S&P Global
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Submitted electronically

Subject: Eumedion's response to the Consultation on the eligibility of non-voting share classes

The Hague, 3 May 2017

Dear Sir/Madam,

Eumedion welcomes the opportunity to respond to your consultation on the eligibility of non-voting share classes. By way of background, Eumedion is the Dutch based corporate governance and sustainability forum for institutional investors. Our 70 Dutch and non-Dutch participants represent more than € 5 trillion assets under management. Participants include a wide range of institutional investors; pension funds, mutual funds, asset managers and insurance companies. Eumedion aims to promote good corporate governance and sustainability in the listed companies our participants invest in. Before responding to the individual questions in the consultation document, we like to share with you our key remark.

**1. Key remark: Index weight should be adjusted for deviations from proportionality principle**

Eumedion welcomes that S&P pays attention to the eligibility of non-voting share classes in indices. Indices, like those offered by S&P, are widely used by institutional investors as a benchmark for setting asset management mandates and subsequently as a starting point for the construction of most investment portfolios. In practice, this means that a large part of the investment portfolio consists of the securities that are included in indices. Currently shares with disproportionate voting rights, such as non-voting shares, are not in any manner excluded by default from the S&P indices.

Eumedion believes that institutional investors have a fiduciary duty to act as responsible investors. More and more institutional investors live up to their fiduciary duties. This is – for example – reflected by an upward trend of the votes cast at Annual General Meetings of Dutch listed companies.[1] We believe that the responsible use by investors of the voting rights attached to shares strengthens the checks and balances within listed companies, which is key to creating long term value for the company and all its stakeholders, including shareholders.[2] The possibility to cast an informed vote at the general meeting is essential in this respect. Eumedion is of the opinion that the voting right itself is fundamental to the share ownership of listed companies and that shareholders' power should be proportionate to their economic interest (the so-called 'proportionality principle'). Therefore Eumedion is not in favour of companies issuing any equity instruments that affect the proportionality principle, such as non-voting or low- and high-voting share classes. The use of disproportionate voting shares will in practice lead to a distortion or even a vacuum in the checks and balances within listed companies. A strong position of the general meeting of shareholders is of the utmost importance to achieve a balanced distribution of power between the board and the shareholders. If shareholders have limited voting rights it will also limit their ability to exercise their stewardship role as responsible and engaged long term shareholders. The use of disproportional voting share classes will increase the risk of malpractices and scandals. It can even affect the trust of the general public in investing in shares, thereby affecting the access to capital for other companies as well.

The aforementioned 'proportionality principle' is not only violated in case of non-voting share classes but also in case of different classes of shares with different voting rights ('dual-class shares') and loyalty voting rights. Of particular concern is that those shareholding structures can be used to allocate founders and large shareholders additional voting rights. This tends to lead to a disproportionate concentration of power for those founders and large shareholders. That power could be used to dictate the decision-making process in the general meeting at the expense of other shareholders. For other shareholders it will become more difficult to block decisions that negatively affect their interests or to hold board members to account. Eumedion is therefore also not in favour of granting extra voting rights to specific shareholders.[3]

Against this background and given the fact that large parts of investment portfolios consist of the securities that are included in indices, we suggest that S&P adheres to the principle that the more a company deviates from the proportionality principle, the less its weight should be in an index. This approach differentiates between more and less aggressive voting structures and provides an immediate incentive to improve voting structures. S&P could further operationalise the principle as follows: the weight of individual share classes of a company that undercut the proportionality principle should be affected proportionally: the lower the effective voting power, the lower the weight in an index. We define the effective voting power of a common share class as:

[1] See: Eumedion's evaluation of the 2016 AGM season (https://www.eumedion.nl/en/public/knowledgenetwork/publications/2016-proxy-season-evaluation.pdf).
[2] See also: Best practices for engaged share-ownership intended for Eumedion participants (https://www.eumedion.nl/en/public/knowledgenetwork/best-practices/best_practices-engaged-share-ownership.pdf).
[3] See also International Corporate Governance Network, *Viewpoint Differential share ownership structures*, February 2017.

$$\text{Effective voting power} = \frac{\text{(total number of votes of all issued shares in a common share class / total number of votes of all issued shares in all common and preferred share classes)}}{\text{(total number of issued shares in a common share class / total number of shares in all common share classes )}}$$

Ideally, all shares have an effective voting power of 1 (i.e. one share 1 vote).This implies that non-voting shares should not be eligible for inclusion in indices. The index weight of shares with an effective voting power that equals or exceeds 1 (share one vote) is not adjusted.

