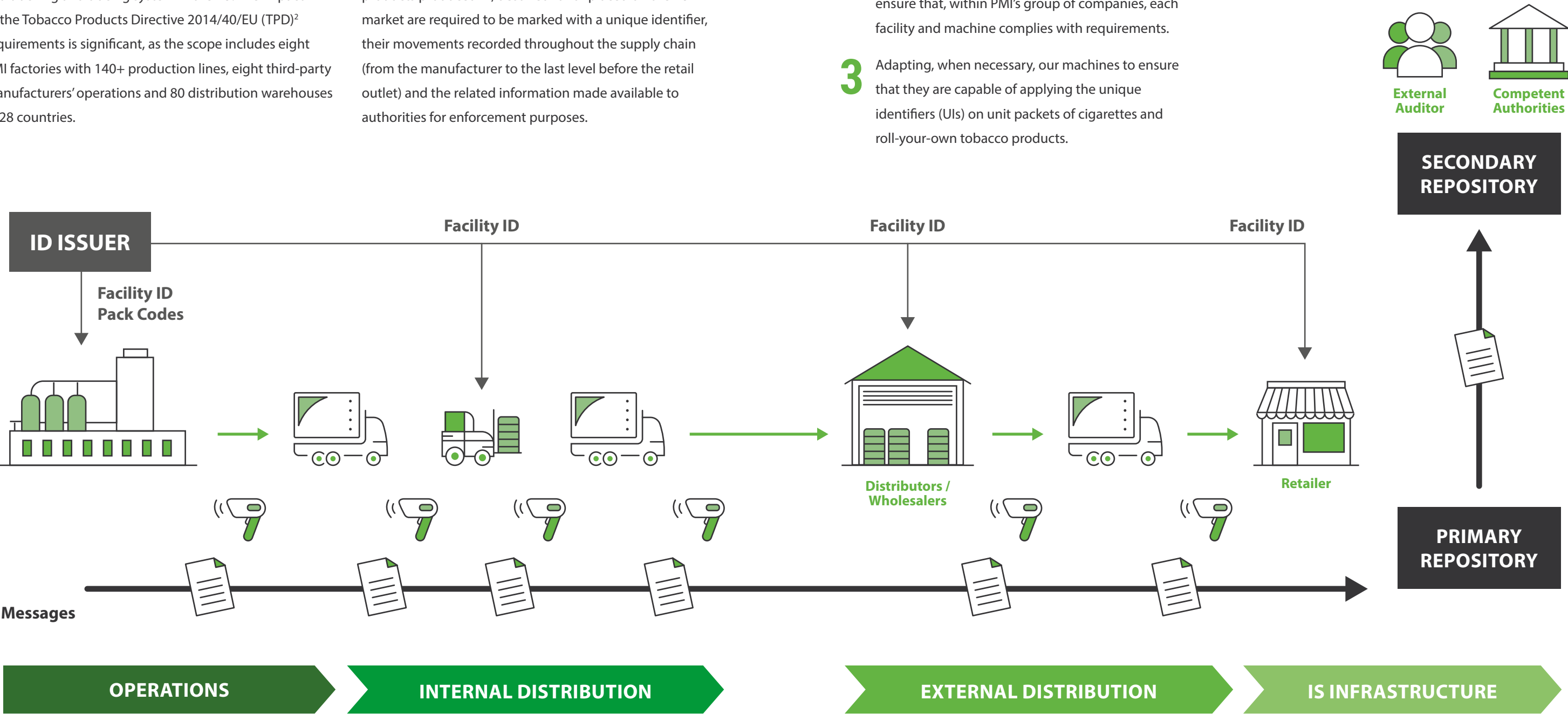
PREPARING TO MEET THE EU TOBACCO PRODUCTS DIRECTIVE REQUIREMENTS

The biggest challenge today is the implementation of a tracking and tracing system in the EU. The impact of the Tobacco Products Directive 2014/40/EU (TPD)² requirements is significant, as the scope includes eight PMI factories with 140+ production lines, eight third-party manufacturers' operations and 80 distribution warehouses in 28 countries.

