Vertex Pharmaceuticals

Vote Yes: Report on Sustainability Metrics for Executive Performance Measures

Item # 7

Annual Meeting: June 15, 2016

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SUMMARY

This resolution seeks a report on the feasibility of integrating sustainability metrics into executive compensation incentive plans. Compensation metrics exist to incentivize behavior, and Vertex's executive compensation package contains no explicit provisions incentivizing its chief executives to oversee the company's sustainability initiatives. Studies show a firm link between corporate sustainability and financial outperformance, and a lack of sustainability metrics at our company means a missed opportunity for Vertex. A "YES" vote on this resolution will provide management with more latitude in prioritizing a business that is both profitable and sustainable; integrating sustainability into compensation metrics will help ensure this outcome. We urge you to vote "YES" for this resolution.

RESOLVE CLAUSE

Shareholders request the Board Compensation Committee prepare a report assessing the feasibility of integrating sustainability metrics into the performance measures of senior executives under Vertex Pharmaceuticals' compensation incentive plans. Sustainability is defined as how environmental and social considerations, and related financial impacts, are integrated into corporate strategy over the long term.

RATIONALE FOR A YES VOTE

Sustainability goals must be incentivized at the executive level. Integrating sustainability metrics into executive compensation plans will prioritize company sustainability as a strategic, long-term business opportunity.

Vertex's executive compensation package contains no explicit provisions incentivizing its chief executives to effectively implement the company's sustainability initiatives. Such a linkage would better enable the Board of Directors to evaluate chief executives' performance, leading to the rewarding of outstanding behavior.

The failure to include sustainability metrics into the executive compensation pay package is a significant lost opportunity. Incenting the chief executives to meet sustainability performance objectives would ensure a greater likelihood that the company's sustainability efforts are treated as strategic business opportunities and integrated into its measured operational objectives. It would also elevate the importance of mitigating known sustainability risks.

A number of studies demonstrate a firm link between superior corporate sustainability performance and financial outperformance relative to peers.[1] Firms with superior sustainability performance were more likely to tie top executive incentives to sustainability metrics.[2]

Leading companies are increasingly taking up this practice. A 2013 study conducted by the Investor Responsibility Research Institute and the Sustainable Investments Institute found that 43.4% of the S&P 500 had linked executive pay to environmental, social and/or ethical issues. These companies traverse industry sectors and include Pepsi, Alcoa, Walmart, Unilever, National Grid, Intel and many others. (See Appendix 2 for citations for these and other relevant studies.)

Investor groups focusing on sustainable governance such as Ceres, the U.N. Global Compact, and the U.N. Principles for Responsible Investment (which represents investors with a collective $59 trillion AUM) have endorsed the establishment of linkages between executive compensation and sustainability performance.

In 2015, over 50% of Vertex's shareholders voted against the advisory vote on pay, one of the highest "against" votes last year. Many of the shareholders objected to an excessive and unjustified retention bonus given to CEO Jeffrey Leiden, which contributed to his total disclosed pay of over $36 million. While the company has made some changes to its compensation practices, they do not address the concerns we outlined above.

Proponents believe that Vertex shareholders would benefit by incenting senior executives to deliver measurable sustainability outcomes. Environmental and social impacts and opportunities are of too great a strategic importance to the company and its stakeholders to be handled in an ad hoc fashion. Significant organizational changes must be driven from the top.

CONCLUSION

The report on a modification on executive compensation requested in this resolution – to introduce metrics incentivizing sustainable performance – will increase executive focus on the long-term best interests of the company. Proponents strongly urge shareholders to vote "yes" and support this resolution.

[1] In Appendix 2, see especially Eccles (2012), CDP/Sustainable Insight Capital Management (2013), and Orlitzky (2003).
[2] Eccles (2011 and 2012), CH2MHill (2013), Deckop (2006).

Appendix 1

Link Executive Compensation to Sustainability Performance

WHEREAS: A large and diverse group of companies has integrated sustainability metrics into executive pay incentive plans, among them Walt Disney, Unilever, Pepsi, Walmart, Group Danone and Mead Johnson.

Numerous studies suggest companies that integrate environmental, social and governance factors into their business strategy reduce reputational, legal and regulatory risks and improve long-term performance.

According to the largest study of CEOs on sustainability to date (CEO Study on Sustainability 2013, UN Global Compact and Accenture):

- 76 percent believe embedding sustainability into core business will drive revenue growth and new opportunities.
- 93 percent regard sustainability as key to success.
- 86 percent believe sustainability should be integrated into compensation discussions, and 67 percent report they already do.

A 2012 Harvard Business School study concluded that firms that adopted social and environmental policies significantly outperformed counterparts over the long-term, in terms of stock market and accounting performance.

The Glass Lewis report Greening the Green 2014: Linking Executive Pay to Sustainability, finds a "mounting body of research showing that firms that operate in a more responsible manner may perform better financially…. Moreover, these companies were also more likely to tie top executive incentives to sustainability metrics."

A 2012 report by the United Nations Principles for Responsible Investment and the UN Global Compact found "the inclusion of appropriate Environmental, Social and Governance (ESG) issues within executive management goals and incentive schemes can be an important factor in the creation and protection of long-term shareholder value."

In 2013, CH2MHill found that firms that set tangible sustainability goals are more likely to tie executive compensation to the achievement of sustainability goals.