The numerical example below explains how the calculation of the effective voting power adjustment would work in practice:

**Effective Voting Power adjustment in index weight**

| | (a) Shares issued | (b) = (a) / total (a) % of total common shares | (c) Votes per share | (d) = (a) * (c) Votes per share class | (e) = (d) / total (d) % of total votes | (f) = (e) / (b) Effective voting power (one share, x effective votes) | (g) = 1 - (Minimum of 1 and (f) ) Effective Voting Power adjustment in index weight |
|---|---|---|---|---|---|---|---|
| Common shares | | | | | | | |
| Common shares Class A | 5,000,000 | 25% | - | - | 0% | - | **-100%** |
| Common shares Class B | 5,000,000 | 25% | 0.1 | 500,000 | 4% | 0.17 | **-83%** |
| Common shares Class C | 10,000,000 | 50% | 1.0 | 10,000,000 | 87% | 1.74 | **0%** |
| Total common shares | **20,000,000** | **100%** | | | | | |
| Preferred shares | | | | | | | |
| Preferred share class A | 1,000,000 | | 1.0 | 1,000,000 | 9% | | |
| Preferred share class B | 1,000,000 | | - | - | | | |
| | | | | **11,500,000** | **100%** | | |

A hypothetical example with the consequences for index weight of an entire company, including an adjustment for free float, is shown below:

**Vote & Free float adjusted market capitalisation for index weight**

| **Common share class** | (g) **Effective Voting Power adjustment in index weight** | (h) **Free float (%)** | (i) = (h) - 1 **Free float adjustment** | (j) **Share price (EUR)** | (k) = (a) * (j) **Market cap (EUR mln)** | (l) = (k) * (1 + (g) ) * (1 + (i) ) **Vote & Free float adjusted market cap for index weight** |
|---|---|---|---|---|---|---|
| Common shares Class A | **-100%** | 100% | 0% | 45.00 | 225,000,000 | - |
| Common shares Class B | **-83%** | 100% | 0% | 47.50 | 237,500,000 | 41,304,348 |
| Common shares Class C | **0%** | 80% | -20% | 52.50 | 525,000,000 | 420,000,000 |
| | | | | | - | |
| | | | | | 987,500,000 | 461,304,348 |

Institutional investors increasingly are faced with companies that only list a fraction of their shares in public markets. Especially companies in the technology sector seem to sometimes prefer a listing less than 25% on Initial Public Offering. The relatively small number of shares available and the relatively high public interest are ingredients for high volatility that bears no relation to the underlying economics of the company. This is not in the interest of thoughtful capital allocation decisions, nor a well-functioning market, nor in the interest of the economy as a whole. We urge S&P, as a responsible index provider, to set a minimum float requirement for including shares in the index. We consider a minimum float of 25% of all common shares and votes outstanding as a bare minimum.

**2. Response to the specific questions**

Below we make some comments on the specific questions raised in the consultation document.

*1. If the only listed share classes of a company do not have voting rights, should that company be eligible for inclusion in an index?*

Answer: No, such company should not be eligible for inclusion in an index. We refer to the introduction of this response; Eumedion is not in favour of non-voting shares. We believe that S&P's indices should adjust the weight of common share classes that effectively have impaired voting rights. If a share class has no voting rights, that class should not be eligible for inclusion in indices; equally, if none of the listed share classes have voting rights, none of the share classes should be eligible for inclusion in indices.

*2. For companies with multiple-class structures where one or more listed share class is non-voting:*
*o Should only the non-voting share classes be ineligible?*
*o Should all share classes be ineligible?*
*o Should all share classes be eligible?*

Answer: None of the three mentioned solutions make reasonable adjustments for preference share classes with voting rights, or adjustments for share classes with voting rights other than 0 or 1 vote(s) per share. We do agree that non-voting shares should not be eligible for inclusion in an index. However, as explained in the introduction of this response, it is our view that the more a company deviates from the proportionality principle, the less its weight should be in an index. Our suggested approach is less binary and thereby also provides a proper incentive for companies to make progress towards the proportionality principle as targeted improvements in voting rights would immediately result in a higher index weight.

*3. If the company does not file information statements regarding shareholder ownership, should the company be ineligible for inclusion?*

Answer: Yes. It is important that institutional investors have sufficient, relevant and transparent information upon which they can base their investment decision. This is not the case if a company does not file information statements regarding shareholder ownership. Therefore we believe that those companies should be ineligible for inclusion.

*4. If the methodology were to exclude all share classes so the company is not eligible, should current constituents be "grandfathered" and remain in the index?*

Answer: We can imagine that the current constituents are offered a grace period that is sufficient to allow management to propose changes in their shareholding structure, before the weight of their shares is adjusted in the index.

*5. Should eligibility of non-voting shares differ in benchmark vs investable index families?*

Answer: No, we see no justification why benchmark and investable index families should be treated differently.

*6. Do you have any additional comments?*

Answer: No.

We hope that our comments and suggestions are of any assistance. If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Martijn Bos (martijn.bos@eumedion.nl, tel. 070 2040 304).

Yours sincerely,

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