According to Article 15 TPD, all unit packets of tobacco products produced in, destined for or placed on the EU market are required to be marked with a unique identifier, their movements recorded throughout the supply chain (from the manufacturer to the last level before the retail outlet) and the related information made available to authorities for enforcement purposes.

PMI has created a cross-functional and cross-market working group to enable the company and its authorized manufacturers to meet the TPD requirements by:

- 1 Adapting our systems, including stock management and IT infrastructure, to ensure the transmission of the required information to the repositories.
- 2 Reviewing all our logistic flows, including internal logistic chains, and manufacturing processes to ensure that, within PMI's group of companies, each facility and machine complies with requirements.
- 3 Adapting, when necessary, our machines to ensure that they are capable of applying the unique identifiers (UIs) on unit packets of cigarettes and roll-your-own tobacco products.



²EU TPD provides for EU-wide systems of traceability and security features for tobacco products to address the issue of illicit trade. This applies to cigarettes and make-your-own/roll-your-own tobacco products, as from May 20, 2019.

MEMORANDUM OF UNDERSTANDING— STATUS & OBJECTIVES

We have signed non-binding Memoranda of Understanding (MoUs) with law enforcement agencies in 49 countries, and the number is growing.

Through Memoranda of Understanding, we set solid foundations for continuous cooperation with governments to share information and raise awareness on links between illicit trade and serious crime. Memoranda of Understanding allow us to exchange information with law enforcement agencies and set the framework for cooperation in seizure inspections.

The cooperation with authorities enables us to support their actions against organized crime groups, as well as take a multi-stakeholder approach to prevent low-volume, high-frequency organized smuggling with ant-traders crossing the countries' borders.

IN 2018...

...the State Fiscal Service of Ukraine and National Manufacturers Association, of which PMI is a member, have signed the memorandum of cooperation aimed at extending collaboration to counteract illicit trade in tobacco products. This memorandum sets a framework for implementation of measures aimed to enhance control and prevention of illegal cross-border movement of tobacco products.

ANTI-COUNTERFEITING PROTOCOL

We must protect our products from being diverted into illicit channels and our trademarks from being infringed. Therefore, we cooperate only with verified, legitimate and responsible suppliers of materials and equipment who share the same commitment against illicit trade and have adequate supply chain controls in place to prevent their materials and equipment from being used for counterfeiting our products.

With most of our global suppliers, we have signed non-binding agreements called the Anti-Counterfeiting Protocol to formalize their commitment.

Our suppliers are regularly reminded to keep strong supply chain controls in place, such as implementing preliminary due diligence for new partners, building contractual obligations for their partners and monitoring suspicious developments.

PROTECTING A SMOKE-FREE FUTURE

By the end of 2018 our smoke-free products were launched in more than 40 markets. Nearly 6 million smokers have switched to our premier smoke-free product. The increasing demand for our new products means we must further increase our efforts to prevent their diversion.

Cross-functional PMI teams work together to safeguard sustainable growth of our smoke-free portfolio by implementing preventive anti-diversion measures.

Among others, we create tailor-made, comprehensive anti-diversion strategies that require that our affiliates use not only “traditional” illicit prevention tools that we developed in our cigarette business, but also a range of new ones, e.g online enforcement working together with e-commerce marketplaces to detect online illicit trade, etc.

IN 2017...

...PMI launched smoke-free products in Colombia's major cities in order to provide a better alternative to adult smokers who would otherwise continue to smoke. With this launch, it was essential to be proactively prepared with a robust anti-diversion plan to prevent diversion.

Before the launch of our smoke-free products, Colombia and Ecuador had already increased their efforts to leverage local anti-contraband agreements to foster cooperation between law

enforcement agencies based on their experience with conventional cigarettes.

