Council of Institutional Investors®
The voice of corporate governance

Via E-Mail: clientservice@msci.com

March 29, 2017

MSCI Equity Index Committee
7 World Trade Center
250 Greenwich Street
New York, NY
10007

Dear Members of the MSCI Equity Index Committee:

I am writing to request that MSCI commence a public consultation regarding the eligibility of non-voting equities for inclusion on MSCI indexes. As a separate matter discussed briefly at the end of this letter, we have a concern on how the indexes treat U.S. companies that take "emerging growth company" exemptions from certain public company reporting requirements.

This request for a public consultation follows MSCI's March 3 solicitation for feedback from the investment community regarding:

> 1) The continuing eligibility of companies that do not have any listed voting shares for potential inclusion into the MSCI Global Investable Markets Indexes and MSCI US Equity Indexes
>
> 2) The continuing eligibility of companies that do not have any listed voting shares for potential inclusion into the MSCI ESG Universal Indexes[1]

The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, and other employee benefit plans, foundations and endowments with combined assets under management exceeding $3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $20 trillion in assets under management.[2]

As you are aware, on March 2 Snap Inc. conducted an initial public offering (IPO) on the New York Stock Exchange by issuing non-voting Class A common shares, its sole public share class. Snap's IPO, the largest since 2014, bestowed indefinite control in the company's two founders, despite their minority stake on a share-for-share basis, and signaled the emergence of a financial instrument that more closely resembles a subordinated unit than public equity.

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[1] See March 3, 2017 Announcement for the MSCI Global Standard Indexes, available at https://app2.msci.com/webapp/index_ann/DocGet?pub_key=LLDu%2BH5J4r0%3D&lang=en&format=html.
[2] For more information about the Council of Institutional Investors ("CII"), including its members, please visit the CII's website at http://www.cii.org/members.

Absent from Snap's structure is the bedrock characteristic of public equity: that owners have a viable mechanism, outside of litigation, to protect against insider entrenchment and the associated risk to long-term performance. While equity indexes at times accommodate some variation in the strength of that mechanism, we contend that Snap warrants special scrutiny as it represents a total abandonment of this fundamental concept.

Our members are deeply concerned about a trend in IPOs toward unequal and even non-voting shares. We believe unequal voting rights diminish accountability and are detrimental to public markets long-term. We believe a robust and open public consultation on inclusion of non-voting share classes, in particular, would be valuable, and would help identify alternatives that MSCI, as a key provider of market indexes, can provide to assist investors in dealing with increasing long-term risk from issuances of low-vote and no-vote shares to public shareholders.

We note that the MSCI Global Investable Market Indexes exclude derivative equity and the MSCI US Equity index further excludes limited partnerships (which we understand to cover master limited partnerships) and limited liability companies.[3] MLP units may be particularly pertinent here. MLP unit holders do not have voting rights, and the security is clearly distinguished from common equity, such that it is not deemed as appropriate for an equity index. A security that is labeled "common equity" but lacks key characteristics of common equity should be treated no differently.

Of additional relevance, we note existing MSCI methodology regarding the classification of international markets recognizes the importance of robust voting rights. When MSCI determines classification for a particular market for a given MSCI universe, there is a review of both "equal and economic voting rights" and "equal rights for minority shareholders".[4]

Moreover, we note that Snap is not subject to certain disclosure requirements, including a requirement for a proxy statements or information statements under Section 14 of the Exchange Act. Reduced disclosure further limits the mechanisms available for owners to understand how their capital is being used, potentially impeding owners' oversight of the use of their capital.

While substantial proxy statement information would be required to be disclosed in the 10-K in any case, the company will have latitude to disclose less than the minimum required for public companies with voting shares. In particular, Snap will not be required to provide information before corporate actions take place; it is required to do so only after the fact, in 8-K filings. Perhaps more importantly, the company clearly will have less incentive than other public companies to provide high-quality disclosures that go beyond the minimum to meet regulatory requirements. This is particularly true for subjects such as executive compensation, board processes, director skills, board and CEO succession planning, and auditor selection. Finally,

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[3] See Sections 1.2.1 and 2.1 MSCI Global Investable Market Indexes Methodology, February 2017, available at https://www.msci.com/eqb/methodology/meth_docs/MSCI_Feb2017_GIMIMethodology.pdf.

[4] See Appendix II: Market Classifications Framework on page 92 and definitions on page 94 of the Global Investable Market Indexes Methodology.

beneficial ownership reporting on Schedules 13D and 13G, and the short-swing profit recover provisions of Section 16(b), generally do not apply.

We also have concerns on handling of conflicts of interest and related party transactions under the Snap share structure, and note that Class A shares may be increased, diluting current shares, with no input from Class A shareholders.

The motivation for our request is not limited to concern over Snap alone. Snap's equity structure potentially foreshadows a broader challenge to the integrity of the equity markets. Relative to stock exchanges, which are conflicted by competition to attract new listings, major index providers like MSCI are well-positioned to play a pivotal role in preserving value-enhancing market norms. As such, we are reaching out not just to MSCI, but also FTSE Russell and S&P on this matter.

