

MSCI ESG THOUGHT LEADERS COUNCIL

FROM MSCI ESG RESEARCH INC.

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INTRODUCTION TO THE MSCI ESG THOUGHT LEADER COUNCIL

The goal of the MSCI ESG Research Thought Leaders Council is to maintain our leading edge in research methodology by regularly seeking feedback and opinions from external experts in key industries and relevant ESG issue areas. The MSCI ESG Research Thought Leaders Council consists of a series of about four panels annually, with three to six members on each panel. We aim to assemble international experts with recognized leadership and expertise on the topic area related to the panel.

The first panel was held on February 10th, 2014 on the Pharmaceuticals industry. Panel members were asked to review MSCI ESG Research's proprietary MSCI ESG IVA rating methodology, as well as specific industry and company reports before participating in the official panel call with MSCI ESG Research analysts.

KEY TAKEAWAYS

- The council thought our approach captured the most relevant key issues for this industry, with risks and opportunities clearly outlined in the industry report.
- Distinguishing more clearly between policy datapoints and performance datapoints would benefit the analysis.
- Monitoring companies' supply chains is of the utmost importance to mitigate environmental and social risks facing the drug industry.
- Capturing companies' capacity for innovation is key, although challenges in developing accurate indicators remain high.

COUNCIL MEMBERS



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KEY DISCUSSION POINTS

1. SUPPLY CHAIN OVERSIGHT

All council members highlighted the importance of supply chain oversight for all the key issues (including environmental aspects) on which we assess Pharmaceuticals companies. In particular, being able to capture the proportion of products outsourced would be a metric that could add a lot of value to our analysis. However, council members acknowledged the difficulties of tracking the global supply chain, for which little comprehensive data exists.

2. TRANSPARENCY

The council recommended better communication on which metrics constitute policy versus performance in the rating model. One council member suggested to structure the approach for each key issue under the four following pillars: Commitments, Transparency, Performance, and Innovation in order to better clarify in which areas companies are under- or over-performing. Capturing future performance policy stance was also recommended as an important general indicator.

3. CAPTURING INNOVATION

Another key aspect is innovation, and finding a way to assess companies to be able to better differentiate the leaders and the followers. In terms of additional indicators, one suggestion was an assessment of the costs and benefits of drugs, especially in developing countries, although all recognized the difficulty of the exercise.

4. PRODUCT SAFETY & QUALITY

The council generally thought indicators related to Good Manufacturing Practices and recall policies could be given less weight in the IVA Rating model, because regulatory requirements dampen the ability to differentiate companies on this metric. We believe these comments will be addressed with improvements to the IVA model already in the pipeline for assessing Product Safety & Quality, which will be used for the next industry rating cycle.

To improve risk assessment, one suggestion was to further increase differentiation between products, as vaccines, biologics and chemicals present different safety risks.

Another suggestion was to differentiate between manufacturing risks and safety issues, and increase the scope of our analysis to parallel imports and counterfeiting. Another participant recommended looking at turnover of key personnel overseeing QA/QC functions as a potential signal of quality problems. In addition, all council members agreed that generic companies generally face lower risks from product safety and quality issues, but recognized the challenges of capturing the blurred lines between generic companies and R&D - based companies.

5. CORRUPTION & INSTABILITY

In terms of risk management, capturing risks associated with interactions with healthcare professionals is already an essential aspect of our analysis, and one suggestion is to look at recidivist behavior, which is currently addressed to some extent through MSCI ESG Research's controversies research. Council members agreed on the difficulties of assessing the gaps between regulations and common practice in countries where companies operate, i.e., capturing the politics associated with corruption, and thought that using the Corruption Perception Index as one of the risk indicators was a good way of capturing some of these risks. Suggestions were provided for finding more healthcare-specific risk indicators. As part of the assessment of risk management capabilities, council members acknowledged the challenges of being forward-looking, and explored the possibilities for looking at whether companies go above regulatory requirements.

Council members expressed positive feedback to the idea of assessing overall company exposure based on the country with the highest perceived corruption, regardless of the size of exposure to that country from a revenue segment perspective. This is an option we have been considering.

6. ACCESS TO HEALTHCARE (ATH)

Council members discussed the differentiation between the ATH strategies of companies based on whether these strategies are implemented by the generics divisions or not, i.e. whether these strategies are for patented or generic products.

