Council of Institutional Investors®
The voice of corporate governance

Via E-Mail: clientservice@msci.com

May 9, 2018

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 in response to MSCI's *Consultation on the Treatment of Unequal Voting Structures in the MSCI Equity Indexes* (Expanded Consultation), which generally contemplates incorporating the proportion of total voting power in the hands of non-strategic shareholders of listed securities into each security's float-adjusted market cap contribution to MSCI's developed and emerging market indexes.[1] I want to compliment MSCI on the care and thought it has brought to this proposal.

The Council of Institutional Investors (CII) is committed to the alignment of economic rights and voting power (Alignment).[2] We support the substance of the proposal with certain qualifications, described further below. Most notably, our suggested revisions seek to mitigate disruption related to the proposal's implementation and afford companies an enhanced incentive to commit to phasing out unequal voting structures after a reasonable period.

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 $3.5 trillion. CII 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 $25 trillion in assets under

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[1] See MSCI January 2018 *Consultation on the Treatment of Unequal Voting Structures in the MSCI Equity Indexes* at https://www.msci.com/documents/1296102/8328554/Consultation_Voting+Rights.pdf/15d99336-9346-4e42-9cd3-a4a03ecff339. See accompanying Discussion Paper at https://www.msci.com/documents/1296102/8328554/Discussion+Paper_Voting+rights.pdf/d3ba68f1-856a-4e76-85b6-af580c5420d7. The Expanded Consultation builds upon the June 2017 *Consultation on the Treatment of Non-Voting Shares in the MSCI Equity Indexes*, available at https://www.msci.com/documents/1296102/1220bc04-83bd-44c1-8527-a4014ef51c8d, which contemplated the exclusion of non-voting shares from index contribution under certain circumstances, impacting six companies with non-voting share classes and less than 0.1% of the ACWI index. CII's August 3, 2017 response to that consultation is available at https://www.cii.org/files/issues_and_advocacy/correspondence/8-3-17%20CII%20response%20to%20MSCI%20Consutation.pdf. For further background on the motivation for our concerns about no-vote and low-vote share classes please refer to CII's March 29, 2017 letter to MSCI at https://www.cii.org/files/issues_and_advocacy/correspondence/2017/03_29_17_MSCI_letter_request_for_consultation.pdf.

[2] See CII Corporate Governance Policies Section 3.3, at https://www.cii.org/corp_gov_policies#shareowner_rights, which reads in part, "Corporations should not have classes of common stock with disparate voting rights."

management.[3] Our response is divided into three sections: a comment on why we believe index providers have a legitimate and important role to play in this matter; a suggestion to provide relief to companies that adopt reasonable time-based sunset provisions; and answers to specific questions posed in the Expanded Consultation.

I. Basis for index provider action

We offer four broad factors, which considered together, lead us to believe that index providers have a legitimate and important role to play in this matter.

1. *Index providers' action is entirely consistent with their history of carefully constructing indexes to cover an asset class extensively, not exhaustively.*

Index providers including MSCI have a long tradition of applying discretion to adjust the size of a constituent's contribution to an index, resulting in a track record of ensuring broad exposure to a given asset class without covering the entire market in a careless or indiscriminate manner.[4] We agree with MSCI's objective of "offering comprehensive coverage while recognizing the importance of voting power," and emphasize that "comprehensive" in this context does not imply covering an asset class in its entirety.[5]

Methodology that ignores voting rights altogether is neither neutral nor moderate, but a stark exception to index providers' careful approach with critical factors to determine index construction and what qualifies as a particular type of security.[6] To treat the 2017 no-vote IPO of Snap, Inc. in the same way as the 2018 "one share, one vote" IPO of DocuSign Inc., *ceteris paribus*, is an extreme position that gives founders or other holders of super-voting rights no incentive to uphold the Alignment principle (which we consider core to the nature of public equity) and arguably encourages founders, including those who hold board and executive roles, to shield themselves indefinitely from accountability and oversight.[7]

Regardless of where one stands on whether voting rights are "core" to the nature of public equity, the former MSCI methodology presupposes that Alignment has *zero* connection to public equity, and that misalignment warrants *zero* adjustment. Index providers are in position to change that by addressing voting rights in a measured way, as they already do with other critical factors.

