CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

November 30, 2018

California State Teachers'
Retirement System
Aeisha Mastagni, Co-Interim Director
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Sent via email: John.zecca@nasdaq.com

John Zecca
Senior Vice President
General Counsel North America & Chief Regulatory Officer
Nasdaq Stock Market
805 King Farm Blvd.
Rockville, MD 20850

Dear Mr. Zecca:

RE: **Support of petition** – Request Nasdaq Stock Market to amend listing standards on Multi-class shares – Sunset provisions

I am writing on behalf of the California State Teachers' Retirement System (CalSTRS) to support the Council of Institutional Investors' (CII) petition to the Nasdaq Stock Market on multi-class common stock structures. Consistent with the CalSTRS Corporate Governance Principles, we support the one-share, one-vote principle[1]. Companies with existing unequal voting structures should disclose and implement processes to move to a one-share, one-vote structure. CalSTRS believes companies with dual-class structures impose an unequal amount of economic risk on public shareholders in relations to their voting power.

CalSTRS reinforces CII's petition asking Nasdaq to amend its listing standards for companies going public that list with multi-class stock structures with differential voting rights. Specifically, we request that on a forward looking basis:

> *The company's certificate of incorporation or equivalent document must specify provisions requiring the share structure to convert automatically to one-share, one-vote no more than seven years after IPO date, subject to extension by additional terms of no more than seven years each, by vote of a majority of outstanding shares of each share class, voting separately, on a one-share, one-vote basis.*

CalSTRS' mission is to secure the financial future and sustain the trust of California's educators. We serve the investment and retirement interests of approximately 914,454 plan

[1] CalSTRS Corporate Governance Principles, updated November 1, 2017. https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf

participants.[2] CalSTRS is the largest educator only pension fund in the world with a global investment portfolio valued at approximately $219.1 billion as of October 31, 2018.[3] We have investments that list on the Nasdaq stock exchange which include ~292.1 million shares with a market value of $21 billion as of October 31, 2018.[4] The long-term nature of CalSTRS' liabilities, its overall stewardship of the fund and the CalSTRS Board's fiduciary responsibility to act in the best interest of our members, makes the fund keenly interested in governance issues. We have a vested interest in ensuring shareholder protections are safeguarded, which includes shareholder voting rights that are critical to holding public companies accountable to shareholders.

From CalSTRS' perspective, the performance record of dual class companies is decidedly mixed in the long-run and even in the medium term, notwithstanding selection bias affecting which companies pursue the dual class experiment.

As stated in CII's petition letter, "The following factors are creating a new dynamic among investors, companies and gatekeepers, with the potential for a high degree of consensus for time-based sunsets on multi-class structures:

- New academic evidence on the declining performance over time of multi-class stock companies;
- Successful use of time-based sunsets on multi-class structures by a growing number of companies;
- Negative investor reaction to Snap's IPO, as well as poor performance by Snap and two other 2017 IPOs with zero-vote share classes – Altice USA and Blue Apron;
- Recent troubles at several established dual class stock public companies (notably CBS and Viacom) and even in a large private company context (Uber, which converted to one-share, one-vote)."

We agree it is critical that U.S. stock exchanges lead the way, because of (1) their size and leadership profile among global exchanges; (2) the significant regulatory role they play through listing rules, especially with regard to shareholder voting rights; and (3) the part played by U.S. exchanges over the last 30 years in eroding the concept of one-share, one-vote at public companies.[5]

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[2] CalSTRS Fast Facts, June 30, 2016. https://www.calstrs.com/sites/main/files/file-attachments/fastfacts_2016.pdf

[3] CalSTRS Current Investment Portfolio for the period ending October 31, 2018. http://www.calstrs.com/current-investment-portfolio

[4] FactSet, Screening of CalSTRS holdings at Stock Exchange Level, October 31, 2018.

5 The Hong Kong Stock Exchange (HKEx) earlier this year, apparently under competitive pressure from the U.S. exchanges, decided to permit some multi-class listings with certain limitations and protections not provided by U.S. exchanges, including a requirement for an "event-based sunset" that prohibits transferring special voting rights to beneficiaries "not materially responsible for growth of the issuer." Notwithstanding these protections, which CII believes are less effective than a simple time-based sunset, HKEx early in its process ruled out a time-based sunset, in part because the U.S. exchanges lack such a rule. We believe the competitive concern was decisive for HKEx, HKEx also argued against the permission for a time-based sunset renewal feature, which we discuss in footnote 10 of this letter; and that a change in control at "an arbitrary date in the future" is not desirable. We note on the latter argument

As cited in numerous empirical studies, companies that commit to improving governance structures produce substantially better operational and market results. CalSTRS' principles reflect that an essential right is the ability to vote on companies' governing structures. A shareholder vote is an important check and balance in the investor – issuer relationship. CalSTRS fundamentally believes shareholders should have a say in transactions that materially affect their investments.

We believe the academic research and developing market practice suggest a logical compromise. We recommend a simple, effective sunset mechanism on common stock structures with unequal voting rights, so that markets do not suffer long-term damage from perpetual or long-lasting multi-class stock structures. We believe that time-based "sunsets" are the way forward, requiring multi-class structures with unequal voting rights to collapse to one-share, one-vote within a reasonable and specified period after IPO. A sunset of no more than seven years offers an appropriate period to harness whatever benefits of innovation and control a multi-class structure may provide while mitigating the agency costs it incurs over time. In recognition both of evolving market practice and academic research suggesting that multi-class structures become problematic five to nine years after IPO, we request in this petition a sunset of seven years or less.

It is important that the exchange, in its regulatory role, concern itself with market dynamics in the near-term and in the longer-term. It is a mistake for the exchange to permit long-lasting or permanent multi-class structures that may do harm well beyond the time horizon that is reasonably foreseeable by investors. Thank you for considering our support for establishing sunset provisions in Nasdaq's listing standards on dual class shares.

If you have any questions, please do not hesitate to contact me at 916-414-7418, AMastagni@calstrs.com, or Mary Hartman Morris, Investment Officer at 916-414-7412, MMorris@calstrs.com.

Sincerely,

Aeisha Mastagni

Aeisha Mastagni
Interim Co-Director of Corporate Governance
California State Teachers' Retirement System

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that transitions of U.S. companies with time-based sunsets have been smooth from a market perspective. Moreover, the controlling shareholder could cause the conversion earlier than the date stipulated in the company charter (which itself can be less than seven years), and a renewal feature would permit shareholders to extend the structure. See "Consultation Conclusions: A Listing Regime for Companies from Emerging and Innovative Sectors," at https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/February-2018-Emerging-and-Innovative-Sectors/Conclusions-(April-2018)/cp201802cc.pdf, pp. 41-42.
Please also note CalSTRS letters in 2017 &2018 to the Singapore Exchange on Dual Class Share Structures. Respectively: https://www.calstrs.com/sites/main/files/file-attachments/2017-04-14_calstrs_sgx_consultation_dual_class_share_structures.pdf
https://www.calstrs.com/sites/main/files/file-attachments/2018-04-25_dual_class_share_structures.pdf