March 12, 2019

To: U.S. Senate Finance Committee

From: Interfaith Center on Corporate Responsibility (ICCR)

Re: Statement for the Record by ICCR before United States Committee on Finance hearing on "Drug Pricing in America: A Prescription for Change, Part II"

Mr. Chairman, Ranking Member and Members of the Committee:

ICCR is a coalition of over 300 global institutional investors representing more than $400 billion in managed assets. Leveraging our equity ownership in some of the world's largest and most powerful companies, ICCR members regularly engage management to identify and mitigate social and environmental risks resulting from corporate operations and policies. While ICCR members never shy away from making the moral case for action, our fundamental proposition as investors is that responsible and sustainable business practices - and a strong corporate culture of ethics - are in the long-term interest of companies, investors and communities.

ICCR members have a long-standing history of engagement with pharmaceutical companies on issues of price restraint, equitable pricing strategies, anti-competitive practices, marketing policies and practice, as well as disclosure of R&D expenditures (e.g., report on the number of products in the R&D pipeline that are new versus enhanced versions of existing products) and lobbying/political activities with agendas that may restrict the access and affordability of medicines.

For decades, ICCR members have pressed drug companies for greater disclosures on pricing structures as a way to promote greater access to medicines. A lack of transparency around how drug prices are determined has led to an industry-wide ethos of "whatever the market will bear", which can lead to predatory pricing. We have asked companies to disclose the rates of price increases year-to-year of their top selling branded prescriptions drugs and to disclose the rationale and criteria used for these price increases. We have also asked the companies to assess the legislative, reputational and financial risks these increases represent for the companies. However, that lack of transparency still prevails.

Most recently, we have become increasingly concerned about pharmaceutical companies' governance structures and their Boards' ability to proactively mitigate risk related to high drug prices. A 2017 Credit Suisse analyst report stated that "US drug price rises contributed 100% of industry EPS growth in 2016" and characterized that fact as "the most important issue for a Pharma investor today." In response to this, in

2018 ICCR members filed [resolutions] at the companies highlighted in the 2017 Credit Suisse report asking "the Compensation Committee (the 'Committee') to report annually to shareholders on the extent to which risks related to public concern over drug pricing strategies are integrated into [company's] incentive compensation policies, plans and programs ("arrangements") for senior executives. The report should include, but need not be limited to, discussion of whether (i) incentive compensation arrangements reward, or not penalize, senior executives for adopting pricing strategies, or making and honoring commitments about pricing, that incorporate public concern regarding prescription drug prices; and (ii) such concern is taken into account when setting financial targets for incentive compensation arrangements." In other words, are executives incentivized to simply increase the price of drugs with no added benefit in clinical efficacy simply to meet short term revenue targets?

In particular, we are seeking better articulation of the goal-setting process and the translation of those goals into incentive pay targets. We would strongly encourage you, as members of the Senate Finance Committee, to also seek written answers to the following questions:

- How assumptions about price changes are incorporated when revenue goals are set;
- Whether any policy or guideline exists regarding the preferred proportion of revenue growth derived from price increases;
- Whether any policy exists regarding unplanned price increases that would enable revenue goals or compensation revenue targets to be met and whether the board has to approve such increases; and
- How the compensation committee uses revenue goals or estimates to produce the various target levels (e.g., minimum, target and maximum) used to determine incentive payouts.

Mirroring Senator Wyden's concern that AbbVie's CEO's bonus is directly tied to the sales of Humira, we have also been asking why Humira sales are an appropriate measure for AbbVie's short-term incentive plan (STIP), and whether the company considers pricing increases when awarding STIP? AbbVie uses net revenue, income before taxes and Humira sales as metrics for the annual bonus and earnings per share (EPS) as a metric for certain long-term incentive awards to senior executives. For Pfizer, it is concerning to investors that the company publicly states that "innovation in medicine has been and continues to be the cornerstone of the company," yet no pipeline metrics are included in the executive incentive agreements.

In addition to increased disclosure on incentive structures, we have also asked companies to formalize board oversight of prescription drug pricing risk. For example, what is Pfizer's board oversight of drug pricing, or lack thereof, which may have led to the settlement of the co-pay kickback investigation and drug shortages due to manufacturing or market issues. A 2018 Credit Suisse report highlighted AbbVie as among the companies most at risk from specialty pricing pressures in commercial insurance. Humira, which accounted for 65% of AbbVie's revenues in 2017 now faces competition in Europe from biosimilars, which are expected to cost less. Therefore, robust board oversight of risks related to drug pricing would provide a valuable outside perspective and help ensure that those risks are being managed for the long term.

Lastly, we also recognize that the strategy to expand monopolies without any meaningful new science is an unsustainable business model that exacts a heavy cost on patients and on the systems in which they seek care, and therefore, encourage companies to refrain from engaging in anti-competitive practices.

