



ICGN

International Corporate Governance Network

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Re: loyalty shares for Belgian listed companies

Dear Madam/Sir:

Led by investors responsible for assets under management in excess of US\$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide.

It has come to our attention that the Belgian government intends to introduce in the Belgian parliament new legislation allowing listed companies to adopt double voting rights through loyalty shares by a change of their by-laws with a simple majority (50% + 1) instead of the usual majority quorum of 75% for any other change of the company's by-laws. From our perspective representing global institutional investors, we find this development problematic in three key ways:

1. Loyalty shares with multiple voting rights ultimately marginalise investor rights and diminish the accountability of executive managers to shareholders. As an investor body with a focus on developing long-term investment perspectives by institutional investors, we are sympathetic to concerns of short-termism that might lie behind this legislative initiative. But we believe that this is a seriously flawed tactic with unintended consequences, and would strongly discourage legislative initiatives to introduce loyalty shares in Belgium.
2. A 50% + 1 threshold is remarkably low for such a profound change in corporate governance, and imposes an unfair obstacle on the ability of minority shareholders to resist a management undertaking to change a company's articles of association to allow for the introduction of loyalty shares.
3. At a time in which regulators around the world are introducing stewardship codes to encourage investors to play a greater, and more responsible, role in monitoring company governance, engaging and informed voting, the imposition of differential ownership rights has the effect of watering down investor influence in a way that is anathema to the goals of investor stewardship. ICGN has publicly described this phenomenon as "regulatory schizophrenia".

We believe factors could affect negatively institutional investor perception of the entire Belgian market if this loyalty shares legislation were to be introduced.

We have read a draft of a letter prepared by Deminor SA, providing a local perspective on this proposed legislation. The draft makes accurate reference to the research that ICGN has done relating to dual class shares, and we are supportive of the Deminor letter's analysis and recommendations.

To elaborate further on this, we cite here a summary of the ICGN position on differential ownership rights from a recent (2018) ICGN comment letter:

Dual class share structures: ICGN position

ICGN has regularly commented about differential rights in regulatory consultations around the world, and has also expressed its views in Viewpoint reports in 2017.¹

¹ See ICGN Viewpoint on differential ownership structures, February 2017: <https://www.icgn.org/differential-share-ownership-structures> and its Viewpoint on the inclusion of non- or limited-voting shares in stock indices, November 2017: <https://www.icgn.org/inclusion-non-voting-or-limited-voting-shares-stock-market-indices>

Our message is consistent: ICGN and its members are fundamentally opposed to differential ownership rights, dual class share structures and the separation of economic ownership and voting control. We believe these structures are fundamentally flawed and carry significant governance risks for minority shareholders by diluting minority shareholder protections, management entrenchment and limited accountability. In extremis such structures create opportunities for expropriation, with controlling shareholder gaining private benefits of control at the expense of minority shareholders.

We are concerned in particular that we are witnessing a “race to the bottom” by major global stock exchanges seeking to attract listings by watering down governance safeguards. In 2017, in an ICGN membership poll, 84% of ICGN members disapproved of differential voting right structures and 67% believed that differential voting structures would impact negatively stock valuations.

We also cite academic evidence which suggests that minority shareholders may be the net losers in differential ownership arrangements:

