Via Electronic Delivery

March 18, 2021

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

Dear Chairman Brown and Ranking Member Toomey:

On behalf of the Council of Institutional Investors (CII), we write to encourage enactment of legislation to increase economic growth, improve access to public capital markets, and upgrade investor protection.¹

Specifically, we recommend adoption of the accompanying attached draft legislation, which we have entitled the “SEC as Investor Advocate Act of 2021.” It would implement recommendations of the Investor Advocate of the U.S. Securities and Exchange Commission (SEC or Commission) in his recent 2020 annual report.²

This draft legislation would direct the Commission to adopt rules under which the national securities exchanges and associations would enact listing standards to prohibit the listing of any security of an issuer that (1) has two or more classes of stock with unequal voting rights for more than a certain period of years or (2) fails to make adequate disclosure of the diversity of its board of directors and senior executives, as well as a company’s efforts to promote diversity. In addition, and apart from these two specific topics, the draft legislation would give the Commission clear statutory authority to set minimum listing standards that apply to all exchanges and associations for investor protection purposes.

CII is 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 – true “Main Street” investors through their pension funds. 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.³

**Multi-class stock sunset provision (section 2)**

Section 2 of the proposed legislation would implement the following policy recommended in the Investor Advocate’s 2020 report:

> If a company chooses to issue multiple classes of stock with differing voting rights, then the dual-class stock must contain a “sunset” provision. While we prefer the principle behind “one share, one vote” for the long-term protection of investors, some companies express reluctance to go public when the founding management team may still be executing a long-term strategy that may not appear profitable in the short term. As a compromise to allow retail investors access to these companies at an earlier stage, a sunset provision would provide a visionary founder a reasonable length of time to execute his or her initial vision as a public company, while ensuring that a disciplined governance mechanism provides long-term protection to investors.⁴

We agree with this recommendation for the following additional reasons:

**Brief Description of the Proposal, Its Economic Impact and Investor Protection**

U.S. public companies that list equity securities on the main exchanges in the U.S.— the New York Stock Exchange and NASDAQ Stock Market — are required to comply with listing standards that are adopted by the exchanges and approved by the SEC. Existing listing standards do not require adherence to the core governance principle of “one share, one vote.” That principle was among the first membership approved policies when CII was founded in 1985, and that policy remains in effect today.⁵ 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.

However, exchanges permit the listing of shares with two or more classes of stock with equal economic rights, often “Class A” shares held by the public, and “Class B” shares held by a

---

³ 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](http://www.cii.org).

⁴ Investor Advocate Report, supra note 2, at 10-11.

⁵ Council of Institutional Investors, Corporate Governance Policies § 3.3 One Share, One Vote (updated Sept. 22, 2020), [https://www.cii.org/files/policies/09_22_20_corp_gov_policies.pdf](https://www.cii.org/files/policies/09_22_20_corp_gov_policies.pdf) (“Each share of common stock should have one vote [and] [c]orporations should not have classes of common stock with disparate voting rights.”).
company’s founder and perhaps other insiders. There are generally far fewer Class B shares, which have multiple votes per share, than Class A shares, which usually have only one vote per share. Class B shares with significant voting power per share can give a founder effective control even if the founder owns only a comparatively smaller number of shares.

This multi-class stock structure is particularly favored by startups in the technology sector as a means of providing visionary founders with the time and space needed to execute that vision. That process can take years, and patience, as well as faith in the founder, can in theory reap enormous rewards for investors. Alphabet Inc. (Google) and Facebook, Inc. (Facebook) are the paradigm examples of this model.

Of course, not every startup is a Google or a Facebook. And recent academic research has been critical of unchecked grants of unequal voting power over time.

In 2018 then-SEC Commissioner Robert J. Jackson, Jr. gave a speech that summarized the negative effects of unequal voting rights in the medium to long term. Startup companies with dynamic leadership and innovative ideas may attract capital in public markets without an apparent diminution in valuation right after an initial public offering. Over time, however, and on average, the valuation of such firms tends to decline, as the “wedge” between ownership and control widens, the agency costs of insider control and lack of shareholder accountability increase, a founder’s entrepreneurial skills and insights that initially propelled a company become dated, and opportunities and risks change in ways not foreseeable by investors at the time of the initial public offering (IPO). Moreover, as a key study demonstrates, “controllers

7 See Rick Fleming, Investor Advocate, Address at ICGN Miami Conference: Dual-Class Shares: A Recipe for Disaster (Oct. 15, 2019), https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster (“without an appropriate level of accountability to shareholders, it is easy to predict that this trend [in dual-class stock] will not end well [and] [i]nvestors will be hurt, and badly, if we continue down this path”).  
have perverse incentives to retain dual-class structures even when those structures become inefficient over time.”

