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Teva Pharmaceutical Industries

Engagement case study, July 2019
Hermes EOS

Engagement objectives

Social

Access to medicine

Governance

Executive remuneration

Board composition

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Teva Pharmaceutical Industries (Teva) has taken significant steps to align its executive compensation to long-term success and investor expectations, against a backdrop of high pay in the industry. Hermes EOS has been engaging with Teva on these issues since 2017 and continues to urge it to play a bigger role in improving access to medicines.

Background

We are increasingly concerned about the high levels of compensation for healthcare and pharmaceutical executives, and the type of behaviour current reward structures can incentivise. A recent study[1] showed that median pay for healthcare and pharmaceutical executives amounted to $14.5 million in 2015, higher than any other sector.

In 2017, Teva appointed a new chief executive officer (CEO) with a remuneration package that included a $20 million cash signing bonus (vesting over six months) without performance conditions; a $2 million annual cash salary; and a performance-linked bonus. This raised serious concerns as the total value of the package was significantly above the peer median, without strong performance conditions or significant minimum shareholding requirements linking it to the long-term success of the company.

Teva's strong industry presence in the generic pharmaceuticals business makes it particularly sensitive to product pricing issues and therefore access to them. With a portfolio that addresses diseases most prevalent in emerging markets, including epilepsy, HIV/AIDS and asthma, Teva is in a unique position to pursue access to medicine opportunities. At the same time, Teva faces an ongoing lawsuit in the US over alleged price inflation of its generic drug portfolio.

Our engagement

Following the appointment of the CEO in 2017, we engaged with the company on remuneration and recommended a vote against the 2018 say-on-pay proposal. Our engagement intensified in late 2018 and early 2019 as the company sought investor feedback ahead of its 2019 annual shareholder meeting. We met with the chair of the board and chair of the compensation committee to express our concerns about the excessive quantum of the executive compensation, which in our view had not been sufficiently justified. We explained that we believe pay should be aligned to the long-term success of the company and desired corporate culture, best achieved through long-term share ownership. We subsequently wrote to the chair of the compensation committee to reiterate our concerns. Given the excessive compensation awarded, we urged the company to require the CEO to buy shares annually, out of his own funds, to build up the minimum shareholding requirements.

Company overview

Teva is one of the largest generic pharmaceutical manufacturers in the world. In the US alone, one in eight generic prescriptions is comprised of Teva products.

[1] https://www.ibtimes.com/healthcare-pharma-ceos-paid-more-top-execs-any-other-industry-analysis-finds-2374013.

We also encouraged the company to begin to build a more coherent strategy on its approach to access to medicines. We have explained that access issues, in particular pricing strategies, should be embedded in the business and survive disruption.

Changes

Teva has since taken significant steps to strengthen its executive compensation in line with the expectations of long-term shareholders and agreed that it needs to further align executive compensation to the long-term success of the company. The company informed us in writing that it has increased the minimum shareholding requirements for the CEO to six times the base salary. At the same time, Teva already prohibited the hedging and pledging of shares by executives[2], preventing executives from diversifying out of the stock whilst still meeting the minimum shareholding requirements, which we believe helps to demonstrate a commitment to long termism.

Overall quantum remained high in 2018, due to the sign-on bonus vesting. However, the company has stressed that it does not intend to use one-time sign-on awards of such magnitude and structure in the future.

Next steps

Whilst continuing to engage on executive compensation, we believe Teva also has a significant role to play in providing access to medicines to underserved populations. Specifically, we continue to encourage it to increase disclosure around its pricing policies, both in the US and in developing markets. We aim to ensure that eligible patients, prescribed Teva's potentially life-saving medicines, can access them through innovative, affordability-based approaches.

[2] Hedging is a strategy to offset or reduce the risk of price fluctuations for an asset or equity. Hedging of company stock severs the ultimate alignment with shareholders' interests. Hedging and significant pledging of shares can be used to undermine share ownership requirements by enabling the effective sale of the economic interest in the shares while still meeting the strict policy criteria of ownership. ISS 2013 Comprehensive US Compensation Policy, https://www.issgovernance.com/policy-gateway/2013-comprehensive-us-compensation-policy/.

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HERMES INVESTMENT MANAGEMENT

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Credit
Absolute return, global high yield, multi strategy, global investment grade, unconstrained, real estate debt and direct lending

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

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Why Hermes EOS?

Hermes EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. Hermes EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

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