Investor Coalition for Equal Votes

28 July 2022

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

Submitted electronically to https://www.onlinesurveys.fca.org.uk/jfe/form/SV_bp8ldXo6hoJ5zfg

Re: DP 22/2: Primary Markets Effectiveness Review: Feedback to the discussion of the purpose of the listing regime and further discussion

Dear Sirs/Madams:

The Investor Coalition for Equal Votes (ICEV) is an informal assemblage of UK and US asset owners with over $1T in assets under management who are concerned about the long-term effects of misalignment between invested capital and shareholder voting rights, and who have extensive allocations to the UK market. Our group has UK roots, having started from dialogue between Railpen and a US-based investor organization, the Council of Institutional Investors (CII), about the need for greater coordination among investors to respond the global proliferation of this misalignment.

We appreciate the work of the Financial Conduct Authority (FCA) to protect investors and ensure high standards of corporate governance. Our comments respond solely to the two questions pertaining to the voting rights aspect of DP22/2.[1] This letter's narrow response reflects the scope of the ICEV mission, and should not be interpreted as taking a position on any other aspect of DP22/2.

Q4. Do you agree with extending the Premium Listing Principles to all issuers of equity shares in commercial companies under a single segment regime? Would any specific changes to the principles be necessary to do so?

Q5. Do you agree that we should consider allowing Dual Class Share Structures (DCSS) in the single segment? Do you agree that the only form of DCSS that should be permitted within a single segment regime should be the regime recently introduced in PS21/22.

ICEV response

Capital structures providing disproportionate voting rights to founders and other insiders cause long-term performance risk by foreclosing companies' ability to make necessary leadership changes in response to sustained underperformance. Boards cannot carry out their fundamental oversight purpose if capital structures are designed specifically to render founders, their favored board members, and their favored managers unaccountable to the holders of a majority of outstanding shares. The risk performance stemming from unequal voting arrangements increases over the course of a company's life as a public company. The ICEV views "one share, one vote"

[1] DP 22/2: Primary Markets Effectiveness Review: Feedback to the discussion of the purpose of the listing regime and further discussion, https://www.fca.org.uk/publication/discussion/dp22-2.pdf.

structures as the optimal way to avoid this performance risk, and we encourage companies that choose not to enter the public markets with proportionate voting rights to at least incorporate reasonable, time-based sunset provisions into their governing documents at the time of going public[2].

While the ICEV considers a "one share, one vote" listing requirement the apex of investor protection on capital structure, our fundamental priority is mitigating long-term misalignment between capital and voting rights. We support extending the Premium Listing Principles to all issuers of equity shares under a single segment regime wherein DCSS is limited to the very specific circumstances identified in PS21/22.[3] Most importantly to the ICEV, PS21/22 limits DCSS to five years for any listed company, at which point the company must either recapitalize to a one share, one vote structure or delist.[4]

We strongly support incorporating this requirement into the single segment regime. While this may reduce flexibility for companies, relative to the requirements of the standard listing segment, we believe it is imperative that the single segment regime have robust protections against long-term use of DCSS. We recognize that a fundamental objective of the previous UK Listings Review was to "examine how the UK can enhance its position as an international destination for IPOs and improve the capital-raising process for companies seeking to list in London". However, we think that the UK's 'Unique Selling Position' as a destination for global capital traces is in large part to robust investor protections and historically high standards of corporate governance.

We agree that no form of DCSS other than what is described in PS21/22 should be permitted in the single segment regime. This is an important clarification given some recent iterations of DCSS that deliver misalignment while maintaining *prima facie* equal voting power between classes. We believe constraints on the eligibility of DCSS companies to list on a single segment regime should be ongoing and mandatory, and that the five-year grace period should commence from the date of initial public offering (IPO), as opposed to the date of joining the single segment.

The proposed limitations on DCSS are more palatable when considering that time-based sunsets are increasingly embraced voluntarily among IPO companies.[5] They are also supported by a 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. The research indicates that over time, and on average, the valuation of these firms tends to decline. For example:

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[2] As a coalition, our preference is for these sunset clauses to be seven years or less – this is based on the available academic evidence, summarized later here, which seems to show that any benefits of dual-class share structures dissipate after five to ten years.

[3] PS 22/21: Primary Markets Effectiveness Review: Feedback and final changes to the listing rules, https://www.fca.org.uk/publication/policy/ps21-22.pdf

[4] Other constraints on DCSS included in PS22/21, which we also support, include a 20:1 maximum ratio between high-vote and low-vote classes; that high-vote classes may only be held by sitting board members or members of their estate; and that high-vote classes' voting rights may only be carried out in cases where a proposal seeks to remove the DCSS holder from the board or following a change in control.

[5] Analysis by the U.S.-based Council of Institutional Investors found that time-based sunset provisions among dual class IPO companies in that country increased from 26% in 2017 to 51% in 2021.

- 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]
- 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]
- Other evidence on the impact of dual-class share structures on long-term financial performance can be found in the previous response from Railpen – the in-house manager for a large UK pension fund and ICEV co-lead – to the UK Listings Review. [12]

We would welcome the opportunity to further discuss with you any of the above issues specifically, or the work of our coalition more generally.

Letter Participants of The Investor Coalition for Equal Votes

Minnesota State Board of Investment
Office of the New York City Comptroller
Ohio Public Employees Retirement System
Washington State Investment Board
Railpen
Council of Institutional Investors

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[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
[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] railpen-response_uk-listings-review_05-01-2021.pdf (azureedge.net)