

Via Electronic Delivery

April 6, 2017

The Honorable Michael D. Crapo
Chairman
Committee on Banking, Housing, & Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, & Urban Affairs
United States Senate
Washington, DC 20510

Re: Request for Proposals to Foster Economic Growth

Dear Mr. Chairman and Ranking Member Brown:

On behalf of the Council of Institutional Investors (CII), we write in response to your request of March 20 soliciting proposals that will increase economic growth.¹ As described in more detail below, we respectfully request legislative proposals that would direct the U.S. Securities and Exchange Commission (SEC or Commission) to adopt rules requiring the national securities exchanges and associations to prohibit the listing of any security of an issuer that (1) does not require majority voting in the uncontested election of directors, or (2) has two or more classes of common stock with unequal voting rights.

CII is a nonpartisan, nonprofit association of employee benefit plans, foundations and endowments with combined assets under management exceeding with \$3 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers, retirees, and their families. CII also has associate (nonvoting) members that include a range of asset manager firms that manage assets in excess of \$20 trillion. We advocate for policies that we believe enhance public trust in the capital markets, protect investors, and promote long-term shareowner value.²

¹ Press Release, U.S. Senate Banking, Housing, & Urban Affairs, Crapo, Brown Request Proposals to Foster Economic Growth (Mar. 20, 2017), available at <https://www.crapo.senate.gov/media/newsreleases/crapo-brown-request-proposals-to-foster-economic-growth>.

² For more information about the Council of Institutional Investors (CII) and its members, please visit CII's website at http://www.cii.org/about_us.

Proposal #1 - Require the SEC to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not require majority voting in the uncontested election of directors.

Brief Description of the Proposal

U.S. public companies that list equity securities on the main exchanges in the U.S.— the New York Stock Exchange (NYSE) and NASDAQ Stock Market (NASDAQ) — currently are required to adopt corporate governance guidelines on certain key areas including director qualifications and responsibilities of key board committees, and director compensation.³ Those listing standards are aimed at maintaining appropriate standards of corporate responsibility, integrity and accountability to shareowners.⁴

However, the existing U.S. listing standards fail to include corporate governance guidelines that would require adherence to a majority voting standard in the uncontested election of directors. The result is that directors at most U.S. listed companies are elected by a plurality, rather than a majority of votes cast.⁵ Under a plurality voting process, a director nominee is elected or reelected as long as they receive a single vote in their favor.

CII's long-standing membership approved corporate governance policies on director elections states:

Directors in uncontested elections should be elected by a majority of the votes cast. In contested elections, plurality voting should apply. An election is contested when there are more director candidates than there are available board seats.⁶

Our policy reflects the view of long-term institutional investors that plurality voting in uncontested elections makes directors less accountable to the shareowners they represent. As the Investors Working Group observed in its seminal report on U.S. financial regulatory reform, “[p]lurality voting in uncontested elections results in ‘rubber stamp’ elections.”⁷ Rubber stamp elections pose no genuine threat of removal, and thus votes cast under a plurality voting system are unlikely to provide shareowners with effective private sector oversight of corporate directors.

Our repeated requests to the NYSE and NASDAQ to amend their listing standards to require the adoption of a majority voting standard in the uncontested election of directors has gone

³ See, e.g., NYSE Listed Company Manual § 303A.09 (Nov. 25, 2009), available at http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp_1_4/default.asp.

⁴ *Id.* § 303.00 Introduction.

⁵ According to FactSet, 9 out of 10 S&P 500 companies have majority voting in place, but just 3 in 10 Russell 2000 companies have it.

⁶ CII, Corporate Governance Policies § 2.2 Director Elections (updated Sept. 30, 2016), available at http://www.cii.org/files/policies/09_30_16_corp_gov_policies.pdf.

