Dual Class/Non-Voting Shares Update

Investment Committee, April 2018

Dual-Class/Non-Voting Shares Update

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Public Equity Ownership

- Public equity stock represents fractional ownership of a corporation
  - Shareholders are granted special privileges depending on the class of stock
    - Common or ordinary shares typically carry specific voting rights, including election of directors, distributions, and buybacks
    - Preferred or preference shares typically do not carry voting rights, but are entitled to receive certain preferential dividend payments
- Master Limited Partnerships (MLPs) combine the tax benefits of a private limited partnership with the liquidity of a publicly traded security
  - Two classes of ownership: the general partner(s) make the decisions, and the limited partners
    - The MLP general partner owes no fiduciary duty to the limited partners
    - Voting rights of MLP common unitholders (LPs) are very limited
    - MLPs are not subject to corporate taxation, they act as pass-through entities
    - Recent tax code changes have had some negative implications for MLPs
  - MLPs typically provide attractive yields, inflation sensitivity and diversification properties, relative to other growth assets

What are Dual-Class Shares?

"Dual-class shares" is a term used to denote differences in voting rights among different classes of common or ordinary shares

- Can also refer to differences in dividend rights and/or liquidation preferences
- Common types of dual-class (voting) shares
  - One class with one vote per share and the other classified as non-voting
  - One class with "super voting" shares, or supermajority shares, and the other with the standard one vote
- In some cases, both classes of shares are publicly tradable
- In other cases, the superior voting shares are privately held

Scope of Dual-Class Listings

As of 2017, there were over 500 publicly listed dual-class securities globally (FTSE)

As a result of differing listing standards globally, the U.S. has recently seen an influx of foreign dual-class listings, including some high profile offerings, such as China's Alibaba in 2014 (the largest ever IPO) and the UK's Manchester United in 2012

Several prominent international exchanges have responded by exploring revisions to listing standards to allow dual-class structures

- UK's FCA conducted a 2017 consultation on capital market effectiveness (no changes were made to listing standards and dual-class structures are still restricted)
- Following consultations in both Hong Kong and Singapore, their local exchanges are expected to allow dual-class structures later this year
- Japan's listing standards allow for dual-class structures, but only when paired with "sufficient shareholder protections" (there is currently only one JA dual-class security)

Dual-Class Shares in the U.S.

- The U.S. prohibited the listing of non-voting common shares until 1985
- The NYSE and NASDAQ allow dual-class/unequal vote structures, but only if the company had that structure when it went public
- The recent dual-class trend began in 2004 when Google sold low-vote shares in its highly publicized IPO
- Some other well known, U.S.-based, dual-class listings are Berkshire Hathaway, Facebook, Ford, Nike and FOX

Recent Dual-Class Statistics

Large Majority of 2017 IPOs were One Share, One Vote (81%)

19% of 2017 IPO's carry unequal voting rights, of which the majority (3/4) have an indefinite term structure

Four 2017 IPO's included non-voting shares in their structures: SNAP, Altice USA, Blue Apron and Cadence Bancorporation (SNAP is the only company that has actually issued non-voting shares to public investors)

IPO's with dual-class shares have become more common:

- 2005: ~1%
- 2014: ~12%
- 2017:~19%

In the last month, two large, well-known tech companies have gone public in the U.S. with dual-class shares, in DropBox (DBX) and Spotify (SPOT)

The Dual-Class Debate

The Case for One Share One Vote	The Case for Unequal Voting Rights
• Shareholders have the incentive to maximize firm value and should be able to participate in all important decisions in proportion to their ownership of equity capital • Unequal voting rights protect insiders from outside control and accountability, leading to potential entrenchment and agency issues • Unequal voting rights may result in higher cost of capital for the firm due to potential lower valuation, as well as agency costs • Effective engagement relies on strong governance rights	• Unequal voting rights may allow management to retain control and invest for long term results without being exposed to outside investor pressure to maximize short term profit • Unequal voting structures may represent an attractive opportunity for certain investors that would be ready to exchange lower or no voting rights for liquidity or dividend advantages • Unequal voting structures are the result of voluntary decisions by informed agents in a free market, and hence will be priced efficiently • Reduced voting rights weaken engagement effectiveness