In 2017, several training sessions were conducted at border cities, where a total of 574 law enforcement and customs officials—384 Ecuadorian and 190 Colombian—were trained. The objective was to create awareness of illicit trade for tobacco products, in particular, the potential diversion of our products, and also to share information. In 2018, as of October, 735 law enforcement officials were trained, 181 Ecuadorian and 554 Colombian.



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding - Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

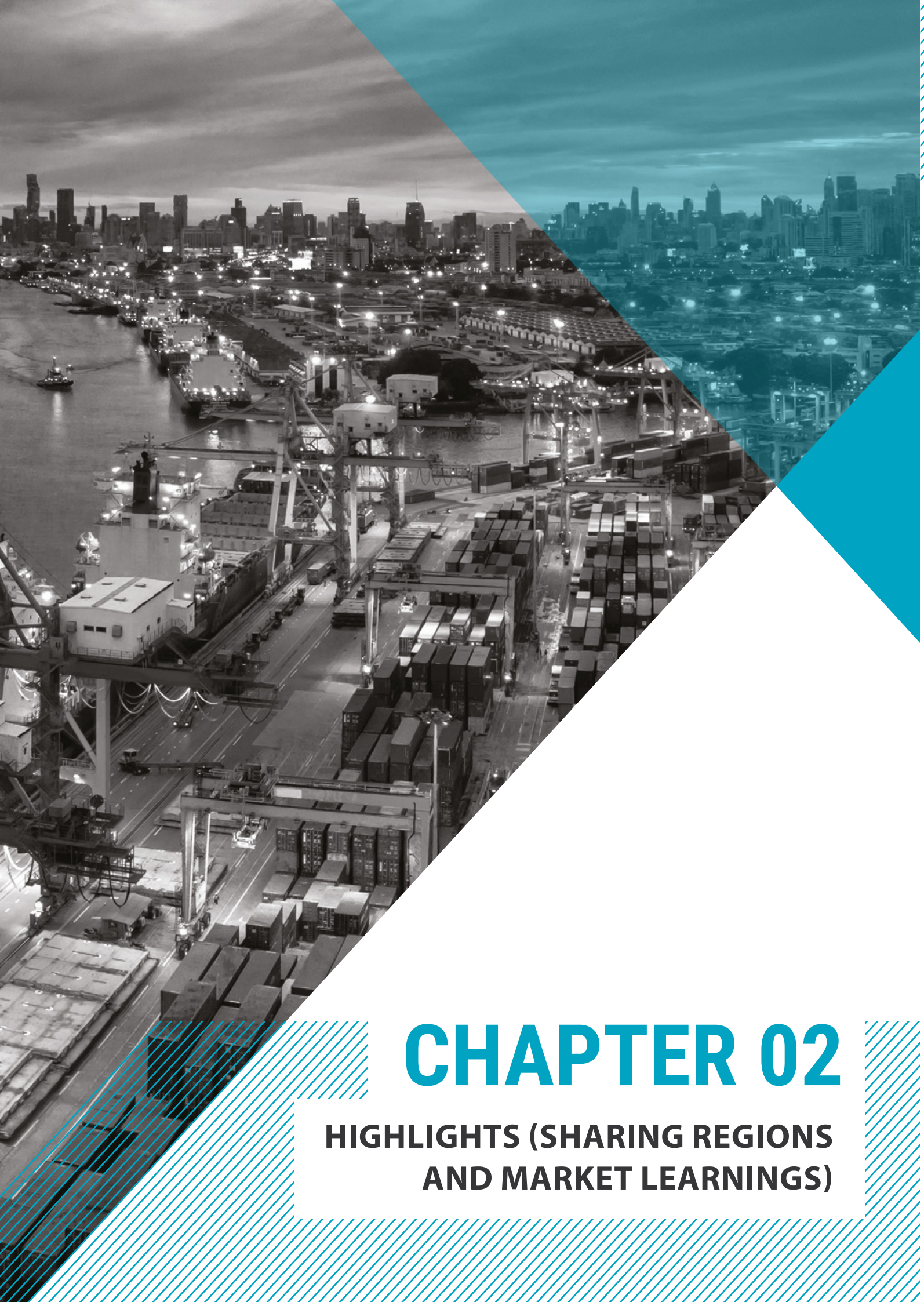
[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