⁷ A report by the Investor's Working Group, U.S. Financial Regulatory Reform, The Investors' Perspective 22 (July 2009), available at http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

unheeded.⁸ Proposal #1 would address a long-standing weakness in U.S. listing standards. As described in the U.S. House of Representatives report on the Securities Exchange Act of 1934:

Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange . . . Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according to shareholders fair suffrage.⁹

Finally, Proposal #1 (see *legislative language* below) would avoid the “one size fits all” criticism of some rules by explicitly permitting the SEC to tailor the listing standard based on the size of the issuer, the market capitalization of the issuer, the number of shareholders of record of the issuer, or any other criteria, as the Commission deems necessary and appropriate in the public interest or for the protection of investors. In addition, the proposed listing standard would require the SEC to allow an issuer an opportunity to come into compliance with the requirement and to cure any defect that would be the basis for a prohibition from continued listing on an exchange.

Impact on Economic Growth

We believe Proposal #1 would have a positive impact on economic growth. Empirical evidence indicates that a change in the director election system from a plurality voting standard to a majority voting standard for the uncontested election of directors has a “statistically and economically significant positive effect” on firm shareowner value.¹⁰ This makes sense, in that a majority vote standard enhances accountability of board members to shareowners who are more likely to be able to hold boards to account for poor performance.

The current lack of a majority voting standard at most U.S. public corporations creates potential competitive problems for U.S. listed companies in the global economy.¹¹ As has been previously explained by the Committee on Capital Markets Regulation:

The strength of shareholder rights in publicly traded firms directly affects the health and efficient functioning of U.S. capital markets. Overall, shareholders of U.S. companies have fewer rights in a number of important areas than do their

⁸ See Letter from Jeff Mahoney, General Counsel, CII to Mr. John Carey, Vice President—Legal, NYSE Regulation, Inc., NYSE Euronext 1 (March 19, 2014) (reiterating request made in June 20, 2013 letter to amend listing standards to adopt a majority voting requirement), available at

http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_19_14_CII_letter_NYSE_majority_voting.pdf; Letter from Jeff Mahoney, General Counsel, CII to Mr. Edward Knight, Executive Vice President & General Counsel, NASDAQ OMX 1 (March 19, 2014) (reiterating request made in June 20, 2013 letter to amend listing standards to adopt a majority voting requirement), available at

http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_19_14_CII_letter_NASDAQ_majority_voting.pdf.

⁹ H.R. Rep. No. 1383-73d, at 13 (1934).

¹⁰ See, e.g., Yonca Ertimur et al., Does the Director Election System Matter? Evidence from Majority Voting 17-18 (May 2013), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1880974.

¹¹ See, e.g., Interim Report of the Committee on Capital Markets Regulation 93 (Nov. 30, 2006), available at <http://www.capmktreg.org/wp-content/uploads/2014/08/Committees-November-2006-Interim-Report.pdf>.

foreign competitors. This difference creates an important potential competitive problem for U.S. companies. If such rights enhance corporate value, capital will be invested, at the margin, in foreign companies, and in the foreign capital markets in which such foreign companies principally trade. The importance of shareholder rights also affects whether directors and management are fully accountable to shareholders for their actions.

Shareholder rights serve the critical function of reducing the agency costs associated with the potential divergence of interests between professional managers and dispersed public shareholders. Without adequate shareholder rights, rational investors will reduce the price at which they are willing to purchase shares, capitalizing into the stock price these expected agency costs. This discount implies reduced valuations for firms that are publicly traded and lower valuations than would otherwise be the case for firms considering an entrance into the public markets. Firms, therefore, would have an incentive either not to enter the U.S. public markets in the first place or to exit them in response to inadequate legal protection of shareholder rights. Indeed, firms that depend on the public capital markets for financing might find it prohibitively expensive to raise necessary capital for funding net present value projects. Even ignoring the entry and exit decisions of firms, public capital markets will be smaller as a result of inadequate shareholder rights, given the reduced valuations resulting from higher agency costs.

. . . .

