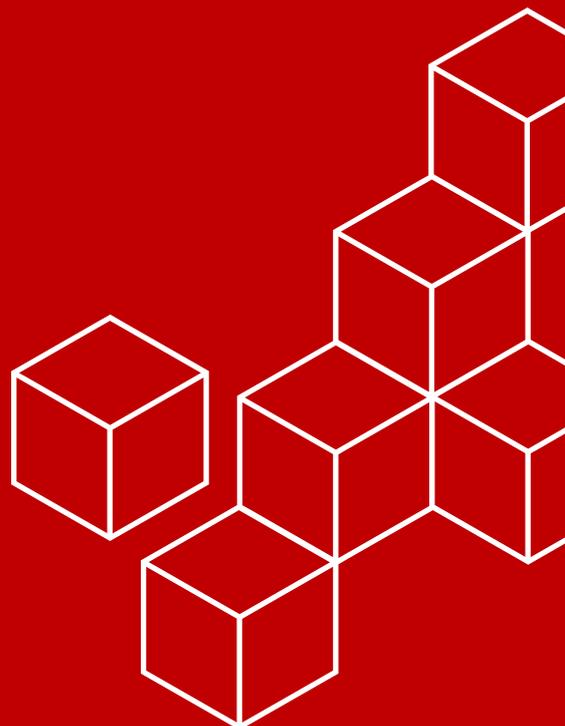


Illicit Market Report: Impacts of Upcoming Vaping Restrictions

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VITA·ARIV 
VAPING INDUSTRY TRADE ASSOCIATION
ASSOCIATION DES REPRÉSENTANTS DE L'INDUSTRIE DU VAPOTAGE



Impacts of Incoming Vaping Restrictions

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The Vaping Industry Trade Association of Canada (VITA) represents vaping industry retailers, distributors, manufacturers, and importers by working with stakeholders and governments to help set and uphold vaping product and sales regulations. VITA is committed to collaborating with Health Canada and other regulatory bodies to promote evidence-based, logical solutions for ensuring that vaping remains available as a harm reduction alternative to cigarettes for adult smokers.

VITA advocates for fair, science-based solutions that protect consumers while allowing for entrepreneurial success in the vaping industry and works to ensure members adhere to strict quality control and safety standards. It also works to educate consumers, governments, and stakeholders about how to use, sell, and promote vaping products to adult smokers responsibly.

Executive Summary

Considering the recent legislative and regulatory changes being enacted or proposed by Health Canada, VITA has undertaken a comprehensive mystery shopping scan, using a reputable investigative agency. We are concerned that these regulations, while well intentioned, may in fact be counterproductive to the stated policy goals and result in many unintended consequences. The scan took place during August 2021, and as a result of the investigation we have discovered the following:

- There is widespread availability in all avenues for the Canadian public to purchase vaping products that are prohibited and noncompliant. There is little to no barrier for average Canadians to acquire these products via online purchases or through retailers both on- and off- reserves throughout Canada and internationally. As a result, the stated purpose of the regulations is being undercut and has little to no effect on the actual marketplace and product availability for Canadians.
- Insufficient oversight and enforcement at all levels is a significant issue across the industry. This lack of enforcement has created an unlevel playing field in the vaping industry with customers seeking to maintain their preferred products and flavors. This leads to companies that are compliant facing a significant competitive disadvantage compared to non-compliant companies.
- Retail shops have begun developing their own inhouse products with non-compliant labelling, at strengths and flavours that are prohibited. This trend will result in a type of circumvention that will be hard to detect as products are made 'on demand' without being evident or onsite during inspections.
- This trend is prompting a strong 'do it yourself' framework for vapers that can access flavors and easily add them to their own products. There is a major concern in the industry that some are using overly strong, incorrect, and inconsistent concentrations. The potential of mishaps increases and could result in health and safety concerns by those self-manufacturing. Flavors that are being added are often intended for foods and are not always suitable for vaping (water soluble vs oil based) which could present significant negative health impacts to users.

