Council of Institutional Investors®
The voice of corporate governance

Mr. Marcelo Santos Barbosa, Chairman of the Brazilian Securities Commission- CVM
Mr. Gilson Finkelsztain, Chief Executive Officer, B3 - Brasil, Bolsa, Balcão

cc: Office of the Superintendent of Market Development – SDM
cc: Flavia Mouta, Issuer Director, B3

Via Email: PTE@cvm.gov.br, gilson.finkel@b3.com.br
cc: sdm@cvm.gov.br, flavia.mouta@b3.com.br

November 9, 2020

Re: Proposal on the Implementation of the Super-voting Shares Structure in the Law 6,404/1976- Iniciativa Mercado de Capitais- IMK (Capital Markets Initiative Working Group)

Dear Messrs. Santos Barbosa and Finkelsztain:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[1] CII members have significant capital invested in Brazil, and we share a commitment to healthy public capital markets around the world and strong corporate governance.

We understand that a Working Group within the Ministry of Economy is exploring amendments to the Corporate Law to allow for super-voting shares.[2] CII stands alongside Associação de Investidores no Mercado de Capitals (AMEC) in opposing super-voting share structures.[3]

Reasons to Oppose Super-voting Shares

Since its founding in 1985, CII's member-approved policies have supported the principle of "one share, one vote": Every share of a public company's common stock should have equal voting

[1] For more information about the Council of Institutional Investors (CII), including its board and members, please visit CII's website at http://www.cii.org.
[2] "Amec voices concern on super-voting structures in letter sent to CVM, B3 and IMK", November 2, 2020, https://en.amecbrasil.org.br/amec-voices-concern-on-super-voting-structures-in-letter-sent-to-cvm-b3-and-imk/?utm_term=Viewpoint_EN3&utm_campaign=amecforeign&utm_source=e-goi&utm_medium=email
[3] AMEC letter, August 2020, https://en.amecbrasil.org.br/wp-content/uploads/2020/10/CARTA-PRESI-Super-Voting-Shares-in-Brazil-v01.pdf.

rights.[4] Since then, as more companies have gone public with unequal voting rights, global competition has continued to erode corporate governance standards. While we acknowledge the prominent role U.S. stock exchanges have played in that erosion, we urge Brazil to avoid yielding to this "race to the bottom" pressure, which presents a meaningful risk to long-term performance.

Our primary concerns with the expansion of dual-class shares or “voto plural” are the principal-agent risks that are exacerbated for investors when equity structures skew the alignment of ownership and voting rights. CII believes that when a company goes to the capital markets to raise money from the public, equity investors with the same residual claims should have equal protections and rights, including the right to vote in proportion to the size of their holdings.

Academic Evidence

CII’s concerns over unequal voting rights are also supported by a growing body of empirical research that shows that negative effects of unequal voting rights tend to develop in the medium to long-term. In recent years, some new companies with dynamic leadership and innovative ideas that have unequal voting rights have attracted capital on public markets with limited apparent valuation discount in the immediate period after the initial public offering (IPO) because insiders hold super-voting shares. But over time, and on average, the valuation of these firms tends to decline. As the “wedge” between ownership and control widens, the agency costs of insider control and lack of shareholder accountability increase, founders’ entrepreneurial skills and insights that initially propelled a company become dated, and opportunities and risks change in ways not foreseeable by investors at IPO.[5] Moreover, as a key study demonstrates, “controllers

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[4] CII Policies, “Shareowner Voting Rights,” https://www.cii.org/corp_gov_policies#shareowner_rights

[5] See CII summary of six studies at https://www.cii.org/files/CII%20Summary%20of%20DC%20Studies.pdf. Lucian A. Bebchuk and Kobi Kastiel conduct an economic analysis indicating that the benefits of multi-class structures can be expected to decline, and the costs to rise, over time. Lucian A. Bebchuk and Kobi Kastiel, “The Untenable Case for Perpetual Dual-Class Stock,” 103 Va. L. Rev. 585-631 (June 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630. Bebchuk and Kastiel presented the first version of their paper in 2015. Empirical studies following this framework include: Martijn Cremers, Beni Lauterbach and Anete Pajuste, “The Life Cycle of Dual-Class Firms,” at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895; Lindsay Baran, Arno Forst and M. Tony Via, “Dual Class Share Structure and Innovation,” at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517; Robert Jackson, “Perpetual Dual-Class Stock: the Case Against Corporate Royalty,” at https://www.sec.gov/files/case-against-corporate-royalty-data-appendix.pdf; Hyunseob Kim and Roni Michaely, “Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Structures,” at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209. Notably, Cremers, Lauterback and Pajuste find that even at innovative companies where multi-class structures correlate to a value premium at the time of the IPO, that premium dissipates within six to nine years before turning negative. Baran, Forst and Via find that multi-class structures correlate with more innovation and value creation in the period shortly after an IPO, but within six to 10 years, the costs of unequal voting structures come to outweigh the benefits. Jackson finds that by seven years after IPO, perpetual multi-class firms exhibit valuations that are significantly lower than firms with sunset provisions. Kim and Michaely find a similar result as multi-class structures become increasingly value destroying by 11 years after IPO. Baran, Forst and Via conclude that “[o]ur findings lend credence to the recent call from shareholder advocacy groups that if dual class structures should be allowed at all, they should face rigorous sunset provisions and be eliminated in a certain period post-IPO.”

have perverse incentives to retain dual-class structures even when those structures become inefficient over time."[6]

Time-Based Sunsets and Additional Safeguards

We recognize that shareholder voting rights can be perceived by some founders as creating negative short-term pressure in some circumstances, and that there may be pressures in Brazil to expand multi-class shares to attract innovative companies. For this reason, while we oppose any expansion of unequal voting rights, if the CVM nonetheless takes that step, we believe some of the risks can be mitigated through a mandatory time-defined sunset of no more than seven years. As shown above, the body of empirical research indicates that any benefits of holding dual-class stock decline over time, with companies with multi-class shares eventually tending to be undervalued as compared to their peers around this time.[7] We agree that additional safeguards as outlined by AMEC, including a prohibition of super-voting structures for currently listed companies, limits on super-voting shares' transferability, restrictions on super-voting in certain specific deliberations and mechanisms for the right to withdraw, would also help blunt the impact on low-vote holders.

Thank you for considering our views. We believe that decisions made by the CVM are consequential not only for companies in Brazil but also more broadly in the region and globally. As such, we appreciate the Commission's careful consideration before reaching any decisions. If we can answer any questions or provide additional information on this matter, please do not hesitate to contact me at +1.202.261.7082 or amy@cii.org.

Sincerely,

Amy Borrus

Amy Borrus
Executive Director

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[6] See Bebchuk and Kastiel. Founders and insiders with super-voting rights have strong incentives to retain multi-class structures even after they become inefficient, and investors cannot rely exclusively on private ordering to eliminate multi-class structures that become inefficient with time.

[7] See CII summary of six studies.