Council of Institutional Investors®
The voice of corporate governance

February 15, 2022

European Commission
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
1049 Brussels, Belgium

Via online survey

Re: Public Consultation on the listing act: making public capital markets more attractive for EU companies and facilitating access to capital for SMEs

Dear Sirs/Madams:

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 $40 trillion in assets under management.[1] CII members have significant capital invested in the EU, and we share a commitment to healthy public capital markets and strong corporate governance around the world.

This letter is in response to the public consultation on the listing act: making public capital markets more attractive for EU companies and facilitating access to capital for SMEs.[2] We appreciate the efforts of the European Commission (EC) to maintain investor protection while facilitating companies' access to EU public markets. We write to suggest an alternative to the expansion of indefinite multiple voting right share structures that we believe could help ensure the goal of investor protection. We ask that any inclusion of multiple voting right share structures in the updated EU listing act be accompanied by requirements ensuring that companies with unequal voting rights convert to equal voting rights on or before the seventh anniversary of their initial public offering or direct listing on the public markets. We also write in response to the targeted consultation questions to encourage the EC to ensure the transparency of conflicts of interest among the sponsors, directors and officers of special purpose acquisition companies

[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] Public Consultation document, the Listing Act: making public capital markets more attractive for EU companies and facilitating access to capital for SMEs, https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2021-listing-act-consultation-document_en.pdf.

(SPACs) and prioritize the alignment of governance and disclosure standards for companies going public through a SPAC merger with the requirements for traditional IPOs.[3]

Reasons to Oppose Multiple Voting Right Share Structures

Since CII's founding in 1985, our 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 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 the EU to avoid yielding to this "race to the bottom" pressure, which presents a meaningful risk to long-term performance and could have reputational risks for the EU financial markets, which are respected worldwide for maintaining high global standards.

Our primary concern with the expansion of multi-class shares is the principal-agent risk that is exacerbated for investors when equity structures skew the alignment of ownership and voting rights. Fundamentally, CII believes that when a company taps the capital markets to raise money from public investors, those investors should have a right to vote in proportion to the size of their holdings.

Support for a Time-Based Sunset

We understand that there may be pressure in the EU to expand multiple voting rights shares to attract SMEs. We agree that "whilst multiple voting rights allow founders to keep control over their business, they may also make it easier for owners to extract private benefits to the detriment of investors, for instance by engaging in related-party transactions."[5] In addition to the extraction concern, we share investors' separate concern that disproportionate founder control presents substantial risk of impeding strategic and/or managerial changes in circumstances where change is critical to ensure long-term performance. For these reasons, CII supports mandatory time-defined "sunsets" on unequal voting rights of no more than seven years. We believe reasonable time-based sunset provisions can mitigate long-term risks to investors that are inherent in multiple voting right share structures. We therefore strongly support the targeted consultation's suggestion to include a reasonable mandatory sunset and would suggest that the length of time be set at seven years or less.[6]

Reasonable time-based sunsets are also supported by a growing body of empirical research that shows that any benefits of holding multi-class stock decline over time; companies with multi-class shares eventually tend to be undervalued compared to their peers.[7] In recent years, some

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[3] Targeted Consultation, Listing Act: making public capital markets more attractive for EU companies and facilitating access to capital for SMEs, ("Targeted Consultation") https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2021-listing-act-targeted-consultation-document_en.pdf.
[4] CII Policies, "Shareowner Voting Rights," https://www.cii.org/corp_gov_policies#shareowner_rights.
[5] Targeted Consultation, p. 65.
[6] Targeted Consultation, Question #103.
[7] See CII summary of six studies; See 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 ("[o]ur findings lend credence to the

new companies with dynamic leadership and innovative ideas that adopted unequal voting rights have attracted capital on public markets with limited apparent valuation discount in the immediate period after the initial public offering (IPO), even though insiders hold super-voting shares. But the research shows that over time, and on average, the valuation of these firms tends to decline. This body of research includes studies from:

- Harvard Law School researchers Lucian A. Bebchuk and Kobi Kastiel that indicates that the benefits of multi-class structures can be expected to decline, and the costs to rise, over time.[8] Moreover, they demonstrate that "controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time."[9]
- the European Corporate Governance Institute that shows 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.[10]
- Lindsay Baran, Arno Forst and M. Tony Via that finds 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.[11]
- Robert Jackson Jr., former commissioner at the U.S. Securities and Exchange Commission, that finds that by seven years after IPO, perpetual multi-class firms exhibit valuations that are significantly lower than firms with sunset provisions.[12]
- the European Corporate Governance Institute (ECGI) and the Swiss Finance Institute that finds a similar result, as multi-class structures become increasingly value destroying by 11 years after IPO.[13]

Reasonable time-based sunsets are catching on in the United States and beyond. A growing number of U.S. companies that go public with differential voting rights are incorporating time-based sunsets into those structures.[14] A CII analysis of companies that made their IPO in 2021 found that 43% of those with dual-class stock had time-based sunsets. That is up sharply from 2017, when just 26% of dual-class IPO companies had time-based sunsets. Additionally, as of the recent U.K. listing review, companies with dual-class stock can now list on the London Stock Exchange's premium listing segment, but they must sunset their multiple voting rights shares

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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.")

