ICGN
International Corporate Governance Network

MSCI Equity Index Committee
7 World Trade Center
250 Greenwich Street
New York, NY
10007

By email: clientservice@msci.com

31 August 2017

Dear Members of the MSCI Equity Index Committee

Re: Consultation on the Treatment of Non-voting Shares in the MSCI Equity Indices

The International Corporate Governance Network (ICGN) welcomes the opportunity to comment on the consultation on the treatment of non-voting shares in the MSCI Equity Indices due for submission by 31st August 2017.

Established in 1995, ICGN Members include institutional investors with global assets under management in excess of US$26 trillion present in over 45 countries. Our mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide. As such, ICGN offers an important investor perspective on corporate governance to help inform public policy development and the encouragement of good practices by capital market participants. For more information on the ICGN, please visit www.icgn.org.

Many ICGN Members either own or manage assets using index-based passive strategies and are concerned about the governance implications of companies that list non-voting shares. From our own policy work in ICGN's Shareholder Rights Committee and from a recent ICGN membership survey we believe that non-voting shares are highly problematic and should not be included in investible benchmark indices. Our response to this consultation will elaborate on the nature of our concerns and the preferred way forward. ICGN has also made similar responses to consultations by Standard & Poor's/Dow Jones[1] and FTSE Russell[2].

General ICGN Position

The protection and enhancement of minority shareholder rights has been a long-standing focus of ICGN. Our Global Governance Principles and Policy Priorities emphasise the importance of equal voting rights for all shareholders and call for disclosure and explanation of any divergences as well as commensurate extra protections for minority shareholders. Ownership structures that allow disproportionate control via voting rights over publicly listed companies relative to economic interests and investment risk are a

[1] See ICGN response to S&P/Dow Jones consultation, May 2017: https://www.icgn.org/sites/default/files/6.%20S%26P%20index%20consultation%20on%20dual%20class%20shares%20May%202017_0.pdf

[2] See ICGN response to FTSE Russell consultation, June 2017: https://www.icgn.org/sites/default/files/11.%20FTSE%20Voting%20rights%20consultation%20June%202017_0.pdf

risk for good governance, as they can lead to entrenchment of control and an erosion of accountability to minority shareholders and other stakeholders.

Differential ownership rights are viewed by some companies and regulators as a viable way to encourage long-term share ownership. ICGN views this as a flawed tactic that can produce unintended, and undesirable, consequences. ICGN has challenged the use of differential ownership structures, which can include shares with differential voting rights or dual class shares, based on their potential for abuse by controlling shareholders. Avoiding mismatches between voting control and economic ownership is an important principle of protecting minority shareholder rights.[3]

The growth of index-based passive investment strategies has given rise to the concerns of the inclusion of companies in indices with shares or share classes with differential voting rights. Those passive funds with a mandate to invest based on an index composition are obliged to hold the securities in the index, notwithstanding any corporate governance concerns about differential ownership. This results in a "captive market" of passive investment funds, and ultimately distribution to retail savers and pensioners. This is a matter of concern to ICGN members, particularly those with large passive portfolios.

MSCI Questions

As noted above ICGN's general position is to discourage differential ownership rights generally and their inclusion key market indices. At the same time we recognize existing practices in some markets, where inclusion based solely on "one-share-one vote" principle is not a feasible option due to the existing differential ownership and control structures. In such cases we agree with MSCI view that listed voting power could be a key criterion for determining index eligibility, as this would offer basic protection and a reasonable degree of control over the future of the company to non-restricted shareholders. We would emphasise, though, that it is not the total listed voting power that matters, but the listed voting power held by non-restricted shareholders - i.e. voting power of the investable free float.

For companies with multiple-class share structures, only shares with voting rights should be eligible for index inclusion. Non-voting shares should not be included in MSCI indices regardless of the listed voting power of the company. If the only listed share classes of a company do not have voting rights, such a company should not be eligible for inclusion in an index.

Non-voting shares are not equivalent to preferred or saving shares admitted into indices in certain markets as they do not have the features (e.g. targeted dividend yield) that compensate for the absence of voting rights.

The listed voting power held by non-restricted shareholders should be at least 50% + 1 of the total voting rights (listed and non-listed). Any company where listed voting power held by non-restricted shareholders (i.e. voting power of the investable free float) is below the above threshold should not be eligible for inclusion into benchmark indices.

We believe the 25% threshold proposed in the consultation is too low and possibly makes an inappropriate comparison with free float—as these measures address two distinct issues. Free float fundamentally deals with market liquidity, and 25% free float in

[3] See ICGN's most recent Viewpoint on differential ownership rights, February 2017: https://www.icgn.org/differential-share-ownership-structures

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

many cases may be sufficient for trading purposes. But market liquidity is not the same thing as corporate governance, and a 25% voting rights threshold would still leave substantial practical limitations in terms of the interests of minority shareholders or improving the quality of benchmark indices.

To address further consultation questions:

- Shares with lower voting power can be included into indices as long as the above threshold for listed voting power in non-restricted hands has been met.

- One year would be a reasonable compliance period for companies. To remain in indices the companies should have concrete proposals by the end of the period that should be put to respective approval bodies within 6 months of end of the period.

- No grandfathering should apply for existing constituents. The number of companies with differential ownership and control structures in MSCI indices is still relatively small, so this is a good time to ensure indices are free from the risks associated with these structures.

- The best way to address governance risks in indices is to eliminate constituents with differential ownership and control structures and set reasonable free float requirements, to ensure minority shareholders have both rights and opportunity to improve corporate governance of listed issuers if/when problems arise.

- ESG factors are relevant in investment analysis and decision making for all companies, but we do not believe that ESG weightings or filters should be applied across companies in broad market benchmark indices. Those investors focused specifically on ESG themes may be best placed to used specialist ESG benchmarks rather than the broad benchmark indices.

We would be pleased to elaborate on any of the points raised in this letter should that be helpful and do not hesitate to contact me or George Dallas, ICGN's Policy Director, by email at george.dallas@icgn.org for more information.

Yours faithfully,

Kerrie Waring
Executive Director, ICGN
kerrie.waring@icgn.org

Copy: Bram Hendriks (BHendriks@ktmc.com) and Eugenia Jackson (Eugenia.Jackson@AllianzGI.com), Co-Chairs, ICGN Shareholder Rights Committee