We believe the academic research and developing market practice suggest a logical compromise: put in place a simple, effective sunset mechanism on multi-class voting structures, so that investors and markets do not suffer long-term damage from perpetual or long-lasting unaccountability. We believe that requiring multi-class voting structures to sunset within a reasonable and specified period after an IPO will allow companies to address the alleged problem of short-termism without requiring shareholders to entirely surrender the ability to hold the managers of their assets accountable. A sunset after seven years or less would offer an appropriate period to harness whatever benefits of innovation and control a multi-class voting structure may provide while mitigating the agency costs it incurs over time.

We propose also a safety valve: If a founder can make the case to shareholders for extending the seven-year startup period, the proposed legislation provides for unlimited extensions of the multi-class structure, assuming each such an extension of seven years or less is approved by each class of shares, voting separately.

The market has validated this approach. A limited but growing number of multi-class companies are choosing to go public with time-based sunset provisions incorporated into their charters. CII has tracked 41 U.S. companies that went public with simple, time-based sunsets since 2004, including 27 from 2017-2020. The sunsets range from three to 20 years. Most are either seven or 10 years; six companies in 2004-2020 used sunsets of five years or less. The mean sunset in 2020 was 12 years, up from 9.5 years in 2019 and 7 years in 2018. Six of the companies that have such sunsets converted to one-share, one-vote in smooth processes well understood by the market. Time-based sunset language can be simple, clear and not subject to change by the controlling holder.

increasingly value destroying by 11 years after IPO. Lindsay Baran et al. conclude that “[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.” Lindsay Baran et al., at 7. See also David F. Larcker & Brian Tayan, “Dual-Class Shares, Research Spotlight,” CGRI (2019), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-research-spotlight-13-dual-class-shares.pdf (“Dual-class shares are generally associated with higher agency costs and lower governance quality.”); Rick Fleming (“A growing body of research suggests that, over the long term, entrenchment of founders produces lower returns for investors [and] [s]pecifically, companies with dual-class structures tend to underperform companies with dispersed voting power.”).

9 Lucian A. Bebchuk & Kobi Kastiel at 585. Founders and insiders with super-voting rights have strong incentives to retain multi-class structures even after they become inefficient, and investors cannot rely exclusively on private ordering to eliminate multi-class structures that become inefficient with time.

10 Investor Advocate Report, supra note 2, at 11 (“As a compromise to allow retail investors access to these companies at an earlier stage, a sunset provision would provide a visionary founder a reasonable length of time to execute his or her initial vision as a public company, while ensuring that a disciplined governance mechanism provides long-term protection to investors.”).

CII believes that this approach would produce benefits all around. It would give startups the “running room” many founders that choose a multi-class structure believe they need to implement their vision for their company without the pressure of demands for short-term improvements in the stock price. Conversely, investors benefit from being able to invest in a company whose vision they share, knowing that the founder will have some measure of freedom, but also that they will enjoy the usual benefits of share ownership once the startup phase is past, and once the company has emerged from its adolescence as a publicly traded company.

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, France, Italy, Switzerland, Sweden, Canada, Hong Kong and Singapore permit companies to issue multi-classes of stock, jurisdictions in Belgium, Spain, South Korea, India and Russia forbid the practice. Even in jurisdictions where dual-class offerings are technically allowed, such as Japan, the United Kingdom, China, Singapore and Hong Kong, dual-class structures are not currently market practice or have significant limitations and safeguards.

As indicated, we believe permitting U.S. companies to have 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.

**Improved corporate governance through enhanced diversity reporting (section 3)**

Section 3 of the draft legislation would implement the Investor Advocate’s recommendation of a “minimum listing standard” to address the following topic:

To make fully informed investment decisions, investors generally would benefit from greater insight into the diversity characteristics of a company’s current board, as well as its policies designed to promote diversity in board composition going forward. Thus, to be listed on a national exchange, a company should be required to provide more fulsome disclosure regarding the composition of its board of directors, nominees for director positions, and executive officers. The company should also provide greater transparency around its nominating process for director

---


14 See The Committee on Capital Markets Regulation at 9 (“Japan and Hong Kong are examples of Asian jurisdictions where dual class equity structures are permitted but uncommon.”).
and officer selection, and any initiatives it has in place to increase board diversity. Voluntary disclosures in this regard have been useful, but listing standards could help ensure that more companies make this information publicly available on a basis that enables investors to draw comparisons. We believe that robust policies of this nature should be a minimum standard for listing on any exchange, and we support efforts in Congress to advance this type of disclosure.\(^\text{15}\)

We agree with this recommendation for the following additional reasons:

