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International Corporate Governance Network

Listing Policy & Product Admission
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ICGN comment on SGX's consultation Possible Listing Framework for Dual Class Share Structures

The International Corporate Governance Network (ICGN) welcomes the opportunity to comment on Singapore Exchange Limited's consultation paper 'Possible Listing Framework for Dual Class Share Structures'.

ICGN's mission is to promote high standards of governance in companies and responsible investment practices by investors, with a long-term perspective on sustainable value creation. This mission extends systematically to promoting efficient financial markets and economies world-wide. ICGN was established over 20 years ago and today our membership of governance professionals spans over 45 countries and includes investors representing assets under management in excess of US$26 trillion. Many of our members have significant investment holdings in companies listed on the Singapore Stock Exchange.

Our policy positions are guided by the ICGN Global Governance Principles and the ICGN Global Stewardship Principles both of which have been developed in consultation with ICGN Members and as part of a wider peer review. They reflect our global perspective as an institutional investor-led body, and we would like to emphasise the important role that investors play as de-facto guardians of good corporate governance to help ensure the health and prosperity of financial markets, and ultimately society as a whole. As such, ICGN plays an important role in serving as a single source of international experience and a platform for balanced and constructive dialogue between investors, companies and policymakers.

Before addressing the proposal related to the suggested introduction of dual-class shares (DCS), we would like to mention that ICGN is encouraged by the investor stewardship code that was recently launched in Singapore. ICGN believes that one answer to the promotion of long-term investor thinking lies in the ongoing development of investor stewardship practices and their integration into the investment management process. Investor stewardship codes are an important tool to establish more responsible investment practices, relating to monitoring, engaging and voting at company AGMs. ICGN recognises that developing a culture of stewardship can take time. Both companies and shareholders have a mutual interest in protecting and generating sustainable corporate value over the long term.

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Question 1: DCS Framework

The protection and enhancement of minority shareholder rights has been a long-standing focus of ICGN and its members. Our Global Governance Principles emphasize 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 backward step for good governance, as they can lead to entrenchment of control and an erosion of accountability to minority shareholders.

ICGN has long advocated a preference for the 'one share, one vote' standard as the optimal structure for companies wishing to benefit from access to public capital. This ensures the equitable treatment of all shareholders and prevents managerial entrenchment, particularly in companies where the board is dominated by a controlling owner. It is our view that the introduction of a DCS framework will not be beneficial over the mid to long term for companies, institutional investors and Singapore's economy.

Since the financial crisis in 2008, there has been resurgence in the promotion and use of differential ownership and control structures, including dual class share structures, in many markets (e.g. United States, France, China, Brazil). ICGN has contributed significantly to the public policy debate on this issue. 1The rejection of differential ownership and control structures by the Hong Kong Securities and Futures Commission, the removal of respective proposals from the European Shareholder Rights Directive and the Italian Growth Decree are among the positive outcomes of these efforts.

We believe there is no strong evidence that differential voting rights provide companies with a better environment for long-term planning and execution. Indeed, the weight of evidence suggests otherwise. ICGN's recent Viewpoint on differential rights cited a recent research literature review of this topic, by Stanford University academics David Larker and Brian Tayan. They conclude that "the evidence suggests that companies with dual-class structures tend to have lower governance quality". [2]

For example, in an empirical study of dual class structures in the United States, the study's authors 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

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[1] For examples of ICGN position statements on differential rights please see: https://www.icgn.org/sites/default/files/Shareholder%20Rights%20Comment%20Letter.pdf; https://www.icgn.org/sites/default/files/Revision%20of%20the%20Shareholder%20Rights%20Directive_4.pdf; https://www.icgn.org/sites/default/files/Italian%20Government%20-%2028.01.2015_1.pdf; https://www.icgn.org/policy/viewpoints/differential-rights;

[2] David Larcker and Brian Tayan, "Corporate Governance Matters", Second Edition, Pearson Education Inc., 2016.

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]

ICGN membership survey on differential ownership rights

ICGN's position on differential ownership and control structures, including dual class share structures, is clarified in a Viewpoint report on the subject that was issued in February 2017.[4] The position that is taken in this Viewpoint is also supported by the outcome of an ICGN membership survey conducted in 2016, in which we questioned our members about differential ownership rights. In the survey ICGN invited Members to share their views on the perception of investment risk associated with differential ownership and control mechanisms, the impact of these mechanisms on their investment decisions, and the preferred policy options to guide ICGN's engagement work. The summary of responses below provides important insights to companies and markets considering differential ownership and control structures:

- 84% of respondents are not supportive of differential voting right structures and 22% would not invest in companies with differential voting and control structures;

- 67% of respondents said differential voting and control structures would impact their stock valuation, including: (i) greater discount rate, lower valuation or higher returns requirement due to increased risk profile; (ii) lower conviction, resulting in underweight positions or shorter-term investment horizon; and (iii) tactical weighting decisions in passive funds.

- 82% of respondents perceive differential voting and control structures as an investment risk. The level of risk depends on other protections available to minority shareholders, the ownership structure and the alignment of interests between the major/controlling shareholders and the minority shareholders, as well as the quality of board and management and actions/preferences of controlling shareholders.

- The preferred structure for the vast majority of respondents (82%) would be "one share one vote". For companies with differential ownership and control structures, investors would like to see strong mitigating measures (board independence, conflicts committee, exemptions from major transactions) and full plain disclosure of impacts on minority shareholder rights. Limiting companies with differential ownership and control mechanisms to special segments of a stock market is not favoured by investors with 57% citing it as the least preferred option.

In summary, the vast majority of ICGN members believe that differential voting and control structures are not features of good corporate governance, and should generally be avoided. Companies should understand the downside of differential rights for their minority investors, particularly those with long-term investment

[3] 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.

[4] See ICGN Viewpoint on differential share ownership structures : https://www.icgn.org/differential-share-ownership-structures

perspectives. Through our policies we encourage members to challenge such structures when they are in place, and also discourage new issues of shares with dual class or differential voting features

Market discount potential

A growing number of investors explicitly integrate the assessment of corporate governance practices in listed companies and associated risks into their investment analysis. Any risks attached to differential ownership and control structures will be priced accordingly and will have greater impact on stock valuations and investment decisions. Therefore companies should be mindful of the impact such structures will have on their investor base and their share price performance.

Safeguards against entrenchment and expropriation risks

In the consultation document DCS is portrayed as a policy initiative that can be risk-adjusted and ring-fenced. Questions 3 to 10 of the consultation deal with suggested safeguards against entrenchment and expropriation risks that result from the introduction of a DCS framework. The fact that the vast majority of the questions in the consultation document deal with safeguards, is a sign in itself that the introduction of a DCS framework triggers uncertainties for minority shareholders. The capital markets find it difficult to deal with situations of uncertainty and the suggested safeguards have not yet proven their effectiveness. The main issue with safeguards is that their effectiveness can only be tested in times of stress, situations where the interests of the minority shareholders and controlling shareholders do not run parallel.

The fact that the suggested safeguards have not proven their effectiveness as guardians of minority shareholder interests makes it difficult for ICGN to provide a reasoned response to the questions 3 to 10. Taking into account the fact that ICGN is opposed to the introduction of differential ownership rights, including DCS, we do not believe that any of the suggested safeguards merit consideration as effective checks and balances.

We would like to thank the Singapore Exchange for the opportunity to provide comments on the consultation related to the framework for dual class share structures. Should you wish to discuss our comments further, please contact George Dallas, ICGN's Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,

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