CHAPTER 02

HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)

BENEFITS OF A RISK-BASED APPROACH

PMI's recent shift from "one size fits all" to a tailored risk assessment focused on risk management has undeniable advantages at the country level. Our colleagues focus their efforts on better understanding their specific risks and monitoring them.

Additionally, it allows markets to make the most efficient use of their specific tools to address their particular areas of risk, be those geographical borders or specific channels or brands. By doing so, they are able to review their processes in cross-functional teams and enhance their controls faster for better outcomes.

RISK-BASED APPROACH - SHARING OUR LEARNINGS

In 2018, when we applied the risk-based approach for the first time, our goal was to anticipate instead of react—to collaborate and support markets in advance by sharing intelligence, good practices and learnings. The results have been promising, and we have identified two key learnings:

Keeping the global picture in mind. While we understand the specific market dynamics, we continue to foster alignment and develop an understanding of the interrelationships between the issues affecting different markets.

Remaining agile and adapting our approach as quickly as possible.



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)





























[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

EXECUTIVE SUMMARY

Select a flag to skip to more detailed information on that country.

HIGHER-RISK COUNTRIES	HIGHLIGHTS	ACTIONS
<div> Algeria</div>	<p>A large number of Algerians—who make up one of the largest communities in France - travel regularly between France and Algeria. Many frequently carry small volumes for personal consumption. This phenomenon, encouraged by the difference in taxation between Algeria and France, is known as “low volume, high frequency”. Substantial investments in human resources, technology and logistics demonstrate PMI’s and its partners’ commitment to combat product diversion despite social acceptance of the cigarette “low volume, high frequency” flows. We openly share our efforts with external stakeholders to address this complex issue.</p>	<div><div> Enhancing volume monitoring</div><div> Following up seizures</div><div> Raising awareness</div><div> Control through T&T</div><div> Employee training</div><div> Three Knows</div><div> Public private cooperation</div><div> Cross-market cooperation</div></div>
<div> Belgium</div>	<p>PM Benelux tightened the “Rules of Engagement” for retailers located at the border with the U.K.</p> <p>PM Benelux wants those retailers to monitor the volumes of high- diversion-risk products and to inform consumers about the indicative quantities of cigarettes and hand-rolling tobacco they are allowed to take with them to other EU Member States.</p>	<div><div> Enhancing volume monitoring</div><div> Following up seizures</div><div> Order controls improvement</div><div> Raising awareness</div><div> Control through T&T</div><div> Employee training</div><div> Three Knows</div><div> Public private cooperation</div></div>
<div> Poland</div>	<p>Polish residents represent close to 14 percent of the U.K.’s³ total foreign population. This affects the legal goods movement from Poland to the U.K. and offers smugglers additional opportunities to divert our product.</p> <p>The cooperation between law enforcement agencies in Poland and in related countries is key to tackling the “low volume, high frequency” product diversion as carried out through coordinated groups crossing the border frequently and carrying several cartons of cigarettes.</p>	<div><div> Enhancing volume monitoring</div><div> Following up seizures</div><div> Order controls improvement</div><div> Raising awareness</div><div> Control through T&T</div><div> Employee training</div><div> Three Knows</div><div> Public private cooperation</div><div> Cross-market cooperation</div></div>



Back to Executive Summary



Back to Regional Highlights map

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)



















[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

EXECUTIVE SUMMARY (CONTINUED)

Select a flag to skip to more detailed information on that country.