*Brief Description of the Proposal, Its Economic Impact and Investor Protection*

Section 3 of the draft legislation incorporates, with some modest revisions, the disclosure provisions of the Improving Corporate Governance Through Diversity Act of 2021 (Diversity Act).\(^\text{16}\) The Diversity Act appears to have broad support from market participants, including the U.S. Chamber of Commerce, National Urban League, Nareit, Financial Services Forum, American Bankers Association, International Council of Shopping Centers, Bank Policy Institute, American Council of Life Insurers, NAIOP the Commercial Real Estate Development Association and the Real Estate Roundtable.\(^\text{17}\)

The draft legislation would require disclosure of data, based on voluntary self-identification, on the racial, ethnic and gender composition of a company’s board of directors and nominees for a board seat, as well as executive officers; disclosure of voluntary self-identification as a veteran, disabled, or LGBTQ+ would also be required. The draft legislation would also require disclosure of any policy, plan or strategy adopted by the board of directors (or board committee) to promote racial, ethnic and gender diversity at the company.

This legislation is in line with CII’s policy on board diversity, which reflects the view that corporate governance best practices include the expectation that corporate boards will reflect the diversity of the company’s communities, customers and employees.\(^\text{18}\) We also believe that diverse boards can have a significant positive effect on financial performance\(^\text{19}\) and that diverse boards can be achieved without quotas that can result in “check-the-box” diversity.\(^\text{20}\)

---

16 See Improving Corporate Governance Through Diversity Act of 2021, S. 374, 117th Cong. § 2(s)(1)-(2) (2021), available at https://trackbill.com/bill/us-congress-senate-bill-374-improving-corporate-governance-through-diversity-act-of-2021/2047284/ (the modest revisions include the insertion of the terms and related definitions for “disabled” and “LGBTQ+” in § 3(b)(2) and § 3(c) of the draft legislation, respectively).
18 See Council of Institutional Investors, Corporate Governance Policies § 2.8b Board Diversity.
19 See id. (“The Council believes a diverse board has benefits that can enhance corporate financial performance, particularly in today’s global market place.”).
We believe that the disclosure-oriented approach in the draft legislation is an important way of fulfilling several key goals in terms of investor knowledge and a better functioning market.

1. Providing material information to investors. Diversity, both at the board level and at the senior executive ranks, is important to many investors, yet it is difficult to obtain that information – and to compare companies against their peers. There is thus an important role that can be played for listing standards, which would provide guidance to listed companies and investors alike. As then-SEC Commissioner Allison Herren Lee stated at CII’s fall 2020 conference, diversity disclosure “gets investors the information they need to make investment decisions based on their own judgment of what indicators matter for long-term value. Importantly, it can also drive corporate behavior.” We believe the cost of compliance is minimal, and the benefits to investors can be significant.

2. Improving corporate performance. There is an extensive body of empirical research demonstrating that diverse boards are positively associated with improved corporate governance and company performance. Examples include a September 2019 report of FCLTGlobal, a 501(c)(3) not-for-profit research organization, finding that “having a diverse board—including a mix of genders and ages—is connected to strong long-term returns.” A separate 2019 study by the same organization highlighted further evidence that diverse boards add long-term value.


See Notice of Filing of Amendments No. 1 and Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Changes, as Modified by Amendments No. 1, To Adopt Listing Rules Related to Board Diversity and To Offer Certain Listed Companies Access to a Complimentary Board Recruiting Solution To Help Advance Diversity on Company Boards, Exchange Act Release No. 91,286, 86 Fed. Reg. 14,484, 14,491 (Mar. 10, 2021), https://www.federalregister.gov/documents/2021/03/16/2021-05343/self-regulatory-organizations-the-nasdaq-stock-market-llc-notice-of-filing-of-amendments-no-1-and (“the Exchange believes that . . . annual [diversity] disclosures would provide consistent information to the public and would enable investors to continually review the board composition of a company to track trends, as well as simplify or eliminate the need for a company to respond to multiple investor requests for board diversity information”).

Id. at 14,491 (“the Exchange states that it has reviewed dozens of empirical studies and found that an extensive body of empirical research demonstrates that diverse boards are positively associated with improved corporate governance and company performance”).

FCLTGlobal, Predicting Long-term Success for Corporations and Investors Worldwide 8 (Sept. 2019),
The%20research%20is&text=Through%20our%20research%2C%20FCLTGlobal%20aims%20to%20help%20corporations%20and%20investors%20understand%20the%20impact%20of%20capital%20markets.

