Investor Coalition for Equal Votes

28 June 2023

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

Submitted via email to cp23-10@fca.org.uk

Re: CP23/10: Primary Markets Effectiveness Review – Feedback to DP22/2 and proposed equity listing rule reforms

Dear team,

The Investor Coalition for Equal Votes (ICEV) consists of UK and US asset owners with around $2 trillion 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 to the global proliferation of this misalignment.

We have appreciated both the previous work of the Financial Conduct Authority (FCA) to protect investors and ensure high standards of corporate governance, as well as your work elsewhere to support asset owners in exercising their voting rights through initiatives like the Vote Reporting Group. Our comments here build upon our previous response to DP22/2 and, like that response, focus solely on the questions pertaining to the dual-class share structure proposals. 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 this consultation.

Q4: Do you agree with our proposed approach to dual class share structures for the single ESCC category and the proposed parameters? If you disagree, please explain why and provide any alternative proposals.

ICEV response

We do not agree with the proposed approach for dual-class share structures (DCSS). We believe that this proposal will make it harder for investors to act as effective stewards of their assets. In turn, this will ultimately not only reduce the pool of long-term, thoughtful capital that both our portfolio companies and other companies tell us they want, but it will also reduce the long-term returns from UK listed companies that we need to support good outcomes for our beneficiaries.

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. Evidence suggests that the risk to performance stemming from unequal voting arrangements also increases over the course of a company's life as a public company. ICEV views "one share, one vote" 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[1].

While 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 had supported, in our response to DP22/2, the extension of the Premium Listing Principles to all issuers of equity shares under a single segment regime wherein the exercise of dual-class share structures (unequal voting rights) was limited to the very specific circumstances identified in PS21/22.[2] Most importantly to ICEV, PS21/22 limited 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.[3]

We note that in DP22/2, the FCA had said that its “intention…would be to continue to maintain the high levels of transparency, corporate governance and shareholder protections that characterise the UK listing regime” and “it may not be appropriate to move to a more permissive form of DCSS.” Only a year after this statement – and only 18 months after the initial relaxation of restrictions on DCSS was implemented – we are disappointed that the FCA is proposing yet further enabling of unequal voting rights structures. We are surprised that these changes have not been allowed further time to bed in.

We also do not believe that it is the case that any change in the number of IPOs on the London market (particularly the Premium segment) in the year since the previous discussion owes to ongoing restrictions on dual-class share structures. Specifically, we note that: IPOs have fallen in many jurisdictions owing to broader economic, policy and political uncertainty; and the number of companies admitted to trade on the AIM market – where the listing rules standards do not apply – has also fallen. As even the FCA acknowledges, there is also a wider trend of decreasing numbers of public companies, not just in the UK, but also in the EU and the US where approaches to DCSS are largely more permissible. We would argue this trend is in part because the era of cheap financing has made remaining private, including the scope for greater leverage that such an approach offers, a more attractive option.

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

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[1] 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.

[2] 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

[3] 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.

UK's 'USP' as a destination for global capital is in large part the robust investor protections and historically high standards of corporate governance.

We would continue to highlight the broad base of empirical research that shows that any benefits of holding dual-class stock decline over a period of a few years; companies with dual-class shares 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:

- 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.[4] Moreover, they demonstrate that "controllers have perverse incentives to retain dual-class structures even when those structures become inefficient over time."[5]
- 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.[6]
- 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.[7]
- 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.[8]
- 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.[9]
- 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. [10]

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

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[4] 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.
[5] *Id.* at 585.
[6] 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.
[7] Lindsay Baran, Arno Forst and M. Tony Via, "Dual Class Share Structure and Innovation," at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517
[8] Robert Jackson, "Perpetual Dual-Class Stock: the Case Against Corporate Royalty," at https://www.sec.gov/files/case-against-corporate-royalty-data-appendix.pdf.
[9] 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.
[10] railpen-response_uk-listings-review_05-01-2021.pdf (azureedge.net)

Letter Participants of The Investor Coalition for Equal Votes

Railpen
Council of Institutional Investors
Florida State Board of Administration
Minnesota State Board of Investment
NEST
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Washington State Investment Board