HIGHER-RISK COUNTRIES	HIGHLIGHTS	ACTIONS
 Ukraine	<p>PMI internal estimates show an increase in PMI outflows of 0.7 pp in 2017 compared to the increase of 2.5 pp in 2016. In volume terms the PMI outflow went down by 7% in 2017.</p> <p>For the past several years, PM Ukraine has worked to counter illicit trade by creating and implementing a comprehensive anti-diversion plan.</p>	<div> Enhancing volume monitoring</div> <div> Following up seizures</div> <div> Order controls improvement</div> <div> Raising awareness</div> <div> Control through T&T</div> <div> Three Knows</div>
 Kuwait	<p>Since the introduction of the June 2017 excise tax in Saudi Arabia, the Kuwait market has witnessed a significant increase in demand for cigarettes from Saudi adult smokers visiting Kuwait.</p> <p>The increase in demand from Saudi smokers visiting Kuwait has significantly affected product availability for local Kuwaiti smokers. It also led PM to undertake a number of measures to mitigate the increased outflow and to ensure product availability for Kuwaiti consumers.</p>	<div> Enhancing volume monitoring</div> <div> Order controls improvement</div> <div> Raising awareness</div> <div> Control through T&T</div> <div> Employee training</div> <div> Three Knows</div> <div> Public private cooperation</div>
 EU	<p>According to the Royal United Service Institute, e-commerce brings new possibilities for trade such as a wider commercial coverage, removal of physical barriers and more connections with consumers who are largely benefiting from this shift.</p> <p>The difficulty in identifying the illicit flow, coupled with a low risk of penalties for illicit carriers, makes the task more challenging for the authorities and PMI.</p>	<div> Raising awareness</div> <div> Public private cooperation</div>



Back to Executive Summary



Back to Regional Highlights map

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



SHARING OUR LEARNINGS

In the next section we highlight key actions and new approaches taken by markets in their day-to-day anti-diversion efforts. Specifically, we collected outcomes and additional learnings from different markets, which analyzed the drivers of outflows and resulted in specific actions.

ALGERIA

Moving Beyond our Commitment with Direct-Store Delivery

A large number of Algerians—who make up one of the largest communities in France—travel regularly between France and Algeria. Many frequently carry small volumes for personal consumption. This phenomenon, encouraged by the difference in taxation between Algeria and France, is known as “low volume, high frequency.”

In addition to the action plan shared in our last report that included a carton aggregation pilot, enhanced controls on Know Your Customer processes and monthly volume monitoring, our local partner aims to implement an in-depth control over the distribution chain from the factory to the consumer. In agreement with PMI, the local distributor invested in a direct distribution system to gradually increase its direct coverage to retailers. The law provides dissuasive penalties for trade layers in the event of seizure of contraband or counterfeit tobacco products. This will be a powerful control measure to fight diversion effectively at the retail level.

During training sessions for the entire supply chain that had already started in 2017, including frontline agents, we raised awareness of the social acceptance of cigarette smuggling and its negative impact on society in general.

Although factories have been heavily impacted by floods in 2017 and 2018, we have sustained our efforts with the gradual implementation of tracking and tracing processes and controls, as this is an essential tool to secure the distribution chain and identify potential diversion layers. We, together with our local partners, plan to continue to equip the production lines through 2019.

Substantial investments in human resources, technology and logistics demonstrate PMI’s and its partners’ commitment to combat product diversion despite social acceptance of the cigarette “low volume, high frequency” flows. We openly share our efforts with external stakeholders to address this complex issue.



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

Key ENFORCE Tools



UKRAINE

Taking Strong Action with Second and Third-Level Tracking and Tracing

Although the volume of cigarettes smuggled from Ukraine to the EU declined by almost 20 percent in 2017 (from 5.8 billion in 2016 to 4.8 billion in 2017), Ukraine remains a major source of contraband cigarettes coming into the EU, according to the 2017 Project SUN report⁴.

For the past several years, PM Ukraine has worked to counter this phenomenon by creating and implementing a comprehensive anti-diversion plan. This includes an excellent control of the second-distribution layer (i.e., the clients of our customers) by doing comprehensive volume monitoring and order-processing controls as well as running second-layer tracking and tracing.