The Committee believes that majority voting for directors, rather than plurality voting, must be the cornerstone of any system of shareholder rights. . . [M]ajority voting is the norm in other developed countries, including the United Kingdom, France, and Germany.¹²

We note that most overseas markets require majority voting in some form, and that legislation has recently been introduced in Canada that would require a form of majority voting in the uncontested election of directors for nearly 270,000 corporations, including Canada's largest publicly traded companies.¹³

Impact on the ability of consumers, market participants, and financial companies to participate in the economy

As indicated, we believe majority voting in the uncontested election of directors provides consumers, market participants, and financial companies as shareowners the ability to have greater participation in the economy by ensuring that their votes for corporate directors count and, therefore, those directors are more accountable to the owners.

¹² *Id.* at 93, 105.

¹³ See, e.g., Anthony Davis, *More Voices at the Table*, Lexpert 2 (Mar. 27, 2017), available at <http://www.lexpert.ca/article/more-voices-at-the-table/>.

Legislative Language

SEC. __. ELECTION OF DIRECTORS BY MAJORITY VOTE IN UNCONTESTED ELECTIONS.

Section 14B of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting “(a) Disclosures Regarding Chairman and CEO Structures.—;” and by adding at the end the following:

“(b) CORPORATE GOVERNANCE STANDARDS

“(1) LISTING STANDARDS.—

“(A) IN GENERAL.—Not later than 1 year after the date of enactment of this subsection, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with any of the requirements of this subsection.

“(B) OPPORTUNITY TO COMPLY AND CURE.—The rules established under this paragraph shall allow an issuer to have an opportunity to come into compliance with the requirements of this subsection, and to cure any defect that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

“(C) AUTHORITY TO EXEMPT.—The Commission may, by rule or order, exempt an issuer from any or all of the requirements of this subsection and the rules issued under this subsection, based on the size of the issuer, the market capitalization of the issuer, the number of shareholders of record of the issuer, or any other criteria, as the Commission deems necessary and appropriate in the public interest or for the protection of investors.

“(2) COMMISSION RULES ON ELECTIONS.—In an election for membership on the board of directors of an issuer—

“(A) that is uncontested, each director who receives a majority of the votes cast for and against shall be deemed to be elected;

“(B) that is contested, if the number of nominees exceeds the number of directors to be elected, each director shall be elected by the vote of a plurality of the shares represented at a meeting and entitled to vote; and

“(C) if a director of an issuer receives less than a majority of the votes cast in an uncontested election—

“(i) the director shall tender the resignation of the director to the board of directors; and

“(ii) the board of directors shall—

“(aa) accept the resignation of the director;

“(bb) determine a date on which the resignation will take effect, within a reasonable period of time, as established by the Commission; and

“(cc) make the date under item (bb) public within a reasonable period of time, as established by the Commission.”

Other background material as appropriate

For additional background information about majority voting in the uncontested election of directors, please see CII publication “FAQ: Majority Voting for Directors” at http://www.cii.org/files/issues_and_advocacy/board_accountability/majority_voting_directors/CI I%20Majority%20Voting%20FAQ%201-4-17.pdf.

Proposal #2 - Require the SEC to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that has two or more classes of common stock with unequal voting rights.

Brief Description of Proposal

The existing U.S. listing standards also fail to include corporate governance guidelines that would require adherence to the core governance principle of “one share, one vote.” That principle was among CII’s first membership approved policies when we were founded in 1985.¹⁴ The principle is based on the belief that when a corporation goes to the capital markets to raise money from the public, public investors are entitled to certain protections and basic rights, including a right to vote that is proportional to the size of the investor's holdings.

Since 1994, when the NYSE and NASDAQ established their current liberal listing standards on multi-class common stock,¹⁵ investors have seen a deterioration of voting rights.¹⁶ Notably, earlier this year, Snap Inc. had an initial public offering and was listed on the NYSE with zero voting rights as the only publicly-traded shares of the company.¹⁷

Stock exchanges serve the long-term interests of a broad range of market participants when they support the alignment of economic rights with voting rights. As those two aspects of ownership diverge, new risks are introduced and profound governance challenges are created. Simply put: corporate directors may be less empowered to actively and effectively oversee management and make course corrections when they can only be elected or fired by the founders/or their descendants.