Vertex shareholders have expressed their dissatisfaction with pay practices at the company. At the company's last annual meeting, only 45% of shareholders approved the advisory vote on compensation. This was the third lowest vote of all S&P 500 companies. A focus on sustainability will be an improvement.

BE IT RESOLVED: Shareholders request the Board Compensation Committee prepare a report assessing the feasibility of integrating sustainability metrics into the performance measures of senior executives under Vertex Pharmaceuticals' compensation incentive plans. Sustainability is defined as how environmental and social considerations, and related financial impacts, are integrated into corporate strategy over the long term.

SUPPORTING STATEMENT: Effectively managing for sustainability creates opportunities for long-term value creation, we therefore believe sustainability should be a key area in which executives are evaluated.

Linking sustainability metrics to executive compensation could reduce risks related to sustainability underperformance and incent executives to meet sustainability goals and achieve resultant benefits. Examples of such metrics might include: greenhouse gas emissions monitoring and reduction goals, green procurement programs, energy consumption (including renewable energy sourcing and efficiency), and progress toward workforce diversity goals.

Appendix 2

Related Studies

1. Exploring the Link Between Active Management of Social and Environmental Issues and Superior Financial Performance

"The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," by Robert G. Eccles, Ionnis Ioannou and George Serafeim. Harvard Business School. May 9, 2012.

> Firms that adopted social and environmental policies significantly outperformed counterparts over the long-term, in terms of stock market and accounting performance. These firms were more likely to tie top executive incentives to sustainability metrics.

"Linking Climate Engagement to Financial Performance: An Investor's Perspective," Sustainable Insight Capital Management, Carbon Disclosure Project, September 2013.

> Companies with industry leading climate change positions exhibited better performance than peers, measured by return on equity, cash flow stability and dividend growth.

"Corporate Social and Financial Performance: A Meta-Analysis," Marc Orlitzky, et. al., *Organization Studies*, March 2003 (24:3).

A 2003 meta-study of 52 studies, on a range of industries and activities, found:

- The relationship between CSR and financial performance was universally positive, varying between highly positive and moderately positive.
- Social responsibility and financial performance affect each other in a "virtuous cycle": successful firms spend more because they can, but such spending helps them become more successful.
- Because markets do not penalize companies for being socially responsible, it is compatible with maximizing shareholder value and thus can be pursued by managers.

"Greening the Green 2014: Linking Executive Pay to Sustainability," Glass Lewis, 2014.

> "[A] mounting body of research shows that firms that operate in a more responsible manner may perform better financially…. Moreover, these companies were also more likely to tie top executive incentives to sustainability metrics."

"Sustainability Goals That Make an Impact," CH2MHill, 2013

> Firms that set tangible sustainability goals are more likely to tie executive compensation to the achievement of sustainability goals.

2. On the Effectiveness of Linking Compensation to Sustainability Performance

"Sustainability Targets in Executive Remuneration: An Analysis of the Contribution of Sustainability Targets in Executive Remuneration to Sustainable Development," S.B.M. Rosendaal. Erasmus School of Economics. August 11, 2011.

> Study of 490 global companies found that including sustainability targets in executive remuneration packages was sufficient to encourage sustainable development. (Executives were not additionally incented by a higher percentage, or whether the rewards were tied to short- or long-term compensation.)
>
> "Both short-term and long-term sustainability targets are found to be effective in encouraging sustainability development." (p. 53)
>
> "Inclusion of the sustainability target is sufficient for a contribution to sustainable development." (p. 56)

"The Effects of CEO Pay Structure on Corporate Social Performance," John R. Deckop, Kimberly K. Merriman, and Shruti Gupta, *Journal of Management*, 32, no. 3, June 2006, pp. 329–342.

> Increase found in the corporate social performance of companies using a long-term focus in CEO pay (as indicated by the % value of restricted stock + stock options in total pay).

"The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," Robert G. Eccles, Ioannis Ioannou, and George Serafeim, , Harvard Business School, 2011.

> Companies considered to be sustainability leaders more likely to align senior executive incentives with non-financial metrics (including E&S).

"Environmental Performance and Executive Compensation: An Integrated Agency-Institutional Perspective," Pascual Berrone and Luis R. Gomez-Mejia, *Academy of Management Journal*, Vol. 52, No. 1, 2009, p. 120.

> A sustainability pay-for-performance system makes management explicitly accountable for a co.'s environmental behavior, even encouraging CEOs to monitor behaviors at lower organizational levels. Creating a link can also provide incentives to dedicate real resources toward environmental initiatives, building legitimacy in the eyes of shareholders and the public.

3. Prevalence of Policy Among Corporations

Integrated Financial and Sustainability Reporting in the United States (Investor Responsibility Research Center and the Sustainable Investment Institute, 2013)

> 43.4 percent of the S&P 500 had linked executive pay to environmental, social and/or ethical issues, such as fraud.

Ceres Road Map for Sustainability (2014)

> Identified 24% of the 600 companies it surveyed implemented the linkage, a rise from 15% in 2012.

Remuneration Theme Report: 3rd in a Series (Eurosif and EIRIS, 2010)

> 29% of the 300 largest listed cos. in Europe have link pay to sustainability targets.

A New Era of Sustainability (Accenture, United Nations Global Compact. 2010).

> 50% of 800 CEOs are incented for meeting sustainability goals.