Source: MSCI's discussion paper, available at: https://www.msci.com/index-consultations

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CalPERS Investment Beliefs that inform the debate

Investment Belief 4

Long-term value creation requires effective management of three forms of capital: financial, physical and human

- Governance is the primary tool to align interests between CalPERS and managers of its capital, including investee companies and external managers
- Strong governance, along with effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long-term and manage risk effectively

→ Support for “One-share/One-vote”

Investment Belief 6

Strategic asset allocation is the dominant determinant of portfolio risk and return

- CalPERS will aim to diversify its overall portfolio across distinct risk factors return drivers

Investment Belief 7

CalPERS will take risk only where we have a strong belief we will be rewarded for it

- CalPERS will use index tracking strategies where we lack conviction or demonstrable evidence that we can add value through active management

→ Support for the most broadly-diversified portfolio possible

Governance & Sustainability Principles

One-share/One-vote

"A shareowner's right to vote is inviolate and should not be abridged. All investors must be treated equitably and upon the principle of one-share/one-vote."

Shareowner Engagement

"CalPERS prefers constructive engagement to divesting as a means of affecting the conduct of the entities in which we invest. This is because investors that divest lose their ability as shareowners to positively influence the company's strategy and governance."

The dual-class debate is also reflected in the tensions within the CalPERS Investment Beliefs and Governance & Sustainability Principles:

- The desire for "One-share/One-vote" and the simultaneous desire for the most broadly-diversified portfolio possible
- The desire to engage as a means to change behavior as opposed to divest

CalPERS Benchmark Exposure

FTSE All-World/All-Cap Benchmark (June 2017)				
	Global	**US**	**DM ex US**	**EM**
Total BM securities	9,884	4,170	3,760	1,954
Dual class shares ex MLPs, Ltd Partnerships & SNAP				
Number of category securities in BM	525	328	175	22
Regional BM weight (%)	10.0%	11.1%	9.4%	5.4%
MLPs, Ltd Partnerships & SNAP - no voting rights				
Number of category securities in BM	123	123	0	0
Regional BM weight (%)	0.6%	1.1%	0.0%	0.0%
Total dual class, MLPs, Ltd Partnerships & SNAP				
Number of category securities in BM	648	451	175	22
Regional BM weight (%)	10.6%	12.2%	9.4%	5.4%

Performance of Unequal Voting Stocks

(Source: MSCI; Data from November, 2007 to August, 2017)

Regulatory Environment

The topic of dual-class listings has seen an increased focus by global regulators and exchanges.

"*Disclosure regarding the operation of dual class voting structures is a question that should be discussed…and about the attractiveness of U.S. public capital markets compared to foreign public markets and global private markets*." –SEC Chairman Jay Clayton (March 2018)

"*Structures where a minority of insiders lock out the interests and rights of the majority may also have collateral effects on our capital markets."* -SEC Commissioner Kara Stein (Feb. 2018)

"The reason we want to have a separated regime for secondary listing is because currently we have many restrictions that makes it difficult for…Greater China companies to come to Hong Kong." -HKEX Chief Executive Charles Li (Feb. 28, 2018)

"Malaysia and Singapore Weigh Dual-Class Shares as Exchanges Battle for IPOs" – Bloomberg (Jan 2018)

Index Provider Methodologies

In 2017, three major global index providers conducted open consultations on the treatment of dual-class and non-voting shares