In 2018, the Ukrainian team voluntarily expanded tracking and tracing to the third-distribution layer for selected customers. Several large customers operating their own retail chains and wholesale depots have agreed to implement tracking and tracing in their supply chain, including product distribution to their own stores and wholesale transactions to smaller retailers.

Key ENFORCE Tools



BELGIUM

Enhancing Retailer Best Practices with Rules of Engagement

Since 2015, PM Benelux has continuously enhanced its anti-diversion plan and cooperation with Her Majesty's Revenue & Customs (HMRC U.K.) to avoid PMI product being seized in the U.K.

Volume monitoring of higher-diversion-risk brands is applied at the border areas with the U.K. and France and order patterns at retail level are reviewed on a monthly basis and further managed in case of significant volume variances. PM Benelux has enhanced the value of its annual site visit for their direct customers by using the momentum to raise awareness on the risk of diversion of PM products, as well as to encourage indirect customers to take preventive measures.

Finally PM Benelux tightened the "Rules of Engagement" for retailers located at the border with the U.K. PM Benelux wants those retailers to monitor the volumes of high-diversion-risk products and to inform consumers about the indicative quantities of cigarettes and hand-rolling tobacco they are allowed to take with them to other EU Member States.



Key ENFORCE Tools



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND

MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

POLAND

Cooperating with Law Enforcement and Supply Chain Stakeholders

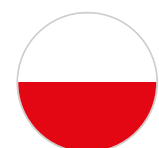
Polish residents represent close to 14 percent of the U.K.'s⁵ total foreign population. This affects the legal goods movement from Poland to the U.K. and offers smugglers additional opportunities to divert our product.

As shown in the SUN report⁶, in 2017 the outflow trend reversed for the first time, showing an overall reduction, particularly in Germany and the U.K. (approximately 110 million and 120 million sticks of cigarettes, respectively). The constant cooperation with law enforcement, including

exchange of information and intelligence, and the continuous awareness efforts with supply chain partners have shown tangible results in reducing illicit trade.

The cooperation between law enforcement agencies in Poland and related countries is key to tackling the “low volume, high frequency” product diversion as carried out through coordinated groups crossing the border frequently and carrying several cartons of cigarettes.

Key ENFORCE Tools



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

⁵U.K. Office for National Statistics

⁶<https://home.kpmg.com/uk/en/home/insights/2018/07/project-sun-2017.html>



KUWAIT

Continuous Monitoring

Since the introduction of the June 2017 excise tax in Saudi Arabia, the Kuwait market has witnessed a significant increase in demand for cigarettes from Saudi adult smokers visiting Kuwait. Moreover, there is historically high cross-border traffic due to geographical proximity, family connections and cheaper shopping (cheaper commodities, such as fuel, energy and carbonated drinks, etc.); retail prices of cigarettes in Saudi Arabia are now double the price of those in Kuwait.

The increase in demand from Saudi smokers visiting Kuwait has significantly affected product availability for local Kuwaiti smokers. It also led PM to undertake a number of measures to mitigate the increased outflow and to ensure product availability for Kuwaiti consumers.

In addition to volume monitoring performed at PM and distributor level, our local partner implemented

the following measures to ensure that product would be available for local Kuwaiti legal-age smokers while concurrently closely monitoring sales:

1. Controlled increase of sales in all territories spread equally across general trade and key account channels.
2. Engagement with retailers to monitor sales quantities to consumers.
3. Increased visit frequency to key account outlets and wholesalers and improved stock monitoring, mainly in general trade outlets.

Additionally, PM has continued to raise awareness on illicit trade by organizing training sessions. Throughout 2018, these were attended by more than 45 Kuwaiti customs officers helping to better understand illicit trade consequences and trigger more enforcement at borders.