- Collectively these regulations are pushing the industry from a professional environment with robust quality control and a commitment to compliance, to an untaxed, unregulated, and unsophisticated DIY industry that is the opposite of the intent of the regulations.
 - More restrictive regulations have increased cigarette sales and have been attributable to pushing consumers back to using harmful combustible products.
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- Nova Scotia enacted stringent regulations similar to what Health Canada is now proposing. They have resulted in widespread economic hardship and closure of the 73% of surveyed vape stores in the province (44% closed within 60 days). Those remaining have struggled, which has led to widespread noncompliance in order to maintain any economic activity. These restrictions have been viewed as heavy handed and resulted in frameworks (including ingenious sources) to effectively circumvent and sell illicit products including black market sales, aliases for flavors, deceptive packaging, and purposeful sale of illicit products by previously compliant retailers “under the counter”.
 - Some manufacturers that have been heavily affected by the ban have begun to implement deceptive packaging specifically to circumvent the regulations and avoid detection. This is done specifically in response to the Nova Scotia regulations that will be further amplified if similar regulations are put in place nationwide. This pushing of otherwise legitimate manufacturers into the illicit space due to what is perceived as over-regulation is a major concern for VITA and the future legitimacy of the vaping industry in Canada.
 - Excessive regulations are prompting and pushing the industry into making products that in most cases follow the rules but not the ‘spirit’ of the regulations. Products are being developed to mimic the “harsher throat feel” of product strengths beyond federal regulations without technically going over the line. These products may have some health and long-term use impacts compared to current product offerings that are being forced out of the market.
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Vaping Regulations: Pending Changes

Pending changes:

- No flavours beyond mint, menthol and tobacco
- Implemented 20 mg/ml Nicotine maximums (70% reduction from previous levels)
- Short sell-off period

Health Canada is currently in the process of banning all flavoured vaping products, except mint, menthol, and tobacco-based flavours. These regulations will add to existing restrictions with little to no research on their impact. Health Canada has also implemented new restrictions that ban the sale of any e-liquid vaping product over 20 mg/ml. These legislative changes are being undertaken quickly with no ability for products to be phased out in a meaningful manner, leaving vaping shops with a substantial amount of their stock that cannot be sold legally. The banning of products during the hardships of COVID restrictions have placed an enormous additional burden on the often small- and medium- sized vape stores.

Read the full upcoming vape regulation changes at tinyurl.com/VapeRegChanges

Many customers and retailers have voiced concerns about the heavy-handed approach being undertaken with vaping regulations. These regulations have prompted near universal comments and resistance by users and industry that believe that they are counter-productive and are going to force many Canadians back to combustible tobacco products while removing a legitimate and useful tool for harm reduction and smoking cessation.

Impact of new regulations by the numbers:

Direct cost in lost inventory:
\$58,254,497 CAD

Collective impact upon the legitimate industry in 2021:
\$78,830,767 CAD

Recent regulatory changes focus on reducing the concentration of nicotine levels substantially (down to 20 mg) from levels three times higher. Additionally, flavors often popular with customers (both adult and youth) are being prohibited in an effort to curb usage. This will prohibit the sale of large volumes of inventory held by the vape industry estimated by the federal government to be worth at least \$58,254,497 in 2021 alone. Further, this will result in an estimated \$20,557,588 in lost gross margins. Combined, this represents a collective impact upon the legitimate industry of \$78,830,767 in 2021. These losses are just the tip of the iceberg, and will be catastrophic to an industry dominated by small-medium sized businesses

Vaping Regulations: As They Are Now

80-90%

Of sales in Nova Scotia specialty vape shops came from non-tobacco flavours before the flavour ban

44%

Of small, brick-and-mortar vape shops in the province closed within 60 days of the Nova Scotia flavour ban

25%

Increase in provincial cigarette sales after the Nova Scotia flavour ban came into effect

Ontario:

As of September 2021, regulations in Ontario limit where, how, and what can be sold. These regulations dictate placement and presence on the sales floor based on point-of-sale (Vape shops/C-stores), and limit almost all promotion of vape products. Regulations also ban the sale of any products over 20 mg/ml, and restrict the sale of any flavours beyond mint, menthol and tobacco, to age restricted specialty vape stores where no one under nineteen may enter.

Nova Scotia:

Nova Scotia was the first province to have banned flavoured vaping products provincially before the federal flavour ban was proposed. In April 2020, the flavour ban in Nova Scotia came into effect.

Prior to this, 80-90% of specialty vape shop sales came from non-tobacco flavours, and an average of 60% of best-selling tobacco flavours sold in shops were tobacco/fruit and tobacco/desert blends. Within sixty days of the flavour ban, 44% of specialty vape shops had closed, citing the flavour ban as the main reason for the decision.

In July of 2020, a new requirement for vape shops to obtain licensing came into effect. In September, a new tax was applied on vape products, of \$0.50 CAD per ml of vaping liquid bought, and 20% on devices which often doubled the price compared to any other province). Additional regulations came into force to restrict nicotine in vape products to 20 mg/ml.

The lack of enforcement of these regulations in Nova Scotia has allowed widespread non-compliance to permeate the marketplace. Retailers have noted that there are two compliance officers for the entire province whose job it is to ensure that vape market regulations and restrictions are being followed. However, the posting of a compliance officer is difficult and rotates every six months leaving officers with little long-term experience. This lack of sufficient resources has left the market to effectively self-regulate against their own interest.