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[3] For more information about CII, including its members, see http://www.cii.org/members.

[4] For example, MSCI analyzes and adjusts equity securities' index contributions based on numerous factors including market capitalization, float, liquidity, international availability and resemblance to common equity. See https://www.msci.com/eqb/methodology/meth_docs/MSCI_GIMIMethodology_March2018.pdf.

[5] See Discussion Paper p. 13.

[6] For example, MSCI does not include master limited partnership stock units in equity indexes, even though they are equity-like in how they trade and are held.

[7] Both multi-billion dollar technology companies, DocuSign went public with a "one share, one vote" structure, while Snap went public with zero voting rights to public investors. See April 27, 2018 DocuSign 424B4 at https://www.sec.gov/Archives/edgar/data/1261333/000119312518139042/d506878d424b4.htm. See March 3, 2017 Snap Inc. 424B4 at https://www.sec.gov/Archives/edgar/data/1564408/000119312517068848/d270216d424b4.htm.

2. *Index providers' action responds to a void left by years of inaction from stock exchanges, regulators and global regulatory coordinators.*

Stock exchanges, regulators and global regulatory coordinators have not adequately responded to the growing separation of ownership and control.[8] While various reasons explain this inaction, and fault cannot not be pinned on any one entity, what is ultimately most important is that for years, public equity has continued to slide down the path toward greater misalignment, and index providers are in position to do something substantive about it.

When the Securities and Exchange Commission (SEC) attempted to require national stock exchanges to adopt "one share, one vote" listing standards under the 1933 Exchange Act, a federal court in 1990 barred the SEC from doing so on the grounds that it would encroach on listed companies' governance.[9] U.S. exchanges subsequently received formal requests to voluntarily adopt forward-looking, "one share, one vote" listing standards, but declined to take action.[10] Multiple other stock exchanges, in competition with U.S. exchanges to win listings, recently adopted (or are actively seeking to adopt) listing requirements to further accommodate misalignment.[11] CII certainly recognizes the responsibility of stock exchanges in this area, and holds out hope for listing standards that would better protect the Alignment principle. But race-to-the-bottom market forces are powerful, and we perceive there to be political pressures on some global exchanges to "race faster."

It is far from certain whether global financial regulatory coordinators could ever generate substantive change on this matter, given their advisory function and their apparent reticence to undertake such an initiative in the past, even as misalignment grew and stock market listing requirements deteriorated. The International Organization of Securities Commissions (IOSCO) develops guidance for national securities regulators but does not make legally binding decisions.[12] Similarly, the Council of the Organization for Economic Cooperation and Development (OECD) has the ability to set best practices and policy guidelines but they do not bind participating OECD members.[13]

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[8] See http://www.oecd.org/gov/regulatory-policy/IOSCO%20profile.pdf.
[9] See *Business Roundtable v. SEC* at https://h2o.law.harvard.edu/cases/2956.
[10] For examples of rulemaking petitions to national exchanges, see CII letter to NYSE https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_2_12_cii_letter_to_nyse_dual_class_stock.pdf and CII letter to Nasdaq at https://www.cii.org/files/issues_and_advocacy/correspondence/2012/10_02_12_cii_letter_to_nasdaq_dual_class_stock.pdf.
[11] For example, see CII response letters opposing proposals to abandon long-standing "one share, one vote" listing standards at Hong Kong Exchange (HKEx) at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/March%2022%20CII%20HKEX%20response%20FINAL.pdf, and the Singapore Exchange (SGX) at https://www.cii.org/files/issues_and_advocacy/correspondence/2017/03_29_17_letter_to_SGX.pdf. See also Investors Exchange (IEX) proposal to introduce an optional listing category facilitating issuer-defined, time-based super-voting rights under the rubric of long-termism at https://www.federalregister.gov/documents/2018/04/02/2018-06568/self-regulatory-organizations-investors-exchange-llc-notice-of-filing-of-proposed-rule-change-to.
[12] See http://www.oecd.org/gov/regulatory-policy/IOSCO%20profile.pdf.
[13] See https://www.oecd.org/legal/legal-instruments.htm.