Key ENFORCE Tools



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND

MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)

Prevention Efforts Against Emerging Illicit Trade Risks in Low-Volume, High-Frequency Patterns

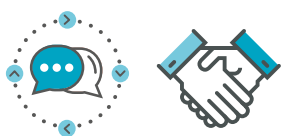
In its recently published occasional paper on e-commerce⁷, delivery services and illicit tobacco trade, the Royal United Service Institute (RUSI) highlighted that e-commerce is proliferating, while the retail landscape is undergoing a fundamental transformation. According to the Royal United Service Institute, e-commerce brings new possibilities for trade such as a wider commercial coverage, removal of physical barriers and more connections with consumers who are largely benefiting from this shift. At the same time, it is creating new challenges for customs authorities accustomed to tackling more traditional forms of illicit trade. Online illicit trade involves a multitude of stakeholders who are shipping goods in insignificant quantities in small parcels across the whole world.

The trends examined in this paper suggest that a new generation of organized criminality is developing across Europe, one that will require new and innovative responses. Collaboration is crucial between European governments, law enforcement agencies and the public and private sectors.”

- Royal United Service Institute, E-Commerce, Delivery Services and the Illicit Tobacco Trade, October 2018

The difficulty in identifying the illicit flow, coupled with a low risk of penalties for illicit carriers, makes the task more challenging for the authorities and PMI.

Key ENFORCE Tools



RUSSIA, UKRAINE AND KAZAKHSTAN

With the launch of our smoke-free products, Russia, Ukraine and Kazakhstan established a collaborative team to protect our supply chain from illicit trade. The team collected intelligence on the potential risk of outflows and aligned their controls in different areas of attention, including consumer registration, e-commerce oversight and sharing information with law enforcement agencies.

Our team assessed different distribution and retail models and implemented a set of additional anti-diversion measures that apply to *HeatSticks* and *IQOS* devices.



[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS

(SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



CONCLUSION

The set of actions taken by our markets and functions to protect our supply chain is testimony that anti-diversion values are an essential part of our DNA. We are not alone on this journey—as evidenced by the growing number of stakeholders who are sharing our commitment and taking action to tackle illicit trade.

Under the direction of the Anti-Diversion Governance Committee, we will continue to train our entire organization on the importance of complying with laws and regulations, our internal principles and practices, and we will continue to raise awareness among our supply chain partners about the consequences of being involved in the diversion of our products.

We are gratified to acknowledge that we are winning some battles, but we also acknowledge that there are many more that we must continue to fight. The new technologies and, in particular, electronics offer greater opportunities to legitimate entrepreneurs to develop innovative business models. However, these new technologies also offer criminals opportunities to bypass the law. Therefore, it is imperative that we stay active on all fronts, remain up to date on the latest developments and enhance the countermeasures vital to battling illegal trade and activities.



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[Back to Executive Summary](#)



[Back to Regional Highlights map](#)

[Foreword](#)

[Introduction](#)

[Designing a Smoke-Free Future](#)

[Our Commitment in Action](#)

CHAPTER 01: OUR STATUS

[Global Numbers](#)

[ENFORCE Icons](#)

[Tracking and Tracing](#)

[Regional Highlights](#)

[Preparing to Meet the EU Tobacco](#)

[Products Directive Requirements](#)

[Memorandum of Understanding](#)

[- Status & Objectives](#)

[Anti-Counterfeiting Protocol](#)

[Protecting a Smoke-Free Future](#)

CHAPTER 02: HIGHLIGHTS (SHARING REGIONS AND MARKET LEARNINGS)

[Benefits of a Risk-Based Approach](#)

[Risk-Based Approach -](#)

[Sharing our Learnings](#)

[Executive Summary](#)

[Sharing our Learnings](#)

[Algeria](#)

[Ukraine](#)

[Belgium](#)

[Poland](#)

[Kuwait](#)

[EU](#)

[Russia, Ukraine & Kazakhstan](#)

[Conclusion](#)



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