The council asked questions about the criteria that MSCI ESG Research assesses as part of companies' ATH strategies, particularly with regards to how non-exclusive voluntary licensing performance is represented/assessed. The questions led to a discussion about how we can better communicate the scope and criteria used in this part of the model. We discussed how to overcome bias related to company disclosure, as panel members pointed to examples of companies whose programs may not be fully reflected through disclosure. In the context of a wide universe, most of the differentiation discussed by panel members was smaller differences among top-performing companies rather than differences between leaders and laggards across the global market cap. Discussion ensued as to how we might introduce more differentiation between low-income countries and

middle-income countries, and focus on unmet medical needs and priority diseases country by country.

Another suggestion was to find a way to include companies' public opinions on bilateral trade agreements related to intellectual property protection. Evaluating which companies take public policy positions against countries and are taking legal action, or support stronger trade agreements that undermine ATH, could yield some useful insights. We currently capture aspects of this suggestion through our controversies research and through the public policy positioning of companies KPIs but more systematically focusing on multi-lateral and bilateral trade agreements related to ATH would enhance coverage of this issue. Participants acknowledged that comprehensive information might be difficult to find.

¹ Annual ranking by Transparency International of countries by their perceived levels of corruption, based on expert assessments and opinion surveys

MSCI ESG IVA SEEKS TO ANSWER THE FOLLOWING QUESTIONS:

Question 1

What are the key ESG risks and opportunities facing companies in each sector?

Question 2

Do companies have ESG risk management strategies commensurate with the level of risk exposure they face?

Question 3

Do companies have strategies to capture potential opportunities from ESG trends?

MSCI ESG IVA rates and analyzes over 5,500 companies, covering the MSCI World, Emerging Markets, US, Canada, UK, Australia, and South Africa Indexes, in addition to 95% by market value of the Barclays Global Aggregate – Corporate Index. Additional bespoke coverage is available through MSCI ESG Research's Custom Research team. Analysts assess thousands of ESG data points across 34 key ESG issues, focusing on the intersection between a company's core business and the key industry ESG issues that can create significant financial risks and opportunities for the company.

MSCI ESG IVA applies a 3-phased analytical approach:

Step 1: Identify Key ESG Drivers of Risks and Opportunity for Each Industry

MSCI ESG IVA identifies four to six key ESG trends and issues where companies in that industry currently generate large environmental or social externalities; these are issues where some companies in those industries may be forced to internalize unanticipated costs associated with those externalities in the medium- to long-term.

Step 2: Evaluate Risk Exposure and Risk Management

MSCI ESG IVA analysts calculate the size of each company's exposure to each key issue based on a granular breakdown of a companies' business, then take into account the extent to which a company has developed robust strategies and demonstrated a strong track record of performance in managing its specific level of risks or opportunities.

Step 3: Rate and Rank Each Company against Sector Peers

Using a sector-specific key issue weighting model, companies are rated and ranked in comparison to their sector peers. The companies in each sector undergo an annual review and are updated on a rolling basis as well as in response to major events.

MSCI ESG IVA - KEY ISSUES

ENVIRONMENTAL	SOCIAL	GOVERNANCE
<ul style="list-style-type: none"> • Carbon Emissions • Product Carbon Footprint • Energy Efficiency • Insuring Climate Change Risk • Water Stress • Biodiversity and Land Use • Raw Material Sourcing • Financing Environmental Impact • Toxic Emissions and Waste • Packaging Material and Waste • Electronic Waste • Opportunities in Clean Tech • Opportunities in Green Building • Opportunities in Renewable Energy 	<ul style="list-style-type: none"> • Labor Management • Human Capital Development • Health and Safety • Supply Chain Labor Standards • Controversial Sourcing • Product Safety and Quality • Chemical Safety • Financial Product Safety • Privacy and Data Security • Responsible Investing • Insuring Health and Demographic Risk • Opportunities in Health and Nutrition • Access to Communications • Access to Finance • Access to Healthcare 	<ul style="list-style-type: none"> • Corruption & Instability • Financial System Instability • Business Ethics & Fraud • Anti-competitive Practices • Corporate Governance

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MSCI's ESG products and services are provided by MSCI ESG Research Inc. and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research are also used in the construction of the MSCI ESG Indexes. MSCI ESG Research is produced by MSCI's indirect wholly-owned subsidiary MSCI ESG Research Inc., a Registered Investment Adviser under the Investment Advisers Act of 1940.

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