3. *Index providers are well-positioned to apply the alignment principle fairly and broadly.*

The market is already seeing signs of capital structures that appear designed explicitly to lock in founder control while complying with a technical definition of "one share, one vote."[14] In light of index providers' relatively nimble process for interpreting, reviewing and updating methodologies, they stand in relatively good position to deal with such gamesmanship fairly and expeditiously. Stock exchanges have a business reason to take a lenient approach with the application and strengthening of listing standards, and have a more bureaucratic rulemaking process in responding to investor concerns on listing standards. This could complicate keeping pace with evasion strategies as they shift. Also to index providers' advantage is the broad global reach of index constituents; the benefits of a stock exchange policy on voting rights are limited to companies listed on that exchange.

4. *Action from index providers is overdue as long-term, fundamental shifts in public capital markets have occurred since the original decision to exclude voting rights from equity index methodology*.

As capital markets evolve in fundamental ways, so too should index methodology. The growth of misalignment and the rising popularity of passive investment strategies are two major developments cited by the Discussion Paper as reasons for incorporating voting power into index methodology.[15] We would add a third trend: the ascent of engaged ownership, including through proxy voting, as an important investor tool for driving shareholder value. In the new era of genuine accountability—particularly annual election of board members, majority vote requirements to elect uncontested directors, and a robust process for challenging underperforming boards—voting authority and vote outcomes shape corporate behavior in ways not imagined decades ago. Each of these three trends may continue, making it increasingly difficult to defend an index methodology that is blind to voting rights.

II. Suggestion to exempt companies opting to sunset their unequal voting structures from voting power calculation

We generally support the revised proposal, but there are two primary concerns that give us pause. First, we have practical concerns about the substantial turnover anticipated in connection with revising the index contributions of existing constituents, who we note adopted their capital structures having no knowledge of MSCI's proposed revision to its methodology, and the extent to which certain current constituents and markets will be underweighted relative to the old methodology.[16] Second, we are aware of growing empirical evidence indicating that the harm

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[14] For example, Spotify's IPO introduced one class of ordinary shares, each entitled to one vote; but the company also granted insiders 10 "beneficiary certificates" for each ordinary share held. Each certificate provides one additional vote but no economic rights. Thus Spotify's structure functions as *de facto* dual class while complying with an overly-narrow definition of "one share, one vote." See April 3, 2018 Spotify 424B4 at https://www.sec.gov/Archives/edgar/data/1639920/000119312518105231/d494294d424b4.htm.

[15] See Discussion Paper p. 13.

[16] According to data as of Sept. 1, 2017, provided to CII by MSCI on 253 ACWI securities with unequal voting rights, 214 would see their contribution to the index decline. The three companies facing the largest impacts, by dollar decline in security market cap contribution, are Facebook (62% reduction in Class A's contribution), Alphabet

caused by misalignment tends to manifest after the earliest stage of a company's public life. [17] As a practical matter, we observe several companies already embrace this concept, having arranged in advance to wind down their misaligned structure through time-based sunset provisions.[18]

Given both of these considerations, we suggest providing exemptive relief to prospective constituents and existing constituents that choose to adopt firm, reasonable, time-based sunset provisions in their governing documents.[19]

> **New IPOs:** We consider "reasonable" any sunset provision that would automatically convert the share structure to a single "one share, one vote" class within a period of no more than seven years of the IPO date. We also believe it would be reasonable if a sunset structure includes a "renewable" feature that provides that the weighted voting rights structure may be extended for additional terms, each of no more than seven years, with the approval of at least a majority of outstanding shares with inferior rights, voting separately on a "one share, one vote" basis. Any such vote to extend should be scheduled to occur no earlier than one year before the date at which the structure otherwise would automatically convert.
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> **Existing companies:** We believe that any company that is an existing index constituent or otherwise eligible to join an index also should be exempted from the new MSCI policy (that is, receive full weighting) if within the three-year grace period the company changes its governing documents to provide for a sunset, with or without a renewable feature on the terms described above, within seven years or less of the commencement of the application of MSCI's new methodology.