At this point, cigarette sales had risen a worrying 25% since the flavour ban, significantly higher than other Atlantic provinces at 7%, which shouldn't be surprising to regulators, given Health Canada's previous statements on the issue.

Pushing vapers back to cigarettes

Health Canada's Regulatory Analysis Impact Statement, published June 19th, 2021 in the Canada Gazette regarding a potential federal flavour ban has admitted that:

"After the proposal comes into force, it is anticipated that some dual users who currently use flavoured vaping products would not substitute their purchases with tobacco and mint/menthol-flavoured vaping products. They would choose to purchase more cigarettes, hence offsetting the loss of sales of tobacco- and mint/menthol flavoured vaping products."

Health Canada allows very little promotion of vaping products, but under certain circumstances Health Canada statements such as "Vaping products and e-cigarettes deliver nicotine in a less harmful way than smoking cigarettes" may be usable. Unfortunately, Health Canada has yet to release a list of authorized relative risk statements that can be used by companies in the promotion of vaping products. This is even though Health Canada recognizes that vaping is a less harmful option for smokers, and that flavour bans on vaping products will push smokers back to cigarettes.

The point of this regulation is to protect underage kids from getting hooked by vape products, which VITA recognizes as an admirable goal, however consumers still have easy access to flavoured vaping products. If the regulation doesn't prevent kids from accessing vape products, and pushes vapers back to more harmful options like cigarettes, is this truly the best way to achieve the stated policy goals?

The Investigation:

Methodology

Online Sales

Examining online vape stores in Canada for compliance with regulations and availability of products for customers in

Stores on Reserves

Mystery shoppers visited stores on reserves to check the availability of regulated products for average Canadians.

Nova Scotia

Visiting stores in a province with existing flavour and strength restrictions to check whether these products continue to be sold “under the table”.

In order to gain a clear understanding of the effects of a flavour ban, VITA sought an environmental scan of products and suppliers that are non-compliant with existing regulations. This provides the ability to showcase the widespread availability of non-compliant products and how the restriction on legitimate enterprises leads to an uncompetitive environment and pushes customers to illicit products and illicit providers. Understanding the need for professional, above-board research, VITA hired a non-partisan investigative firm with extensive and credible experience examining issues of noncompliance and illicit market activity. They undertook a mystery shopping survey in Nova Scotia, Online(domestic & international) and within Indigenous reserves in Ontario and Quebec. A key objective was to determine if the average Canadian customer can still access prohibited products and banned flavours.

The existing regulations and regulatory compliance in place by governments in Canada do not prevent consumers from accessing flavours, but instead put small, brick-and-mortar businesses on an unfair playing field against stores that do not comply and push consumers to the black market for their needs.

Our mystery shopping focused upon E-liquid, vape pods, and disposable vapes, with emphasis on anything above the federally mandated 20 mg/ml nicotine cap, and any flavours beyond mint and tobacco (the flavours that are not threatened by the proposed ban).

The Investigation:

Canadian Online Sales

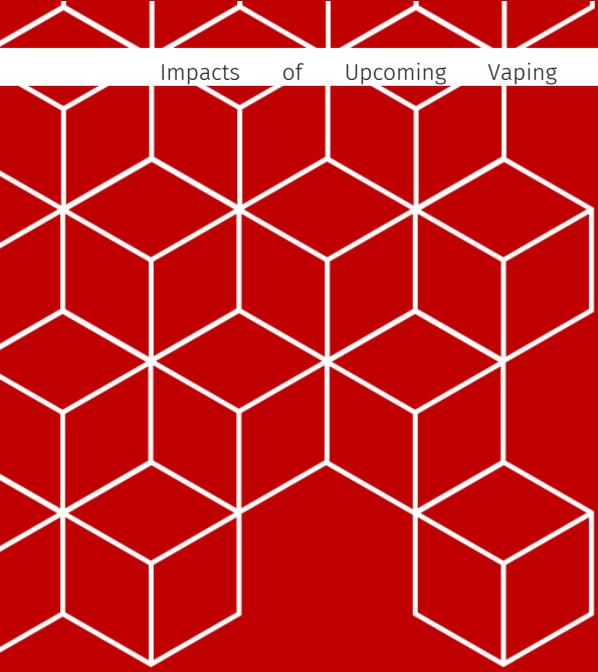
On the behalf of VITA, investigators looked into online sales in Canada with the ability to deliver to Nova Scotia. This mystery shopping and scan was completed to understand whether concentration and flavour bans currently in place achieve their goal of keeping flavours out of reach. There are hundreds of Canadian-focused vaping sites easily accessible through online search engines, with many physical stores having online counterparts. These stores are based across the country, from provinces with and without various vaping restrictions in place.