- FTSE/Russell – Developed market companies with less than 5% of voting rights held in free-float shares are not eligible for index inclusion in all standard indices (Existing constituents have a five-year grace period)
- MSCI (*proposed rules*) – Constituents with unequal voting rights would have their weight reduced to reflect free-float voting power across MSCI's standard developed and emerging market indices (Potential for a three-year grace period for compliance)
- S&P Dow Jones - Will exclude all future dual-class IPO's from its flagship S&P Composite 1500 and related component indices

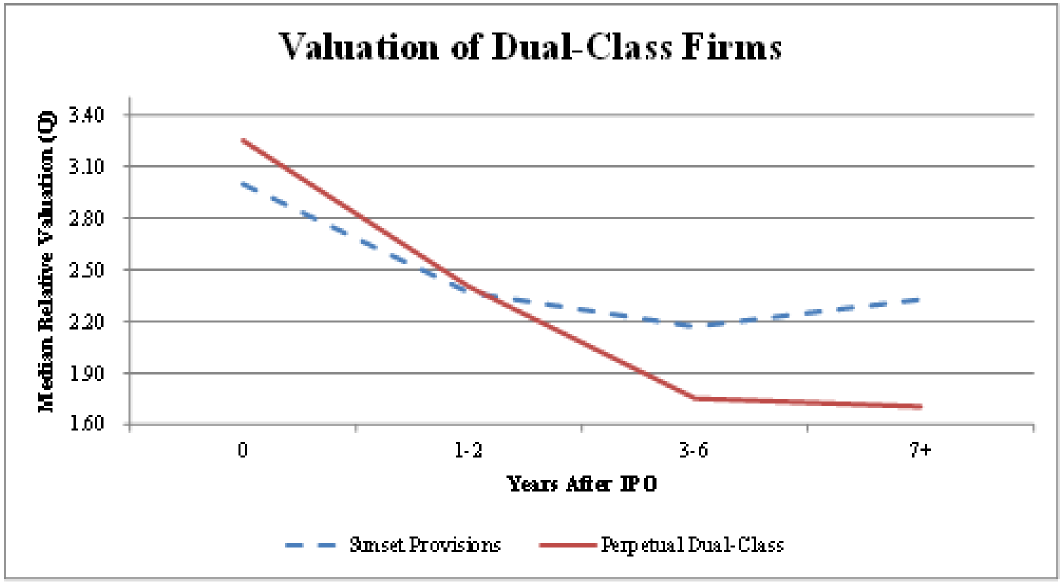
Potential Solution: Sunset Provisions

With recent efforts to increase the attractiveness of the IPO process, along with evidence of dual-class structures potentially providing an initial value premium, support has grown for dual-class structures with defined, time-based sunset provisions.

- Long-term performance impact of individual dual-class offerings is decidedly mixed
- On average, dual-class structures provide a value premium at the time of the IPO
- On average, within six to nine years, that premium dissipates, before turning negative

Impact of Sunset Provisions

A preliminary SEC study of 157 dual-class IPOs that have occurred over the past 15 years identified some pretty significant differences between the 71 dual-class companies with sunset provisions and the 86 who gave insiders control forever. Regression models predicted relatively similar valuations at their IPO dates, however, seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions.



Source: “Perpetual Dual-Class Stock: The Case Against Corporate Royalty”, SEC Commissioner Robert L. Jackson (Feb 2018)

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Types of Sunset Provisions

"*Perpetual dual-class ownership—'forever shares'—don't just ask investors to trust a visionary founder. It asks them to trust that founder's kids. And their kids' kids. And their grandkid's kids*."
– SEC Commissioner, Robert Jackson (Feb 16, 2018)

Time-based sunset provisions - Dual-class share structures with a finite term, including a provision automatically winds down the dual-class structure upon a chosen anniversary of the IPO (commonly five to ten years), unless an extension is approved by shareholders. In 2017, 26% of dual-class IPO's instituted a time-based sunset provision.

Contingent time-based sunset provisions - Dual-class share structures that have a finite term with specified contingencies. Examples include company market cap, growth, dilution, etc.

