REMARKS TO THE SEC INVESTOR ADVISORY COMMITTEE
KEN BERTSCH
EXECUTIVE DIRECTOR, COUNCIL OF INSTITUTIONAL INVESTORS
"UNEQUAL VOTING RIGHTS IN COMMON STOCK"
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Thank you Kurt and members of the IAC for your invitation to join the discussion today.

Snap Inc.'s IPO last week, featuring public shares with no voting rights, appears to be the first no-vote listing at IPO on a U.S. exchange since the New York Stock Exchange (NYSE) in 1940 generally barred multi-class common stock structures with differential voting rights.

Members of the Council of Institutional Investors have watched with rising alarm for the last 30 years as global stock exchanges have engaged in a listing standards race to the bottom. With NYSE-listed Snap's arrival with "zero" rights for public shareholders, perhaps the bottom has been reached.

The Snap IPO took place as the Singapore Exchange proposed to permit multi-vote common stock, and Hong Kong Exchange leaders suggested their exchange may revive consideration of the same. The Hong Kong Securities and Futures Commission, which has provided strong leadership on the matter, blocked such a move just two years ago.

It is clear that Singapore and Hong Kong are responding to competitive pressure from low standards at the NASDAQ and the NYSE, just as NYSE was pressured to relax its rules in 1986 by the lack of restrictions on dual-class listings at NASDAQ. The Council of Institutional Investors was founded in 1985, and this was the first issue we confronted. The Council at that time adopted a strong policy setting one-share, one-vote as a bedrock principle. That remains our policy today, with strong support from all of our constituent groups, including asset owners and asset managers with varying investment methodologies.

We believe multi-class common structures and their power to separate ownership from control pose substantial risks with respect to all three aspects of the commission's tripartite mission: protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation. It is time for the SEC to revisit with U.S.-based stock exchanges the rules on new offerings of multi-class common structures with differential voting rights.

If the exchanges are not willing to bar future common share structures with differential voting rights, the SEC should work with U.S.-based stock exchanges to:

- Bar future no-vote share classes;
- Require true and reasonable sunset provisions for differential common stock voting rights (that cannot be overridden by the controlling shareholder, as often happens); and
- Consider enhanced board requirements for dual-class companies to build greater confidence that boards do not simply rubber-stamp founder managers or the controlling family.

Some background: Soon after the NYSE matched NASDAQ on this in the 1980s, the SEC took action itself to sharply limit multi-class share structures with differential voting rights. But the SEC rule was struck down by a court in 1990. Subsequently, the SEC approved new rules from the U.S. stock exchanges themselves. While the rules created consistency between U.S. exchanges, they have proven weak and decreasingly successful in promoting equal voting rights.

The core concern here is corporate governance 101: Separation of ownership and control over time can lead to a lack of accountability, and accountability to owners is necessary for course corrections that are critical in our capitalist system. Private equity owned firms typically have owners who are engaged and able to force change where management is failing. Public company shareholders rely on the board members they elect to do the same. At Snap, public shareholders, who likely will come to be the dominant providers of capital, have no role in electing directors. And disclosures may be limited compared with true public companies, including no requirement to file a proxy statement or hold an annual meeting open to public shareholders.

Corporations are led by human beings, who are fallible and who do not always see clearly their own mistakes and limitations. Eventually, every company runs into problems, and there needs to be an effective mechanism of accountability to owners. The vitality of American capitalism stems in large measure from U.S. companies' responsiveness to pressures for change from the providers of capital, even when egos are bruised, strategies are upended and executive careers derailed.

Proponents of shielding founders and managers from a company's owners through multi-class structures say that the public markets too often are impatient, and visionary leaders must be protected from company owners to create value for the long-term. For example, Snap CEO Evan Spiegel says it will be five years before markets will see what he can do.[1] That seems to be the basis for Snap's extreme disenfranchisement of public shareholders.

I believe the assertion is dubious. But even if true, why not sunset the share structure in five years, or at least provide an opportunity at the five-year mark for shareholders to vote on a one-share, one-vote basis on whether to extend this protection for another five years?

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[1] "We built our business on creativity," Spiegel said. "And we're going to have to go through an education process for the next five years to explain to people how our users and that creativity creates value." See *Los Angeles Times*, at http://www.latimes.com/business/technology/la-fi-tn-evan-spiegel-bobby-murphy-20170302-story.html.