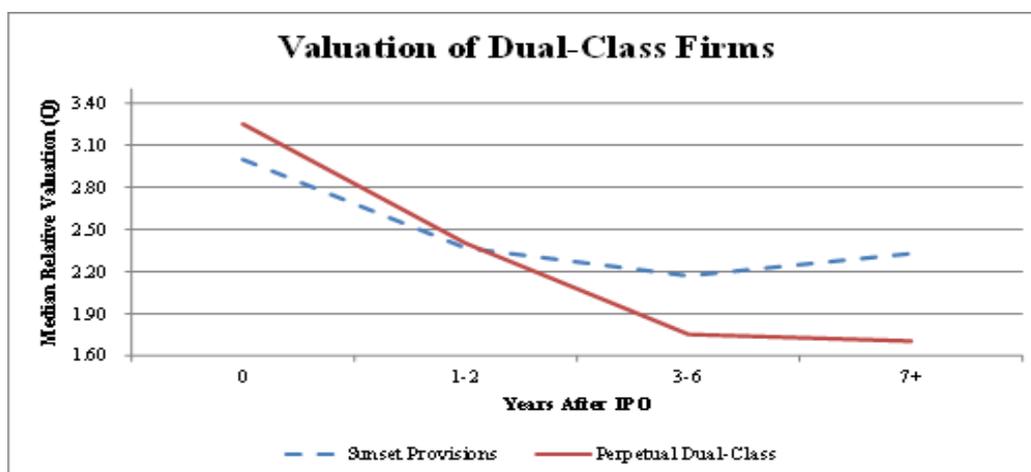
- A recent research literature review of differential ownership by Stanford University academics Larcker and Tayan concludes “the evidence suggests that companies with dual-class structures tend to have lower governance quality”.²
- In an empirical study of dual class structures in the United States, the study’s authors (Gompers, Ishii and Metrick of Harvard, Stanford and Yale, respectively) concluded “we find that firm value is positively associated with insiders’ cash-flow rights, negatively associated with insiders’ voting rights, and negatively associated with the wedge between the two.” The authors go on to say that “a majority owner of a private company can rationally choose to sacrifice some firm value in order to maintain private benefits of control.” That may be well and good for the controlling owner. But it also suggests that these private benefits come at a cost to minority investors.³
- A study of dual class share structures by Harvard Law School academics (Bebchuk and Kastiel) outlines the risks of entrenchment, self-dealing and perverse incentives that come with dual class shares, noting that there is an “untenable” case for perpetual dual class shares. They state that “as time passes the potential costs of a dual class structure tend to increase and the

² See: David Larcker and Brian Tayan, “Corporate Governance Matters”, Second Edition, Pearson Education Inc., 2016, page 333.

³ See: Paul A. Gompers, Joy Ishii and Andrew Metrick, “Extreme Governance: An Analysis of Dual Class Firms in the United States” *Review of Financial Studies* 23 (2010): 83-120.

benefits tend to erode.” The authors propose a requirement for sunset provisions in cases where such structures exist.⁴

- Robert Jackson, a former Columbia Law School Professor, and currently a Commissioner at the US Securities and Exchange Commission also recently articulated similar reservations about dual class share structures. Like Bebchuk and Kastiel he is not an advocate of dual class shares, and also supports the use of sunset provisions in cases where they exist. His own research suggests that if there is an advantage to dual class structures, such structures should not be permanent as they can lead to value deterioration over time.⁵ The following graph makes this point clear:



Source: Robert Jackson, US Securities and Exchange Commission, 2018

From this body of research we believe there are strong theoretical and empirical foundations that demonstrate the risks that dual class shares bring to minority investors. Though much of this research was based in the US, we believe it also has relevance in other markets globally, including Belgium. While the risks of dual class structures can ultimately be priced into a company’s valuation we believe the most sensible starting point is simply to avoid the introduction of dual class share regimes in the first place. Otherwise we believe there is a slippery slope to unintended consequences, even with the best of intentions.

We hope these comments are helpful with regard to your deliberations on these

⁴ See: Bebchuk, Lucian and Kobi Kastiel: The Untenable Case for Perpetual Dual-Class Stock, Discussion Paper No. 905, Harvard Law School, April 2017, pp 1-6.

⁵ See: Jackson, Robert J. Jr. (2018) Perpetual Dual-Class Stock: The Case Against Corporate Royalty, U.S. Securities and Exchange Commission: https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty#_ftn19

matters. Please contact ICGN Policy Director George Dallas if you would like to discuss this in further detail: george.dallas@icgn.org

Yours sincerely,



Kerrie Waring
Chief Executive

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