In a sampling of nineteen stores selected at random from the larger lists provided by online search engines, 15 websites sold vape products online. Of that group of 15:

- 93% of stores sold flavoured products beyond mint, menthol and tobacco
- 93% of stores sold confectionary-based flavours, and of that group, 79% advertised products as being dessert-flavoured, which is federally prohibited
- 87% were age-gated, and 53% had a Health Canada warning visible on their site

Stores often had clever solutions to get around existing regulations, such as using subtle names for dessert flavours (ex: “Polar Bear” instead of Chocolate Thin Mint Cookie), encouraging customers to do an online search or provide a link to outside reviews (like YouTube videos) where influencers describe the flavours that Canadian websites cannot.



- 93% of stores will ship flavoured products to provinces with flavour bans
- New product lines designed to feel harsher on the throat are emerging in response to strength restrictions
- Pop culture references are being used by non-compliant companies to promote vaping

Though almost all online stores were compliant with the Canadian 20 mg/ml nicotine cap, brands are finding ways to satisfy consumer demand. New product lines such offer a hybrid nicotine product designed to give a harsher feeling vape that will “make 20 mg/ml feel like 50 mg/ml” without breaking any rules. These product offerings indicate that the current regulations seem to be encouraging manufacturers to create products that are designed to comply with regulations, while attempting to effectively satisfy the pre-existing demand for a product that is no longer legally available.

Some websites just break the rules outright, selling past the 20 mg/ml cap or using popular culture references to promote products, like naming them after famous celebrities and characters, or by choosing a name customers will recognize without appropriate trademark licensing authorizations and advertising compliance. Examples of this include “Black Mamba” and “Queen’s Gambit” salts, “Red Wedding,” “Pinkman,” and “Heisenberg” pods.

Of the stores that offered flavoured products, 93% were willing to ship to provinces with existing flavour bans. From the consumer perspective, it is very quick, easy and convenient to locate, purchase, and have flavoured or illegally strong products shipped to your door. Clearly, flavour bans are failing to restrict certain products from flowing into their impacted areas; the sales have just moved from entrepreneurial businesses within the province to businesses outside of it that might not be as heavily regulated or that lack enforcement. This trend will increase by orders of magnitude if flavour restrictions are applied nation-wide. This will cause consumers and industry to increasingly purchase internationally, negatively impacting the Canadian vape sector to the benefit of other nations.

The Investigation: Stores on Reserves

Shopping on Indigenous Reserves is a common activity for Canadians living off-reserves, and is another avenue to access vapour products.

Mystery shopping was undertaken by investigators to determine enforcement or compliance of restrictions and products being sold on Indigenous reserves in Ontario and Quebec. It is important to note that this report does not seek to criticize the treaty rights and ability to conduct trade on reserves by Indigenous peoples. VITA recognizes the importance of existing treaties and alternative regulatory frameworks that govern commerce. This mystery shopping is intended to showcase the potential availability and range of products on reserves.

Indigenous Reserves have long been known to Canadians as a cheap place to stock up on tobacco, gas and cannabis products, due to the lack of taxes charged on reserves and the freedom from restrictions on what can be sold.

As flavor and concentration bans are implemented, it is useful to understand and predict avenues that Canadians might explore to fill the void left by a flavour ban. The reserves visited by VITA were four of the largest and most populated reserves in Ontario and Quebec, namely; Tyendinaga, Six Nations, Kahnawake, and Kanesatake. All are close to major population centers and major highways.



VITA respects the sovereignty of Indigenous people. However, Indigenous local governance structures and frameworks have diverged from off-reserve regulations. It is important to note that this has resulted in a dual regulatory system that affects many markets in Canada. The implementation of a federal flavour ban will likely exacerbate this divergence.

VITA noted several concerning behaviours during its scan, including selling expired products, incentive (free gift) programs for buying, an abundance of sales and specials, and lower prices than the Canadian average. Products were usually openly displayed in places where they could be visible to minors. Strength of products often ranged as high as 50 mg/ml, more than double the federal limit.



0% of stores (surveyed) on reserves that sell vape products checked ID



80% of stores sold products stronger than the federal nicotine cap of 20 mg/ml



The most common strength of vape products available was 50 mg/ml



95% of stores selling vape products had flavours available beyond mint, menthol and tobacco

The Investigation: Nova Scotian Stores

During VITA's investigators' secret shopping scan in Nova Scotia vape stores, we found an abundance of products with flavours and potencies beyond those allowed by regulations, which should concern both regulators and enforcement. We found a large variety of products at the 35 mg/ml and 50 mg/ml, that often-included fruit and confectionary flavours.