Snap has a type of sunset provision, but it is triggered only when both founders die (unless they sell off their shares). One founder is age 26, and the other is age 28. Sumner Redstone turns 94 in May, and problems in recent years at Viacom, which he controls by virtue of dual-class shares, are a good example of long-term pitfalls of multi-class stock companies. Assuming that Mr. Spiegel matches Mr. Redstone in longevity, Snap shareholders may be stuck with current control for the next 66 years.

The Council's membership of asset owners, mostly pension funds, have 25- or 30-year investment horizons. They view the increasing prevalence of ever-worse multi-class share structures as seeding problems that will manifest decades from now, harming pension beneficiaries and others. And all on the basis of a theory for which there is little evidence – that founders and controlling holders can grow companies more successfully if they are insulated from accountability to shareholders.

Evidence is lacking that, on net, the management teams, founders and families protected by dual class shares outperform. An upcoming Council study comparing multi-class companies with other firms finds that a multi-class structure neither increases nor decreases return on invested capital (ROIC). The study, of 1,763 U.S. companies in the Russell 3000 index, looks at ROIC from 2007 through 2015. Similarly, two IRRC Institute studies in recent years, including a 2016 paper, have found no clear advantage at controlled companies with differential voting rights, and some evidence of underperformance.

We hear an argument that as long as disclosure rules are good, multi-class structures are acceptable, as purchasers of shares with inferior voting rights can factor that into pricing. To the extent there is validity to that argument at IPO, it breaks down over the longer term given the present operation of our security markets, with long-term investors acting as universal owners, and portfolios to one extent or another indexed to the entire market.

Indeed, the growing importance of indexed investment in the market has increased the need for strong definitions around categories of securities. The idea of an endless variety of securities offerings, with fuzzy, poorly defined boundaries between categories, is attractive to investment bankers and law firms that can make a lot of money off their creative ideas. Such creative ideas include innovative structures that provide comfort to founder/managers that they will not be challenged by company owners, even as they pull in significant capital from public markets. But at some point there is substantial risk of market confusion, and disenabling of simple passive approaches to investment. We learned in the financial crisis that greater complexity in financial structures can have real downsides.

The Snap offering lacks some components for the definition of "equity security" that our members regard as inherent in the definition of an equity, most importantly voting rights. We have heard suggestions that Snap's public share class is less like common equity and more like a preferred share, or a derivative, or a master limited partnership unit. There is merit in these comparisons, although the Snap public share class is a poor cousin to all of them as well. Just to take the preferred shares comparison, the Snap security lacks a higher claim on company assets, and there is no mechanism for providing voting rights if the company fails to perform or falls into distress.

CII and a group of our members are approaching index providers to explore exclusion from core indexes, on a prospective basis, of share classes with no voting rights.

But this does not absolve stock exchanges of responsibility. When the SEC worked with U.S. stock exchanges in the 1990s to put the present rules in place, I do not believe many envisioned significant classes of shares with zero voting rights. With the Snap IPO, it is clearer than ever that current rules are ineffective and need to be revisited. With each further step in enabling multi-class stock structures, critical investor protections are eroded and the potential for strong rules recedes. To the extent that Singapore, Hong Kong and other exchanges that have maintained strong standards on multi-class common share listings decide they cannot compete, we will see further decline that will be very difficult to reverse.

We also hear an argument that investors should tolerate multi-class structures as they entice private companies to go public when they might not otherwise. We believe the primary driver of reduced IPO activity relative to other times in history is easy access to private capital, not a fear among founders that their performance as managers will become subject to oversight from the company's owners. In our view, asking public company investors to accept multi-class structures for the sake of IPO growth is as unreasonable as asking private company investors to cease investing in private companies for the sake of IPO growth.

I recognize that the chair-designee of the SEC, Jay Clayton, was intimately involved as a securities lawyer in Alibaba, a Chinese company that succeeded in sharply limiting voting rights of public shareholders only by listing at the NYSE rather than in Hong Kong. Nonetheless, I hope that the Investor Advisory Committee will work with the Commission, including its new chair, assuming that he is confirmed, on reviewing the adequacy of U.S. stock exchange rules.