We observe that a seven-year sunset exemption would permit those relying on the index for investment or benchmarking to capture early-stage public company growth, even with entities with protective structures in place, while assuring that in the longer term, there are appropriate structures of accountability to shareholders. And the approach described here would provide an

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(50% reduction in Class C's contribution and 56% reduction in Class A's contribution), and Roche Holding Genuss (77% reduction in security contribution). The impact to these four securities alone aggregates to more than $700 billion, while the impact to all 214 affected securities totals an estimated $1.9 trillion.

[17] See Kim, Michaely, "Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Structures", 2018, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209. See also the working paper of Cremers, Lauterbach and Pajuste, "The Life-Cycle of Dual Class Firms," 2017, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895 These and other studies are discussed in the CII Explainer of Key Academic Literature on Multi-Class Structures and Firm Value, at https://www.cii.org/files/Board%20Accountability/CII%20Summary%20of%20DC%20Studies.pdf.

[18] CII is aware of the adoption of almost two dozen time-based sunset provisions, some of which have already triggered conversion into a single class. Details are available at https://www.cii.org/files/Board%20Accountability/4-16-18%20Time-based%20Sunsets.pdf.

[19] A limited number of capital structures with unequal voting rights feature time-based sunset provisions phasing out the super-class over time. CII is aware of the adoption of 22. Details are available at https://www.cii.org/files/Board%20Accountability/4-16-18%20Time-based%20Sunsets.pdf. In 2017, three-quarters of US dual-class IPOs did not feature a time-based sunset provision. See https://www.cii.org/files/Board%20Accountability/2018Q1%20IPO%20Stats%20for%20Website.pdf.

option to give full weighting to existing companies that persuade low-vote shareholders that the weighted voting rights structure provides long-term value and should be sustained.

We accept that much can go wrong in the short-term, and a protective structure even for seven years is not ideal and in some cases will delay necessary and appropriate corrective action. However, we recognize a strong desire by management and boards of some private companies considering tapping public markets for protective structures, and the core of our concern is lack of accountability in the long-term, beyond a reasonable time horizon for understanding risks and opportunities.

III. Answers to specific questions posed by the Expanded Consultation

MSCI: Do you agree that unequal voting shares should remain eligible for index inclusion?

We can support inclusion of unequal voting shares on an underweighted basis, as proposed by MSCI. Unequal voting shares are still equity by definition (although we question whether shares with zero voting rights should be considered true "equity").

MSCI: Do you agree that the index weight of securities with unequal voting structures should be linked to voting power?

Yes. Factoring into each security the proportion of total voting power in the hands of non-strategic holders of listed shares is appropriate.

MSCI: Is it appropriate to delete securities with zero company voting power from the MSCI Equity Indexes?

Yes. It is appropriate to delete securities with no listed voting power in the hands of non-strategic shareholders if after three years those companies do not revise their capital structure or adopt a time-based sunset provision as described above in Section II.

MSCI: Is the application of a voting power adjustment an appropriate way to reflect misalignment between voting power and economic interest?

We believe the proposed adjustment to each security, based on the proportion of total voting power in the hands of non-strategic shareholders of listed shares, appropriately reflects misalignment.

MSCI: Is the method for calculating the adjustment adequate?

We generally believe this method is adequate for calculating the adjustment of securities with similar economic rights. However, we disagree with the proposal to ignore partial restrictions on the election of directors. We believe taking that approach will encourage companies to design capital structures around establishing control solely through the right to elect directors. We propose that for partial restrictions on the election of directors, MSCI should peg the adjustment to the lower of (a) company voting power (i.e. proportion of total voting power held by non-

strategic shareholders of listed securities) on voting items *other than the election of directors*, or (b) the percentage of total board seats on which inferior class holders can vote on a "one share, one vote" basis.

