



**ICGN**

International Corporate Governance Network

## **Fighting for Shareholder Democracy** **By Kerrie Waring, Executive Director, ICGN**

This year, ICGN Members approved the fifth edition of the ICGN Global Governance Principles, first published in 2002. One core principle remained virtually untouched – that the optimal share structure for companies wishing to benefit from access to public capital should be one vote for each share. Any divergence to this principle should be explained as well as ensuring commensurate extra protection for minority shareholders. It helps to ensure the equitable treatment of all shareholders and protects against managerial entrenchment and an erosion of accountability.

Today, this stalwart principle is under attack. A growing number of companies are seeking to adopt multi-class share structures with voting rights disproportionate to underlying economic interests and investment risk. Arguing that this is justified in order to safeguard their long-term vision, the real effect is to consolidate power in the hands of just a few shareholders – often the company founder - at the expense of minority investors.

Last year's US-based SNAP initial public offering (IPO) with exclusively non-voting shares proved a tipping point and it has provoked a series of public consultations by the world's leading index providers. An MSCI consultation on the treatment of non-voting shares in their benchmark indices has recently concluded, and we await an announcement.

Alongside this unfortunate trend is the growing number of stock exchanges and regulators willing to consider the amendment of listing rules to accommodate companies with multi-class share structures. In some cases the purported rationale is to protect them from perceived short-termism, in others it is clearly a response to competition between exchanges for high-value IPOs. Either way, the concerted attack on the 'one share one vote' principle risks creating a regulatory race to the bottom.

Last month, the Singapore Stock Exchange (SGX) issued a 'clarification' that companies with dual class share structures which are primary listed in developed markets are able to have a secondary listing in Singapore. The SGX has also consulted on the possible introduction of dual class share structures in its primary market, a proposal which was strongly denounced by the ICGN and many of the world's most influential investors. We expect a conclusion from SGX by the year end.

At the same time, the Hong Kong Exchanges and Clearing Ltd is deliberating on whether to introduce a 'Third Board' which would allow for further market segmentation with 'non-standard' governance structures, weighted voting rights and 'compliance flexibility' – in other words, lower governance standards and weaker investor protections.

This is not just an issue in Asian markets, ICGN successfully advocated against the introduction of so called 'loyalty' shares during negotiations on the revised EU Shareholder Rights Directive, which became law earlier this year. Together with the Italian investor body Assogestioni we also persuaded the Italian Government not to extend a provision passed in 2014 that allowed Italian companies to modify their statutes to introduce double voting rights to shareholders that have owned shares for two years via a simple majority vote, rather than requiring a supermajority.

More recently the UK's Financial Conduct Authority (FCA) is consulting on a new 'premium-lite' segment for international listings. The consultation describes this as "attractive to companies where there is a founding family or government that wishes to retain control

rights that are incompatible with a conventional premium listing". Many suspect the consultation has been timed to entice Saudi Aramco to list in London, and some fear that watered down listing rules could irrevocably damage the reputation of the UK as a leading market with high standards of corporate governance and investor rights.

The irony is that these efforts to water down shareholder rights are happening at the same time as politicians and regulators are putting pressure on investors to do more to monitor and engage with boards, to safeguard the value of underlying investments and prevent managers putting their own interests ahead of those of their shareholders and stakeholders.

Foreign (or often misleadingly referred to as 'minority') investors hold vast chunks of public equity in most major markets around the world. Today, around 20 countries have introduced stewardship codes which call on investors – asset owners and their managers – to monitor the governance practices of investee companies and challenge them where necessary. In the European Union, the Shareholder Rights Directive will require investors to explain publicly how they do so, including how they have voted.

This is regulatory schizophrenia of the worst kind. Demanding investors do more to hold boards account while removing the most important means by which they can do so is setting them up to fail. 'Comply or explain' corporate governance codes and other similar measures, while very important, are of only limited use if shareholders do not have the ability to enforce them.

So how can we reverse this race to the bottom and preserve high governance standards and shareholder democracy? There are four things that need to be done.

1. Change the thinking of stock exchanges, and convince them that a race to the top will be more beneficial for them. Markets such as the UK, Singapore and Hong Kong are well regarded for their strong governance frameworks and investor protection regimes, which provide a competitive advantage. High governance standards and effective shareholder rights make markets more attractive to international capital, and many investors apply a discount in markets that lack them.
2. Encourage global index providers to take more responsibility, by penalizing companies with lower governance standards. This is particularly important for investors who pursue index strategies and do not have the luxury of exit. S&P Dow Jones now excludes companies with multiple share classes from its key benchmarks, while FTSE Russell announced a list of more than 30 companies that would be excluded unless they increased the proportional voting rights in the public float. And, as noted, MSCI has just consulted on the treatment of non-voting shares.
3. Encourage securities regulators to exercise stricter oversight. They can play a pivotal role in keeping a check on conflicts of interests to uphold the equitable treatment of shareholders, whilst balancing the need to pursue commercial gains. The 2014 decision by the Hong Kong Securities and Futures Commission to overrule a concept paper by the Exchange to introduce dual-class share structures is a good example of where a securities regulator has acted in the interests of the market as a whole.
4. Ensure there are effective mitigating measures to provide protection and redress in those markets with multiple share class structures. Supporters of differential voting rights will often point to the New York Stock Exchange, where such structures have long been permitted. But the US does have fairly robust investor protections to mitigate abuses, as evidenced by stronger fiduciary duties bestowed on controlling owners and a contingency-fee based class action system for private enforcement. Other examples of mitigating measures might include sunset provisions and ensuring

that minority investors have an equal say in decisions that can materially impact the company's value, such as a merger or acquisition

ICGN encourages regulators, stock exchanges and indices to pursue a 'race to the top', to develop their respective financial markets as centers of excellence and ultimately attract new IPOs, and to think of investors as their allies in this mission. The alternative is a decline in governance standards and a lack of effective oversight, which will leave markets ripe for another corporate failure at the expense of the investing public – pensioners, retail savers, insurance premium holders and society as a whole.

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## **END Notes:**

### Principles

"Rights of all shareholders should be equal and must be protected. Fundamental to this protection is ensuring that voting rights are directly linked to economic stake and that minority shareholders have voting rights on key decisions or transactions which affect their interest in the company." Principle 8: [ICGN Global Governance Principles \(2017\)](#)

### Commentary

ICGN is actively engaged in responding to consultations regarding the issues of multi-class shares and the impact on shareholder rights. Recent submissions include:

- [Consultation on the Treatment of Non-voting Shares in the MSCI Equity Indices](#), 31/08/17
- [Hong Kong Exchanges and Clearing Limited \(HKEx\) consultation on the New Board Concept Paper](#), 15/08/17
- [FTSE Russel. Voting Rights Consultation](#), 16/07/17
- [S&P Dow Jones Indices consultation on dual class shares](#), 03/05/17
- [Singapore Exchange Limited's consultation paper 'Possible Listing Framework for Dual Class Share Structures](#), 13/04/17
- [Viewpoint on differential ownership rights](#), 02/17