SUSTAINALYTICS
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THE ESG RISK RATINGS

MATERIAL ESG ISSUE: ACCESS TO BASIC SERVICES

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How companies manage their ability to ensure affordability and accessibility of their medical products and healthcare services can pose varying degrees of social and governance risks to investors' portfolios. Sustainalytics' ESG Risk Ratings assess this risk through an analysis of the Access to Basic Services material ESG issue. This issue shows investors which companies are most exposed to this risk and how well they are managing it. In this backgrounder, we will examine why this issue is growing in importance, analyze which industries are most exposed to this issue and highlight companies that perform well on this material ESG issue.

The Growing Importance of Access to Basic Services

As healthcare costs continue to rise globally, accessibility of medical products and healthcare services remains a challenge in both developed and developing countries. The COVID-19 pandemic further highlighted pricing and accessibility issues, as institutional investors have urged pharmaceutical companies to follow principles of transparency and cooperation in their race to develop treatments and vaccines.

Scrutiny of drug pricing and affordability has increased in recent years, as public payers shift toward value-based models to control the cost of healthcare. This is particularly relevant in the US, which has the highest spending per capita on prescription drugs — on average approximately USD 1,200 per person per year. In the absence of regulatory oversight in the US, the Institute for Clinical and Economic Review (ICER) has gained importance as an independent body that assesses the cost effectiveness of prescription drugs. While an ICER designation of cost effectiveness is not necessary for reimbursement, payers appear to be using ICER analyses in negotiations with drug firms. Drug manufacturers are also pricing in anticipation of ICER's cost effectiveness scrutiny.

At the same time, in developing countries, according to the World Health Organization (WHO), nearly 2 billion people still lack access to important medical products and healthcare services[1]. This highlights the need for pharmaceutical and healthcare companies to expand their products and services in such markets, so that healthcare inequalities decrease. To expand their market share in developing markets, companies should develop and implement an inclusive business strategy that can prove viable in low- and medium-income markets.

Assessing the Unmanaged Risk of Access to Basic Services by Industry

Affordability and accessibility of medical products and healthcare services, in both developed and developing countries, is crucial to ensure equitable social development. While medicines have contributed to increasing life expectancy globally, quality of life, and save millions of lives every year, in the US, prices of branded drugs have been sharply increasing and not always with a commensurate health gain. Moreover, prices for branded drugs in the US are much higher than in any other country, with a recent study finding that prices for branded drugs in the US are approximately 2.5 times higher than in other developed countries. Pharmaceutical companies with high US revenue exposure, large global price discrepancies, and a history of large annual price increases are particularly exposed to pricing and affordability issues.

The ESG Risk Rating for a company's Access to Basic Services combines the risk it cannot manage due to the nature of its products or business model combined with the risk that it is not actively managing with relevant programs and policies. Applying our consistent and comparable ESG Risk Ratings model, we see that Access to Basic Services is material for approximately 250 companies in our comprehensive universe of more than 4,500 companies, spanning two industries and five subindustries. As indicated in Exhibit 1 below, companies in the pharmaceutical industry have the highest unmanaged risk scores on average, followed by healthcare.

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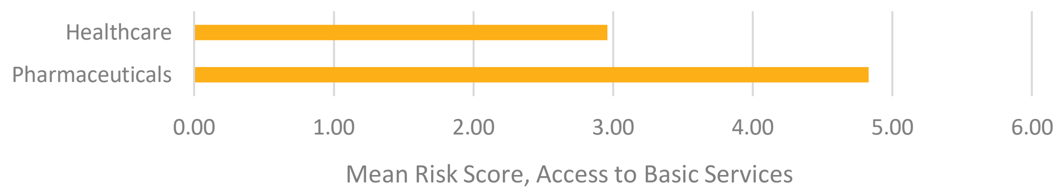
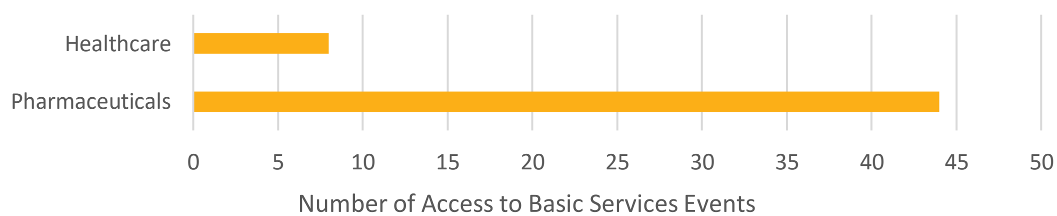
[1] https://www.who.int/publications/10-year-review/chapter-medicines.pdf

Exhibit 1: Unmanaged Risk by Industry (Source: Sustainalytics)



The ESG Risk Rating for a company's Access to Basic Services consolidates the risks it cannot manage due to the nature of its products or business model combined with the risk that it is not actively managing with relevant programs and policies in place. In contrast, incidents and controversies indicate a failure of the company's programs and policies. As seen in Exhibit 2 below, as of July 2021, Sustainalytics has recorded a total of 52 events related to Access to Basic Services, which are assessed on a scale of 1-5 based on impact on stakeholders and business risk. Events are captured through our news screening of more than 60,000 news items, third party sources or company and regulator reporting. For this issue, events often involve drug prices deemed not cost-effective by national watchdogs and lawsuits filed by third party payers alleging exponential drug price increases over time that are not justified by new clinical evidence.