As investors, we want the companies in which we invest to be successful in the long term, with sustainable business models that deliver value to customers and stakeholders. Because pharmaceutical companies derive their social license to operate from their contribution to public health, it is critical that their businesses – including their executive incentives structures – reinforce, not undermine, that social contract. After many years of investor engagement in an effort to promote greater access and affordability of medicines, today we seriously question the value pharmaceutical companies are delivering to their shareholders and to the greater public.

If you have any questions, please contact, Meg Jones-Monteiro, Program Director – Health Equity, mjonesmonteiro@iccr.org or (212) 870-2984.

APPENDIX: 2019 ICCR EXECUTIVE INCENTIVES AND DRUG PRICING RISK RESOLUTIONS

2018 Companies: AbbVie, Amgen, Biogen, Bristol-Meyers Squibb, Eli Lilly
2019 Companies: AbbVie, Biogen, Bristol-Meyers Squibb, Celgene, Johnson & Johnson, Merck & Co, Pfizer, Vertex

Example 2019 Resolutions:

AbbVie (ABBV)

RESOLVED, that shareholders of AbbVie Inc. ("AbbVie") urge the Compensation Committee (the "Committee") to report annually to shareholders on the extent to which risks related to public concern over drug pricing strategies are integrated into AbbVie's incentive compensation policies, plans and programs (together, "arrangements") for senior executives. The report should include, but need not be limited to, discussion of whether (i) incentive compensation arrangements reward, or not penalize, senior executives for adopting pricing strategies, or making and honoring commitments about pricing, that incorporate public concern regarding the level or rate of increase in prescription drug prices; and (ii) such concern is considered when setting financial targets for incentive compensation arrangements.

Supporting Statement: As long-term investors, we believe that senior executive incentive compensation arrangements should reward the creation of sustainable long-term value. To that end, it is important that those arrangements align with company strategy and encourage responsible risk management.

A key risk facing pharmaceutical companies is potential backlash against high drug prices. Societal anger over exorbitant prices and pressure over limited patients' access due to unaffordability may force price rollbacks and harm corporate reputation.

We applaud AbbVie for committing not to increase prices by more than 10% for 2018, yet we are unaware of a like commitment for 2019 or beyond. Moreover, we are concerned that the incentive compensation arrangements applicable to AbbVie's senior executives may undermine any such commitment.

AbbVie uses net revenue, income before taxes and Humira sales as metrics for the annual bonus and earnings per share (EPS) as a metric for certain long-term incentive awards to senior executives. (2018 Proxy Statement, at 31) A 2017 Credit Suisse analyst report stated that "US drug price rises contributed 100% of industry EPS growth in 2016" and characterized that fact as "the most important issue for a Pharma investor today." The report identified AbbVie as a company where price increases accounted for at least 100% of EPS growth in 2016. (Global Pharma and Biotech Sector Review: Exploring Future US Pricing Pressure, Apr. 18, 2017, at 1.) It has been noted that the company's 2018 9.7% price increase for Humira could add $1.2 billion to the U.S. healthcare system https://www.fiercepharma.com/pharma/drug-price-hikes-a-few-bad-actors-or-widespread-pharma?mkt_tok=eyJpIjoiWWpZeFltRTBOMlZoTkRJNSIsInQiOiJhckk2U0NqNXBxN0x2UCtvdVdIdzZVZXRIUHlrS0xZOVRBNXdTV1F0eVNBSDMxb3NWUGJsRWtNcFROZmlPYmM5d2hXd3VuV0k1dGlCelBTYmk2).

In our view, excessive dependence on drug price increases is a risky and unsustainable strategy, especially when price hikes drive large senior executive payouts. We believe that the company's strategy to use "nursing support," which the California Department of Insurance claims in its suit against the company to be largely a kickback scheme to boost Humira sales, may have been better managed by leadership if Humira sales were not an explicit part of the payment incentive plan (https://www.law360.com/articles/1084008).

The disclosure we request would allow shareholders to better assess the extent to which compensation arrangements encourage senior executives to responsibly manage risks relating to drug pricing and contribute to long-term value creation. We urge shareholders to vote for this Proposal.

Merck & Co. (MRK)

RESOLVED, that shareholders of Merck & Co., Inc. ("Merck") urge the Compensation and Benefits Committee to report annually to shareholders on the extent to which risks related to public concern over drug pricing strategies are integrated into Merck's incentive compensation policies, plans and programs ("arrangements") for senior executives. The report should include, but need not be limited to, discussion of whether (i) incentive compensation arrangements reward, or not penalize, senior executives for adopting pricing strategies, or making and honoring commitments about pricing, that incorporate public concern regarding prescription drug prices; and (ii) such concern is considered when setting financial targets for incentive compensation arrangements.

Supporting Statement: As long-term investors, we believe that senior executive incentive compensation arrangements should reward the creation of sustainable value. To that end, it is important that those arrangements align with company strategy and encourage responsible risk management.

