CalPERS

Investment Committee
Agenda Item 6a

April 16, 2018

Item Name: Dual Class/Non-Voting Shares Update and Debate

Program: Sustainable Investments

Item Type: Information

Executive Summary
The issue of disparate voting structures has come under recent scrutiny. The CalPERS Governance & Sustainability Principles recommend that companies adopt the concept of "one-share, one-vote" – a longstanding corporate governance best practice. CalPERS has a history of advocacy in this space, including our December 12, 2016 lawsuit to stop IAC/Interactive Corp from diluting shareowner voting power using dual class shares. We continue to monitor and track this issue.

Strategic Plan
This agenda item supports the CalPERS 2017-22 Strategic Plan goal of Fund Sustainability, and the 2017-18 Business Plan goal of Investment Beliefs and ESG Risk Integration across the total fund. Specifically, our efforts in this area are consistent with our Governance & Sustainability Principles and our efforts under the 5-year Sustainability Plan.

Investment Beliefs
This item relates to the following CalPERS Investment Beliefs, as well as some of the tension that exists within them:

- Investment Belief 4: Long-term value creation requires effective management of three forms of capital: financial, physical and human, and the sub-beliefs relating to strong governance structures and investor rights.
- Investment Belief 6: Strategic asset allocation is the dominant determinant of portfolio risk and return, and the sub-belief that CalPERS will aim to broadly diversify its overall portfolio across risk factors and return drivers.
- Investment Belief 7: CalPERS will take risk only where we have a strong belief we will be rewarded for it, and the sub-belief regarding tracking a diversified index in the absence of conviction for an active implementation.

Background
The issue of disparate voting structures came under scrutiny after the Snap, Inc. (SNAP) March 2017 initial public offering (IPO), which offered only non-voting shares to public investors. Prior to SNAP's IPO, no other company had completed an IPO of non-voting stock on a U.S. stock exchange.

Analysis
Institutional investors across the globe are concerned about the SNAP IPO and its implications for the health of public markets. Institutional investors strongly favor a “One-Share, One-Vote” governance structure.

In March 2016, motivated by investors' concern about high-profile IPOs on U.S. markets using dual-class structures, Council of Institutional Investors (CII) Members approved a policy statement “Investor Expectations for Newly Public Companies." The statement asserts that companies going public should have "one share, one vote."

February 3, 2017 CII and its members sent a joint letter to SNAP Inc. CEO Evan Thomas Spiegel, SNAP’s Chief Technology Officer and Director Robert Murphy, and Chairman-Designate Michael Lynton urging them to reconsider their plans to go public with a share structure that offers public investors no voice in the company's corporate governance.

March 9, 2017 CII Executive Director Ken Bertsch testified before the Securities and Exchange Commission (SEC) Investor Advisory Committee highlighting the need for the Commission to revisit the U.S.-based stock exchange rules on IPOs which include multi-class structures with different voting rights. That same day, SEC Commissioner Kara Stein also called for the reassessment of exchanges’ rules on the IPO process.

In May/June 2017, CalPERS wrote three letters responding to open consultations by MSCI, S&P Dow Jones and FTSE/Russell on the eligibility of non-voting shares, stating our belief in “one-share, one-vote” and our opposition to the use of non-voting shares as the only available public instrument, a structure not aligned with what we consider good governance.

In the 2017 proxy season, CalPERS voted “For” four proposals (out of four) which called for the elimination of dual class share structures. We also voted “Against” two (out of two) proposals to authorize an increase of dual class shares.

The Legal and Investment Issues Associated with Non-Voting Stock.” The discussion was led by Charles Elson, the Chair in Corporate Governance at the University of Delaware. A roundtable on the same topic will be held in April 2018.

In its December 2017 meeting, in which CalPERS participated, the Securities and Exchange Commission (SEC) Investor Advisory Committee (IAC) featured a discussion on dual-class and other entrenching governance structures in public companies, noting that such structures have increased dramatically since 1980 going from 2% to 18% of IPOs.

In March 2018, the Investor as Owner Subcommittee of the SEC IAC provided a recommendation to the SEC on Dual Class and Other Entrenching Governance Structures in Public Companies. CalPERS participated on the subcommittee and provided comments to the final draft that addressed additional issues of no-vote shares.

CalPERS team-members are engaged. We will continue to track and monitor index treatment of no-vote and unequal-vote shares and respond to consultations and engage in discussions as appropriate. Other market participants are also engaged and we expect this topic to evolve significantly over the course of the next year to 18 months.

In addition to participating in this evolving policy debate, the team plans to research potential modifications to the Global Equity benchmark, including potential divestment via index methodology and its resulting impact on the ability to sufficiently diversify the overall portfolio.

Budget and Fiscal Impacts
Not applicable.

Benefits and Risks
Benefits: Investor rights protect CalPERS' interest.

Key governance risks identified:

- No shareowner voting rights to elect directors and Say-on-Pay vote, thereby removing shareowner ability to voice concerns with strategic and governance matters.
- SNAP is not required to file annual proxy statements and information statements under Section 14 of the Exchange Act thereby eliminating access to disclosures and much needed transparency for shareowners.
- Constraining the investible universe potentially impairs the ability to diversify the overall portfolio across distinct risk factors and return drivers.

Attachment
Attachment 1 – CalPERS Recent Efforts on Dual Class/Non-Voting Shares

____

Ted Eliopoulos
Chief Investment Officer