See FCLTGlobal, Data Shows More Diverse Boards Create More Value (May 28, 2019),
https://www.fcltglobal.org/resource/data-shows-that-diverse-boards-create-more-value/ (“When looking at MSCI ACWI firms between 2010 and 2017 through a lens of both age and gender diversity, we found that the most diverse boards added 3.3% to return on invested capital (ROIC) as compared to their least diverse peers.”).
These reports highlighted the literature in this area, noting that other researchers have used a multi-dimensional measure of diversity combining ethnicity, age, gender, education, financial expertise and prior board experience, resulting in a finding that greater board diversity correlates with lower stock price volatility, more consistent investment in R&D projects over time and better performance overall.\(^{26}\)

In our view, the draft legislation’s required disclosures would likely contribute to public company board consideration of diversity and such consideration can benefit long-term shareholder value.\(^{27}\)

3. **Disclosure as a cost-effective approach.** A key virtue of this emphasis on disclosure is that the cost to the company will be minimal, particularly in light of the benefits to investors in getting a better understanding of a given company’s approach to diversity issues, as well as a more uniform disclosure requirement that permits investors to compare a given company with its peers in the industry or elsewhere in the economy.\(^{28}\)

---


\(^{27}\) See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Maxine Waters, Chair, Committee on Financial Services, United States House of Representatives et al. 4 (July 10, 2019), https://www.cii.org/Files/July\%202010\%202019\%2020Letter\%20to\%20Committee\%20on\%20Financial\%20Service s\%20.docx\%20(final)%20KB.pdf (“In our view, the disclosures . . . that would be required by H.R. 3279 or H.R. 1018 would likely contribute to enhancing public company board consideration of diversity consistent with CII’s policies [and] CII believes long-term investors, including our members, will benefit from the long-term shareowner value that can result, in part, from corporations embracing board diversity.”).

\(^{28}\) See 86 Fed. Reg. at 14,490 n.80 (The Nasdaq Stock Market LLC finding that “the majority of the organizations were in agreement that companies would benefit from a disclosure-based, business-driven framework to drive meaningful and systemic change in board diversity, and that a disclosure-based approach would be more palatable to the U.S. business community than a mandate”).
Additional SEC authority over listing standards (section 4)

The two topics addressed above are specific areas where legislative guidance would benefit investors. There is a broader issue, however, which the Investor Advocate addressed, and that is the inability of the SEC to be a “first responder” to situations in which there may be a need for new listing standards. The law as it now stands assigns the Commission an oversight role, and in the absence of authorizing legislation, only the exchanges themselves have broad authority to regulate other areas of governance. On occasion, Congress has passed specific statutes authorizing the Commission to require listing standards on specific topics, but the Commission’s role in creating listing standards is otherwise generally reactive and limited.29

As the Investor Advocate noted, the existing regulatory structure was enacted more than 85 years ago, at a time when stock exchanges had a different structure than they do today. Given the changes in market structure in recent decades, the Investor Advocate stated that—

... it is time to revisit this allocation of responsibility. The primary listing exchanges are now for-profit entities that, unlike their prior mutual ownership structure, have an inherent conflict of interest between protecting investors and generating business revenue from listed issuer fees. Our Office has long been concerned about an apparent race-to-the-bottom in this area—with the primary listing exchanges proposing to voluntarily lower their qualitative corporate governance standards in an effort to attract issuers, but at the expense of the protections the original standards provided investors.

If these for-profit businesses are to be entrusted with regulatory responsibility for corporate governance standards, it would make sense for Congress to set, by statute, certain minimum standards to guarantee investor protections. As an alternative, Congress should give the Commission clear statutory authority to set minimum listing standards that apply to all exchanges.30

We agree. Experience suggests that in today’s fast-moving marketplace, there may be times when the SEC is in the best position to move swiftly to respond to a situation, rather than waiting for legislation to be enacted or an exchange to make a proposal. Thus, we applaud the Investor Advocate’s decision to raise this important issue and encourage Congress to “revisit this allocation of responsibility.”31

---

29 One example is section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 USC § 78j–4, which directed the SEC to require the issuance of listing standards regarding “clawbacks” of unearned executive compensation. A more recent example is the Holding Foreign Companies Accountable Act, Pub. L. 116–222 (2020), which requires the SEC to prohibit the listing of securities of companies whose auditors or accounting firms that perform an audit are located in jurisdictions that limit the ability of the Public Company Accounting Oversight Board to inspect the auditors.

30 Investor Advocate Report, supra note 2, at 10.

31 Id.
Thank you for considering CII’s draft legislation. We hope our letter is helpful to the Committee in reviewing the need for legislation in this area. As always, we welcome the opportunity to discuss our perspectives on these topics at your convenience.

Sincerely,

Jeffrey P. Mahoney
General Counsel

Attachment

CC: The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives (via email)

The Honorable Patrick T. McHenry, Ranking Member, Committee on Financial Services, United States House of Representatives (via email)