¹⁴ See § 3.3 Voting Rights (“Each share of common stock should have one vote. Corporations should not have classes of common stock with disparate voting rights.”).

¹⁵ See § 313.00(A) Voting Rights Policy (“On May 5, 1994, the Exchange's Board of Directors voted to modify the Exchange's Voting Rights Policy, [to be] . . . more flexible”); NASDAQ IM-5640. Voting Rights Policy (adopted Mar. 12, 2009) (“The . . . Voting Rights Policy is . . . more flexible . . . Nasdaq will consider, among other things, the economics of such actions or issuances and the voting rights being granted.”), available at http://nasdaq.cchwallstreet.com/nasdaq/main/nasdaq-equityrules/chp_1_1/chp_1_1_4/chp_1_1_4_3/chp_1_1_4_3_8/chp_1_1_4_3_8_32/default.asp.

¹⁶ See, e.g., Maureen Farrell, Tech Founders Want IPO Riches Without Those Pesky Shareholders, Wall St. J., Apr. 3, 2017, at 1 (“About 15% of the tech companies that went public in the U.S. between 2012 and 2016, . . . did so with at least two classes of stock, up from 8% between 2007 and 2011”), available at <https://www.wsj.com/articles/control-geeks-tech-founders-want-ipo-investors-not-their-input-1491236464>.

¹⁷ *Id.* (“Snap was the first major company since at least 2000 to do an initial offering in the U.S. that gave new shareholders no voting rights whatsoever”). See generally Adolf Berle & Gardiner Means, *The Modern Corporation & Private Property* 72 (1932) (“Both the New York Stock Exchange and the New York Curb have refused to list new issuers of non-voting common stock; for practical purposes, this would seem to have eliminated the use of this device on any large scale in the immediate future.”).

As with majority voting, our repeated requests to the NYSE and NASDAQ to amend their listing standards to prohibit companies from having two or more classes of common stock with unequal voting rights has gone unheeded.¹⁸ We believe that Proposal #2 would enhance the accountability of U.S. publicly traded companies and strengthen investor confidence in the integrity of the U.S. markets.

Finally, by incorporating the legislative language of Proposal #1, Proposal #2 avoids “the one size fits all” criticism of some rules by explicitly permitting the SEC to tailor the listing standard as the Commission deems necessary and appropriate in the public interest or for the protection of investors. In addition, the proposed listing standard would require the SEC to allow an issuer such as Snap Inc. to have an opportunity to come into compliance with the requirement and to cure any defect that would be the basis for a prohibition from continued listing on an exchange. Permitting newly listed public companies the opportunity to adopt a one share, one vote structure within a reasonably limited period through sunset mechanisms is consistent with CII membership approved policies.¹⁹

Impact on Economic Growth

Consistent with our analysis of Proposal #1, we believe Proposal #2 would have a positive impact on economic growth. Multi-class common shares with low voting rights tend to trade at a discount, and a majority of empirical studies on this topic indicate that multi-class structures decrease firm value.²⁰

In addition, the existence of multi-class structures on the main U.S. exchanges creates potential competitive problems for U.S. listed companies in the global economy. While exchanges in Germany, Italy, Switzerland, Sweden, and Canada permit companies to issue multi-classes of