Exhibit 2: Events by Industry (Source: Sustainalytics)



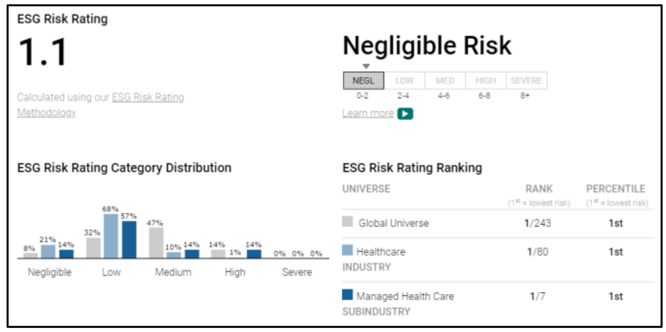
How Sustainalytics' Evaluates Companies on the Access to Basic Services

Leveraging our ESG Risk Ratings framework, we score companies on a set of subindustry-specific exposure and management indicators. We consider whether a company has in place polices and management programmes to ensure affordability and accessibility of its medical products or healthcare services. Depending on the subindustry, risk management scores are based on adoptions of value-based medicine or healthcare programs, transparency around price increases, global access initiatives, willingness to share IP in certain geographies of high need and low ability to pay, research into neglected diseases, customized pricing policies based on a patient's or nation's wealth, and the number and severity of pricing and affordability related controversies.

At the company specific level, exposure to pricing and affordability risks can vary based on a company's specific factors, determined by its portfolio and history of unjustified drug price increases. Increased exposure to pricing risks is identified for companies marketing drugs with a history of unsustainable price increases (as defined by the ICER Unsupported Price Increase Report) and for companies that mainly focus on insulin or other therapeutic areas with perceived pricing issues. Conversely, clinical stage biotech and pharma firms, or those focused on ultra-rare diseases, are significantly less exposed to pricing risk. Decisionmakers generally consider higher willingness-to-pay thresholds for such ultra-rare diseases.

One example of a company with strong management of this issue is GlaxoSmithKline (GSK), a pharmaceutical company headquartered in the UK. GSK develops and commercializes pharmaceuticals, vaccines and consumer healthcare products. As seen below, GSK falls within the negligible risk category for Access to Basic Services, putting it within the 2nd percentile for its subindustry.

Source: Sustainalytics ESG Risk Rating Report, GSK



Source: Sustainalytics ESG Risk Rating Report, Anthem

GSK's strong management around accessibility and affordability issues is demonstrated by its leading position in developing and marketing HIV treatments, accounting for 14.3% of its FY2020 revenues. GSK has leading programmes to enable affordable access to these treatments in developing countries and for low-income people in developed countries. Furthermore, GSK has a history of prioritizing global access, offering adequate disclosure on price increases, and avoiding large price hikes. The company also has the largest R&D pipeline that targets priority diseases, with the majority being HIV (16 out of 81 projects) and COVID-19 projects (16). Moreover, the company has ranked number one in the Access to Medicine Index for several years, and in FY2018 it also ranked number one in the Access to Vaccine Index, demonstrating outstanding practices to ensure patients' access to its products.

Another example of leading practice is Anthem, one of the world's largest private health insurance companies, located in the US. Anthem is within the negligible risk category for Access to Basic Services, putting it within the top one of its subindustry (Managed Health Care). Anthem has an enhanced personal health care programme, which supports reduced health care costs and improved patient outcomes. Through this programme, Anthem increases traditional fee-for-service with shared savings opportunities for providers when healthcare costs are less than projected, and certain quality measures, based on nationally accepted standards, are met. As of 2020, more than 60% of Anthem's health care spending was in value-based care models.

High U.S. Drug Prices Remain a Key Affordability Concern

While healthcare costs continue to rise globally, the US is the country with the highest costs per capita, amounting for USD 1200 annually on prescription drugs. Drug pricing in the US is close to double the price in most developed markets. While the US population represents only about 5% of the world population, the US market generates almost half of biopharma profits, driven by high drug prices. Such high drug prices not only increase pressure on the US healthcare budget but also jeopardize access to medicine, raising questions about the sustainability of drug price increases. Using our ESG Risk Rating framework, investors can clearly see which companies are most exposed to this important and growing issue and how well they are managing their related risks.

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