The source and forms of the products varied from disposables imported from China, to flavoured pods imported from the US, and other Canadian provinces, as well as e-liquids which appeared to be manufactured DIY-style in the back of a vape shop. These products are coming in from unregulated markets without any oversight or guaranteed quality control. The unknown factors involved in these products could pose a greater health risk to Canadian consumers compared to regulated products on the Canadian market.

In our investigation, we were told repeatedly by vape store employees that they feel the government is unsympathetic to their struggles and have forced them between a rock and a hard place with the regulations banning the sale of flavoured products. They also said that they were not given the chance to sell off existing stock, which can cripple the purchasing power of small businesses. This situation is pushing legitimate retailers who were and want to be compliant and respectful of regulations to sell prohibited products under the counter to survive. Enforcement is not strong enough to prevent these issues; most stores communicated that they had never been "raided" – meaning they haven't had a detailed inspection in the past year.



One shop owner bragged that they have a foolproof strategy to avoid being investigated: when they see anyone in their parking lot with a clipboard, they lock the door and turn out the lights.

Of equal concern is an emerging incognito packaging trend. Some large Canadian manufacturers of vape pods and e-liquids are purposefully packaging flavoured pods and e-liquids under tobacco flavour names for sale in the Nova Scotia market, in order to allow retailers to hide the flavours from inspectors. Stores we visited were well-aware of the intentional work-around, and often had coding charts to determine which real flavour corresponded with each kind of fake packaging. For example, one popular brand of pod system uses letters from the legal flavour name in other provinces to identify the actual flavour which is prohibited in Nova Scotia.

Examples of questionable packaging found in Nova Scotian stores:

Packaged as	Actual Flavour
Tobacco – A	Apple
Tobacco – C	Cherry
Tobacco – G	Grape

Note: Product names/flavours have been changed to avoid singling out any brands. This table is for example only

The restrictions placed on the Nova Scotia market are pushing formerly compliant manufacturers to use fraudulent packaging, and stores have the weighty burden of deciding what is more important; finding a way to continue selling their most popular products to remain competitive or complying with regulations and going bankrupt.

Flavoured vapour products are still readily available in Nova Scotia, despite the existing flavour ban. The major changes since the new regulations came into force are creating an increasingly difficult sales environment for small businesses already struggling through a global pandemic. The lack of consistent enforcement, the availability of various non-compliance strategies being utilized by competitors, including packaging, DIY, and under the counter sales, are forcing small business owners to make an impossible choice in an already difficult situation.

Conclusion

The bottom line is, when it comes to getting around flavour bans and concentration limits, Canadians have options. The range of options include a variety of methods, both in-person and digital, to purchase products, whether it be under the counter at regulated shops, buying online and having it shipped to your house, shopping on reserves, or trying even riskier options like making their own products or the black market.

It is evident that the customer does not face barriers to purchase and use restricted vape products. With the impending federal regulations, only the regulatory compliant retail and manufacturers will be affected, with a persistent source and availability of illicit products remaining in the marketplace.

In actuality, the regulations being imposed nation wide will in fact increase the illicit vaping industry, increase unregulated product use by consumers and enhance the untaxed and non-compliant markets. This will push the burgeoning vape industry back underground and its benefits such as stability and quality control for Canadian consumers will be lost.

With no ability to sell off existing stock or a reasonable phase out period, this will force small business owners to take a loss

on \$58,254,497 of existing product, rendered unsellable by the ban. This large burden will prompt some retailers to maintain selling prohibited stock to recoup their existing investments. The lack of a proper phase out period inherently poses a large ethical challenge to retailers heavily impacted by these changes.

The incoming flavour ban has been recognized by Health Canada as having the potential to push nicotine users back to much more harmful options like cigarettes, and yet it is being touted as a harm reduction strategy. While these regulations are designed to limit desirability of vape products by youth, the ban will not actually prevent access. By limiting vape products that customers desire, these regulations will in fact push vapers back to cigarettes with all the associated health risks and damages.

The proposed regulations, from our perspective will not meet the stated policy goals and will in fact hurt small businesses in the middle of an ongoing global pandemic, steer current vape users back into combustible products and provide a sustained boost to the illicit market.

We need to return to regulations that are practical, research-based and collaborative solutions that work for all stakeholders who all seek to improve the health of the Canadian public, and VITA stands ready to assist in that process.