¹⁸ See Letter from Jeff Mahoney, General Counsel, CII to Mr. John Carey, Vice President—Legal, NYSE Regulation, Inc., NYSE Euronext 2 (Mar. 27, 2014) (reiterating request for adoption of a listing standard regarding “the fundamental corporate governance principles of one share, one vote and majority voting for directors”) *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_27_14_CII_letter_to_NYSE_one_share_one_vote.pdf; Letter from Jeff Mahoney, General Counsel, CII to Mr. Edward S. Knight, Executive Vice President & General Counsel, NASDAQ OMX 2 (Mar. 27, 2014) (reiterating request for adoption of a listing standard regarding “the fundamental corporate governance principles of one share, one vote and majority voting for directors”), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_27_14_CII_letter_to_nasdaq_one_share_one_vote.pdf; Letter from Ann Yerger, General Counsel, CII to Judith C. McLevey, VP, Corporate Actions & Market Watch, NYSE Euronext 1 (Dec. 10, 2012) (follow-up letter to in-person meeting to discuss CII’s “Oct. 2, 2012, letter requesting that the New York Stock Exchange prohibit companies seeking an initial listing from having two or more classes of common stock with unequal voting rights”), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2012/12_10_12_cii_to_NYSE_dual_class_followup.pdf; Letter from Jeff Mahoney, General Counsel, CII to Mr. Edward S. Knight, Executive Vice President & General Counsel, NASDAQ OMX 1 (Oct. 2, 2012) (requesting adoption of a listing standard “under which (1) companies that seek an initial listing . . . will be ineligible for a listing if they have two or more classes of common stock with unequal voting rights, and (2) companies newly listed . . . in the future will be prohibited from issuing multi-class stock with unequal voting rights subsequent to their initial listing”), *available at* http://www.cii.org/files/issues_and_advocacy/correspondence/2014/03_27_14_CII_letter_to_nasdaq_one_share_one_vote.pdf.

¹⁹ CII Policies, Investor Expectations for Newly Listed Companies, *available at* http://www.cii.org/ipo_policy.

²⁰ Christopher C. McKinnon, Dual-Class Capital Structures: A Legal, Theoretical & Empirical Buy-Side Analysis, 5 Mich. Bus & Entrepreneurial Law L. Review 81, 90 (2016), *available at* <http://repository.law.umich.edu/cgi/viewcontent.cgi?article=1038&context=mbelr>.

common stock, jurisdictions in Hong Kong, Singapore,²¹ Japan, India, Russia, and the U.K. currently forbid the practice.²²

Impact on the ability of consumers, market participants, and financial companies to participate in the economy

As indicated, we believe permitting U.S. companies to have common stock structures with unequal voting rights diminishes accountability and shareowner value and, thereby, inhibits the ability of consumers, market participants, and financial companies as shareowners to participate in the economy.

Legislative Language

SEC. ____ . PRINCIPLE OF ONE SHARE, ONE VOTE.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by adding at the end of section 14B, as added by this title, the following:

“(3) PRINCIPLE OF ONE SHARE, ONE VOTE—Issuers shall not have two or more classes of common stock with unequal voting rights.”

Other background material as appropriate

For additional background information on unequal voting rights in common stock, please see remarks to the SEC Investor Advisory Committee by CII Executive Director Ken Bertsch at http://www.cii.org/files/issues_and_advocacy/correspondence/2017/03_09_17_IAC_testimony.pdf.

Thank you for considering our proposals. If we can answer any questions you may have, please do not hesitate to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,



Jeff Mahoney
General Counsel

²¹ The Singapore exchange recently issued a public consultation to consider whether a dual class share structure where certain shares have a higher voting rights than others should be introduced and if so, what safeguards might be appropriate. SGX, Consultation Paper, Possible Listing Framework For Dual Class Share Structures (Feb. 16, 2017), available at http://www.rajahtannasia.com/media/2716/sgx_dcs_consultation_paper_-_sgx_20170216-final.pdf; see Letter from Kenneth A. Bertsch, Executive Director, CII to CEO Loh Boon Chye, Chief Regulatory Officer Tan Boon Gin, Singapore Exchange Limited 1 (Mar. 29, 2017) (CII response to Consultation Paper), available at http://www.cii.org/files/issues_and_advocacy/correspondence/2017/03_29_17_letter_to_SGX.pdf.

²² Christopher C. McKinnon at 84.