MSCI: Do you agree that the votes per share should be zero in cases where voting rights are restricted, as described on page 10?

We generally agree with assigning zero votes per share in cases where shareholders cannot vote on the same items on the agenda as another share class; a share class for which certain types of shareholders cannot vote on the same items on the agenda as other types of shareholders; and share classes for which the voting rights are conditional. To be clear, we disagree with certain proposed exceptions, as detailed immediately below.

MSCI: Do you agree with the proposed exceptions on page 10?

As previously stated, we disagree with the proposed exception under which MSCI would ignore partial restrictions on the election of directors. We believe taking that approach will encourage companies to design capital structures around establishing control solely through the right to elect directors. We propose that for partial restrictions on the election of directors, MSCI should peg the adjustment to the *lower* of (a) company voting power (i.e. proportion of total voting power held by non-strategic shareholders of listed securities) on voting items *other than the election of directors* or (b) the percentage of total board seats on which inferior class holders can vote on a "one share, one vote" basis.

Additionally, while we accept that votes per share cannot be calculated for companies with "loyalty share" structures, MSCI should still expect those companies to provide, on an annual basis, sufficient information to calculate the proportion of total voting power in the hands of non-strategic shareholders of listed securities.

MSCI: Is it appropriate to grant a grace period for current constituents?

It is appropriate and critically important to grant a grace period for current constituents.

MSCI: Is a three-year grace period sufficient or should more time be given?

A three-year grace period alone is not sufficient. We believe it is appropriate for reasons stated above to supplement the three-year grace period with a time-based sunset exemption for both existing and prospective constituents. We also could support a multi-step transition lasting up to three years (see response to "multiple step transition" question below).

MSCI: Are the proposed index maintenance rules for the Vote Adjusted Security Free Float appropriate?

We have no objection to the maintenance rules described in the proposal.

MSCI: Should MSCI implement the changes for current index constituents in one step or would a multiple step transition be appropriate?

We are aware of some investor appetite to spread the implementation of the proposed changes over a period of time. Doing so could be beneficial to affected companies and investors facing the prospect of significant portfolio turnover. A multi-step approach could also be particularly appealing to certain international markets anticipated to have substantial impacts from the proposed changes. We would envision a multi-step implementation applying only to existing constituents, commencing upon the end of the three-year grace period, and concluding no later than three years thereafter.

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In conclusion, we support MSCI and other major index providers taking proactive and necessary steps to revitalize long-term adherence to the Alignment principle. The Appendix below generally summarizes our recommendation. 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

APPENDIX
CII recommendation for the application of proposed MSCI methodology

New IPOs	Nov. 2018 and thereafter
IPO companies with "one share, one vote" structures	Full application (no impact)
IPO companies adopting sunset provisions (upon IPO) to collapse unequal voting rights by 7 year anniversary of IPO (unless inferior class holders vote to extend)	Permanent exemption*
Other IPO companies	Full application

<table>
<tr><th>Existing public companies</th><th>Nov. 2018 – Nov. 2019</th><th>Nov. 2019-Nov. 2020</th><th>Nov. 2020 - Nov. 2021</th><th>Nov. 2021-Nov. 2022</th><th>Nov. 2022 – Nov. 2023</th><th>Nov. 2023 and thereafter</th></tr>
<tr><td>Existing public companies with "one share, one vote" structures</td><td colspan="6">Full application (no impact)</td></tr>
<tr><td>Existing public companies adopting sunset provisions before Nov. 2021 to collapse unequal structures by Nov. 2025 (unless inferior class holders vote to extend)</td><td colspan="3">Permanent exemption upon adoption of provision*</td><td colspan="3">N/A</td></tr>
<tr><td>Other existing public companies</td><td colspan="3">Temporary exemption</td><td>33% application*</td><td>67% application*</td><td>Full application</td></tr>
</table>

* Recommendation differs from MSCI proposal, which contemplates no exemption for sunset adopters and a one-step transition.