[8] 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.

[9] *Id.* at 585.

[10] 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.

[11] Lindsay Baran, Arno Forst and M. Tony Via, "Dual Class Share Structure and Innovation," at

[12] Robert Jackson, "Perpetual Dual-Class Stock: the Case Against Corporate Royalty," at https://www.sec.gov/files/case-against-corporate-royalty-data-appendix.pdf.

[13] 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.

[14] CII's list of Companies with Time-Based Sunsets on Dual-Class Stock, https://www.cii.org//Files/issues_and_advocacy/DualClassStock/7-22-21%20Time-based%20Sunsets.pdf.

within five years.[15] In 2019, India also began allowing companies to go public with dual-class share structures with a mandatory five-year sunset.[16]

For these reasons, we urge the EC to include a mandatory sunset of seven years or less in any rule change that would provide for the expansion of multiple voting rights shares in the EU.[17]

Other controls and minimum corporate governance requirements

We are generally supportive of additional rules that limit the use of multiple voting right share structures. We would generally support restrictions capping the weighted voting ratio of shares with multiple voting rights and limiting the circumstances in which super-voting rights can be used. However, we continue to believe that the most important control is a reasonable time-based sunset that phases out the multiple voting rights shares and allows for long-term alignment between ownership and voting power.

CII supports the minimum director independence requirements. CII policy states that at least two-thirds of the directors on a board should be independent, regardless of the company's size.[18] We also support requiring that all key committees (audit, compensation and nominating/corporate governance) are comprised entirely of independent directors.

SPAC Listing Regime

We note that the EC is also consulting on ways for companies to list through SPACs. We agree with the Commission's assessment that "SPAC IPOs present weaknesses and risks that investors, in particular retail ones, should be aware of."[19] In particular, CII is concerned with widespread poor governance practices, conflicts of interest and weak disclosures with regard to SPACs and the de-SPAC business combination.[20] Recent research shows that SPAC mergers, which often have less disclosure and more conflicts of interest than traditional IPO companies, often result in steep decreases in cash per share post-merger, with SPAC shareholders who held shares at the time of the merger bearing these costs.[21]

Another recent paper by Klausner and Ohlrogge explains that:

> The core challenge for SPAC governance is to address the inherently conflicting interest of a sponsor and public shareholders. SPACs respond to this conflict by holding proceeds of their IPOs in trust and by granting public shareholders a right to redeem their shares for a pro-rata portion of that trust. For the redemption right to be effective, however, a SPAC's board must provide shareholders with accurate and complete information

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[15] *See* "Primary Market Effectiveness Review: Feedback and final changes to the Listing Rules" at https://www.fca.org.uk/publication/policy/ps21-22.pdf.
[16] *See* "Framework for Issuance of Differential Voting Rights (DVR) Shares" at https://www.sebi.gov.in/sebi_data/meetingfiles/aug-2019/1565346231044_1.pdf.
[17] CP 21/21: Primary Markets Effectiveness Review, p. 34, https://www.fca.org.uk/publication/consultation/cp21-21.pdf.
[18] CII Policies, Section 2.3, Independent Board, https://www.cii.org/corp_gov_policies.
[19] Targeted Consultation, p. 57.
[20] John Coates, "SPAC Law and Myths" at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4022809.
[21] Michael Klausner, Michael Ohlrogge and Emily Ruan, "A Sober Look at SPACs" at https://ssrn.com/abstract=3720919.

> regarding the merger. Doing so may conflict with the interests of the SPAC's sponsor, which will profit substantially even in a deal that is bad for SPAC investors.[22]

With this in mind, we would support the proposal to "put measures in place to ensure that post IPO shareholders get clear information about the dilutive effects of [issued] warrants and that the dilutive effect of those warrants remains limited."[23] Additionally, we would support greater transparency about conflicts of interest among SPAC sponsors, SPAC directors and SPAC officers. We also generally agree with the need for a clear framework for the deposit and management of the securities and proceeds held in escrow by a SPAC.

CII has generally supported efforts to align listing requirements for companies going public through SPAC mergers with those of traditional IPOs to avoid pro-SPAC biases, particularly since SPACs can impose higher and less transparent costs to investors. We also support efforts to bolster governance at SPACs, particularly in areas where SPACs tend to have challenges, including director independence and director compensation, for the purposes of investor protection and the public interest.

Thank you for considering our views. We believe that decisions made by the European Commission are consequential not only for companies listed in EU markets but also globally. As such, we appreciate this review process 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

[22] Michael Klausner, Michael Ohlrogge, "SPAC Governance: In Need of Judicial Review" at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3967693.
[23] Targeted Consultation, p. 58.