We seek a broad public consultation (open to all market participants) that would carefully evaluate the advantages and disadvantages of a host of potential alternatives, including:

Approaches tailored to Snap-style no-voting-rights structures

Historical reach

- Whether equity indexes should bar non-voting common share classes on both a backward- and forward-looking basis, or strictly on a forward-looking basis.

Availability of alternative classes with voting rights

- Whether equity indexes should bar non-voting share classes unless the company has at least one class of voting common stock that is listed on the same index (or, alternatively, available for purchase on a public exchange).

Dividend and liquidation terms of the class

- Whether equity indexes should bar common classes with no voting rights unless the non-voting shares pay a higher dividend than at least one class of common voting shares.

- Whether equity indexes should bar common classes with no voting rights unless the non-voting shares have preferential liquidation rights.

Sunset mechanisms

- Whether equity indexes should bar non-voting share classes unless the company's governing documents state that non-voting shares shall convert to a "one share, one vote" structure within a clear time period (e.g., three to five years) after IPO.

- Whether equity indexes should bar inclusion of non-voting share classes, unless the company's governing documents provide that a clear time period after IPO (e.g., three or five years), common shareholders shall cast a binding vote on a "one share, one vote" basis on the multi-class structure. Shareholders would vote on whether to (a) convert to a "one share, one vote" structure, or (b) retain the multi-class structure for another period of three or five years.

<u>Moratorium</u>

- Whether equity indexes should bar non-voting share classes for some period of time (for example, three to five years) from the date of the IPO.

<u>Broader approaches to multi-class equity with differential voting rights</u>

<u>Forward-looking prohibition on shares with inferior voting rights</u>

- Whether equity indexes should grandfather current constituents, but on a going-forward basis require "one share, one vote," given continued deterioration in voting rights, including but not limited to non-voting common equity.

<u>Sunset mechanisms for all common equity with inferior voting rights</u>

- Whether equity indexes should bar inclusion of all share classes with inferior voting rights unless the company's governing documents state that all common share classes shall convert to a "one share, one vote" structure within a clear time period (e.g., five years) after IPO.

- Whether equity indexes should bar inclusion of all share classes with inferior voting rights unless the company's governing documents provide that a clear time period after IPO (e.g., three to five years), common shareholders shall cast a binding vote on a "one share, one vote" basis on the multi-class structure. Shareholders would vote on whether to (a) convert to a "one share, one vote" structure, or (b) retain the multi-class structure for another period of three or five years.

<u>Moratorium</u>

- Whether equity indexes should bar low-voting share classes for a moratorium (for example, three to five years) from the date of the IPO.

<u>Minimum 25% of voting power free float</u>

- Whether equity indexes should require that at least 25% of voting power be in the hands of non-controlling shareholders to ensure there is some minimal influence from non-controlling shareholders to distinguish the company from privately held firms.

Weighting mechanisms

- Whether equity indexes, which are weighted to market capitalization, should undergo a second weighting based upon the voting rights of the least powerful class of common stock listed, such that "one share, one vote" companies receive a 1.0 weighting, inferior class listings under 10/1 dual-class structure receive a 0.1 weighting, and no-vote listings receive a 0.0 weighting.

No or slower fast track

- Whether fast track be disallowed for any common equity class with inferior voting rights, or extend the minimum number of days before fast-tracking the listing into an index to at least one month. This would allow appropriate pricing, and time for MSCI to consider the details of the structure of the new entity prior to fast-tracking.

The Snap offering also raises considerations on criteria for inclusion in some indexes of "emerging growth companies" (EGCs). Under the JOBS Act of 2012, companies such as Snap that qualify for, and claim, EGC status can delay adopting new or revised accounting standards until those standards apply to public companies, although Snap has said that it will not avail itself of that exemption. However, Snap apparently intends to take advantage of EGC exemption from certain public company reporting requirements, including the requirement to have internal control over financial reporting audited under Section 404 of the Sarbanes-Oxley Act, and reduced disclosure obligations on executive compensation. While Snap's EGC status adds to our concerns, we recognize that reduced requirements on EGCs raise an issue that is distinct, in part, from the concerns on differential voting rights; we would like to better understand whether these exemptions affect consideration of inclusion of an equity security in any MSCI index.

We view disclosure and control elements for which EGC's are exempt as potentially essential information for company valuation in the U.S. context. It can be argued that companies offering public shareholders only limited (or no) voting rights need even more transparency, rather than less.

In conclusion, the unprecedented Snap IPO with non-voting shares puts a significant hazard on the horizon that risks a material deterioration in the quality of equity markets. We are particularly concerned that if Snap is included in core indexes, non-voting equity may gain unstoppable momentum. We therefore encourage MSCI to open a public consultation as to whether the criteria for inclusion on MSCI equity indexes warrant revisiting.

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Thank you for consideration of our views. If we can answer any questions or provide additional information on this important matter, please do not hesitate to contact me at 202.822.0800 or ken@cii.org.

Sincerely,

Kenneth A. Bertsch
Executive Director
Council of Institutional Investors