We are concerned that the incentive compensation arrangements applicable to Merck's senior executives may discourage them from taking actions that result in lower short-term financial performance even when those actions may be in Merck's best long-term interests. Merck has committed to limit average price increases of its drugs to no more than the rate of inflation (https://www.marketwatch.com/story/merck-to-lower-price-of-hep-c-treatment-zepatier-by-60-commits-to-responsible-pricing-2018-07-19), but incentive compensation arrangements may be inconsistent with that commitment.

Merck uses revenue and pre-tax income as metrics for the annual bonus, and earnings per share (EPS) is a metric for performance share units granted after January 1, 2017. (2018 Proxy Statement, at 51, 61) A 2017 Credit Suisse analyst report identified Merck as a company where U.S. net price increases accounted for at least 100% of 2016 net income growth. (Global Pharma and Biotech Sector Review: Exploring Future US Pricing Pressure, Apr. 18, 2017, at 22)

In our view, risks to long-term value arise when large senior executive payouts can be driven by price hikes. Attention may focus on both high senior executive payouts and drug pricing, fueling public outrage. Ovid Therapeutics CEO Jeremy Levin has argued that incentives to boost short-term performance, such as EPS, lead executives to raise prices (and rebates to middlemen), starve research and development and buy back shares. (https://www.biocentury.com/biocentury/strategy/2016-09-19/why-jeremy-levin-says-executive-compensation-and-drug-pricing-must-)

Incentives may have societal implications, as one critic of high pay for healthcare executives has noted: "[I]f the most influential executives of these companies are being paid to keep that [cost] trajectory up, that's money that's being taken away from education or infrastructure or other parts of the economy that may not be growing as quickly, and maybe that we'd want to grow more quickly." (https://www.npr.org/sections/health-shots/2017/07/26/539518682/as-cost-of-u-s-health-care-skyrockets-so-does-pay-of-health-care-ceos)

The disclosure we request would allow shareholders to better assess the extent to which compensation arrangements encourage senior executives to responsibly manage risks relating to drug pricing and contribute to long-term value creation. For example, it would be useful for investors to know whether incentive compensation target amounts reflect consideration of pricing pressures. We urge shareholders to vote for this Proposal.

Pfizer (PFE)

RESOLVED, that shareholders of Pfizer Inc. ("Pfizer") urge the Compensation Committee (the "Committee") to report annually to shareholders on the extent to which risks related to public concern over drug pricing strategies are integrated into Pfizer's incentive compensation policies, plans and programs ("arrangements") for senior executives. The report should include, but need not be limited to, discussion of whether (i) incentive compensation arrangements reward, or not penalize, senior executives for adopting pricing strategies, or making and honoring commitments about pricing, that incorporate public concern regarding prescription drug prices; and (ii) such concern is considered when setting financial targets for incentive compensation arrangements.

Supporting Statement: As long-term investors, we believe that senior executive incentive compensation arrangements should reward the creation of sustainable value. To that end, it is important that those arrangements align with company strategy and encourage responsible risk management.

A key risk facing pharmaceutical companies is potential backlash against high drug prices. Pfizer has been criticized for repeated price increases, and in July 2018 President Trump called out "Pfizer & others" in a tweet, saying they "should be ashamed that they have raised drug prices for no reason"; Pfizer then postponed planned increases.

We are concerned that the incentive compensation arrangements applicable to Pfizer's senior executives may discourage them from taking actions, like foregoing price increases, that result in lower short-term financial performance even when those actions may be in Pfizer's best long-term interests.

Pfizer uses revenue and earnings per share (EPS) as metrics for the annual bonus and operating income as a metric for performance share awards. (2018 Proxy Statement, at 66, 68) A 2017 Credit Suisse analyst report identified Pfizer as a company where U.S. net price increases accounted for at least 100% of 2016 net income growth. (Global Pharma and Biotech Sector Review: Exploring Future US Pricing Pressure, Apr. 18, 2017, at 22) In its 2018 report, Credit Suisse characterized Pfizer's 2017 10% net price increase as above-average for the industry and noted that its list price increases were the second highest. (Global Pharmaceuticals: Scoring Sensitivity to Trump's Reforms, May 25, 2018, at 15, 20)

In our view, excessive dependence on drug price increases is a risky and unsustainable strategy, especially when price hikes appear to drive large senior executive payouts. Highlighting this connection, a March 2018 article carried the headline, "Pfizer CEO Gets 61% Pay Raise—to $27.9 Million—As Drug Prices Continue to Climb." (https://arstechnica.com/science/2018/03/amid-drug-price-increases-pfizer-ceo-gets-61-pay-raise-to-27-9-million/; see also https://www.usnews.com/opinion/articles/2017-08-30/bernie-sanders-take-on-big-pharma-and-lower-prescription-drug-prices) We are concerned that large payouts based on financial metrics that can be affected by pricing create risks for Pfizer.

The disclosure we request would allow shareholders to better assess the extent to which compensation arrangements encourage senior executives to responsibly manage risks relating to drug pricing and contribute to long-term value creation. For example, it would be useful for investors to know whether incentive compensation target amounts reflect consideration of pricing pressures. We urge shareholders to vote for this Proposal.