Council of Institutional Investors®
The voice of corporate governance

September 14, 2021

Capital Markets Policy
Financial Conduct Authority
12 Endeavour Square London E20 1JN

Via email: cp21-21@fca.org.uk

Re: CP 21/21: Primary Markets Effectiveness Review

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 $35 trillion in assets under management.[1] CII members have significant capital invested in the U.K., and we share a commitment to healthy public capital markets around the world and strong corporate governance.

This letter is in response to Consultation Paper 21/21: Primary Markets Effectiveness Review.[2] We appreciate the Financial Conduct Authority's (FCA) efforts to prioritize investor protection and high standards of corporate governance in this consultation. While we continue to oppose the expansion of dual-class share structures (DCSS), we commend the FCA's inclusion of controls and limits to mitigate long-term risks associated with unequal voting rights. We believe the most vital of these safeguards is the mandatory five-year sunset for premium DCSS listings.

Reasons to Oppose Dual-Class 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.[3] 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 U.K. 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 U.K. financial markets which are respected worldwide for maintaining high global standards.

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[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] CP 21/21: Primary Markets Effectiveness Review, https://www.fca.org.uk/publication/consultation/cp21-21.pdf.
[3] CII Policies, "Shareowner Voting Rights," https://www.cii.org/corp_gov_policies#shareowner_rights.

Our primary concern with the expansion of dual-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 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.

Support for a Time-Based Sunset

We understand that there may be pressure in the U.K. to expand DCSS to attract listings of innovative technology companies. We also recognize that some founders and companies "may be particularly sensitive to the threat of a takeover or removal as directors once they become listed companies, before they have had an opportunity to deliver the next phase in their business strategy."[4] For these reasons, CII supports mandatory time-defined "sunsets" on unequal voting rights of no more than seven years. We believe modest time-based sunset provisions can mitigate long-term investor risks of DCSS. We therefore strongly support the consultation's proposal to limit the use of DCSS within the premium listing segment to five years.

Reasonable time-based sunsets such as the consultation's five-year approach are also supported by a growing body of empirical research that shows that any benefits of holding dual-class stock decline over time; companies with dual-class shares eventually tend to be undervalued compared to their peers.[5] 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), 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:

- A study 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.[6] Moreover, they demonstrate that "controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time."[7]
- A study from 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.[8]
- A study from 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.[9]

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[4] CP 21/21: Primary Markets Effectiveness Review at 59.

[5] 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 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.")

[6] 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.

[7] *Id.* at 585.

[8] 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.

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

- A study from 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.[10]
- A study from 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.[11]

Reasonable time-based sunsets are catching on in the United States. A growing number of U.S. companies that go public with differential voting rights are incorporating time-based sunsets into those structures.[12]

For these reasons, in response to Question 20 of the consultation, we agree that five years is an appropriate runway for DCSS in the premium listing segment.[13]

Other DCSS Controls and Limits

While CII does not have any specific policies on the other proposed controls and limits, we are generally supportive of additional rules that limit the use of DCSS. We would generally support restrictions capping the weighted voting ratio of DCSS 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 DCSS and allows for long-term alignment between ownership and voting power.

Thank you for considering our views. We believe that decisions made by the U.K. government are consequential not only for companies listed on the London Stock Exchange but also more broadly in the region and 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

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

[11] 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.

[12] 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.

[13] CP 21/21: Primary Markets Effectiveness Review, p. 34, https://www.fca.org.uk/publication/consultation/cp21-21.pdf.