Event-driven sunset provisions - Preserve unequal voting rights for as long as circumstances permit. Examples include requiring conversion upon an insider's departure, disability, death or transfer of shares

Next Steps

- Continued advocacy for “One-share/One-Vote”
- Continued engagement in the dual-class/no-vote matter, independently and through partners, including global listing standards, index methodology, and regulatory environment
- Review of the CalPERS Global Equity benchmark at the ALM mid-cycle, or earlier, if preferred

Appendix

CalPERS Recent Efforts

- 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.

- In September 2017, James Andrus served on a panel at the ABA Business Law Section fall meeting entitled "SNAP Judgment, 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.

Index Provider Methodology

	MSCI Indices	*S&P Dow Jones Indices*	*FTSE/Russell Indices*
Launch date	March 3, 2017 / Re-opened January 31, 2018	3-Apr-17	30-May-17
Due date	31-May-18	3-May-17	16-Jun-17
Index proposed approach to IPOs with non-voting rights	MSCI would weight its indices by voting power in all global markets except for frontier markets. MSCI's plan would slice the index market cap of 209 dual-class firms, but not affect another 32.	S&P Dow Jones plans to ban all multi-class IPOs after five years but allow existing dual-class issuers.	FTSE Russell plans to bar IPOs with a free float of 5% or less voting rights from developed market indices, but not emerging market indices.
Proposed effective date for new and existing listings	The plan would apply to new listings in November 2018 and to existing listings in 2021.	The methodology change to make companies with multiple share class structures ineligible for inclusion in the S&P Composite 1500 is effective immediately. Existing S&P Composite 1500 index constituents are grandfathered in and are not affected by this change.	For potential new constituents, including IPOs, the rule will apply with effect from the September 2017 semi-annual and quarterly reviews. For existing constituents, the rule will apply with effect from September 2022, thus affording a five-year grandfathering period to allow constituent companies to change their capital structure if they so wish.
Notable activities	*__February 16, 2017__ - Singapore Stock Exchange consults public on dual class structure. *__March 2017__ - SNAP IPO offering only non-voting shares to public investors giving shareowners no voice on SNAP's strategic and governance matters. *__June 2017__ - Hong Kong Stock Exchange consults public in "Review of the Growth Enterprise Market (GEM) and Changes to the Gem and Main Board *__July 28, 2017__ - Singapore Stock Exchange announces plans to allow dual-class shares in Singapore. *__October 27, 2017__ - The Hong Kong Stock Exchange indicated its plans to permit dual-class (or "weighted voting right") listings, with some limitations *__December 7, 2017__ - The SEC IAC announces agenda for the Committee meeting which included a discussion on dual-class shares		

Time-Based Sunset Provisions

Time-Based Sunset Approaches to Dual-Class Stock

Company	IPO Year	Sunset trigger
MuleSoft	2017	5 years or superclass falls below 15% of outstanding common
Groupon	2011	5 years (converted in 2016 to one share, one vote)
Yelp	2012	7 years or superclass falls below 10% of outstanding common
Apptio	2016	7 years or superclass falls below 25% of outstanding common
Kayak Software	2012	7 years
Mindbody	2015	7 years
MaxLinear	2010	7 years (converted in 2017 to one share, one vote)
Twilio	2016	7 years
Stitch Fix	2017	10 years or superclass falls below 10% of outstanding common
Alteryx	2017	10 years or superclass falls below 10% of outstanding common
Pure Storage	2015	10 years or superclass falls below 10% of outstanding common
Hamilton Lane	2017	10 years or founders and employees hold less than 25% of voting power
Okta	2017	10 years
Castlight Health	2014	10 years
Veeva Systems	2013	10 years
Altair Engineering	2017	12 years or “executive holder” holds less than 10% of outstanding common
Fitbit	2015	12 years
Nutanix	2016	17 years
Workday	2012	20 years or superclass falls below 9% of outstanding common

Source: CII analysis of SEC filings
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