



Submitted electronically

MSCI Equity Index Committee
7 World Trade Center
250 Greenwich Street
10007 NEW YORK, NY
UNITED STATES OF AMERICA

The Hague, 31 August 2017

Ref: B17.21

Subject: Eumedion's response to 'Consultation on the treatment of non-voting shares in the MSCI Equity indexes'

Eumedion appreciates the opportunity to respond to your consultation on the treatment of non-voting shares in the MSCI Equity indexes. Eumedion represents the interests of 65 institutional investors, all of whom are committed to a long term investment horizon. Together our participants invest over € 4 trillion of capital in equity and corporate non-equity instruments. Eumedion aims to promote good corporate governance and sustainability in the companies our participants invest in. We regard index services as a key part of the global financial infrastructure, as most asset owners and managers use indexes to define asset management mandates. Institutional investors, predominantly in their role as minority shareholders, may even be the key stakeholders of MSCI.

We thank MSCI for executing this outreach on the important topic of the treatment of non-voting rights, as these and similar instruments are at cross with the principle that shareholders' power should be proportionate to their economic interest (the so-called 'proportionality principle'). Below we will discuss the importance of the proportionality principle and our suggestion to relate index weight of share classes directly to deviations from the proportionality principle. We would like to note that the proposals in the consultation only seem to affect the most flagrant breaches of the proportionality principle. The severe risks from a governance perspective arising from those breaches justify in our view a call for a much firmer approach.

The importance of the proportionality principle

We believe that the responsible use by investors of the voting rights attached to shares strengthens the checks and balances within listed companies. This is instrumental to creating long term value for the company and all its stakeholders, including shareholders.¹ Eumedion is of the opinion that the right to vote at the AGM in itself is fundamental to the share ownership of listed companies and that shareholders' power should be proportionate to their economic interest. Therefore Eumedion is not in favour of companies issuing any equity instruments that affect the proportionality principle, such as non-voting and dual-class shares. 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' voting rights are limited in any way, this will immediately resonate negatively in 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.

Of particular concern are cases where share classes with limited voting rights are, or could be, used to allocate founders/large shareholders voting rights that exceed their economic interest. This tends to lead to a disproportionate concentration of power for those founders/large shareholders. That power tends to dictate the decision making process in the general meeting at the expense of other shareholders. It becomes more difficult, or even impossible, for other shareholders to block decisions that negatively affect their interests and to hold board members to account. Eumedion is therefore also not in favour of granting extra voting rights to specific shareholders.² We consider our concerns on deviations from the proportionality principle to be in line with those of the International Corporate Governance Network.³

Proportionate adjustment in index weight

Against this background, we suggest that MSCI 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 as improvements would lead to an increased index weight. This principle results in the consequence that any listed share class of a company that does not have voting rights, would never be eligible for inclusion in the MSCI indexes. Unlike the proposed solution in the consultation document, this principle not only addresses non-voting shares, but also more complex shareholder structures that effectively deviate from the proportionality principle, such as dual-share classes, shares with multiple or fractions of voting rights and loyalty shares.

¹ 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).

² See also International Corporate Governance Network, *Viewpoint Differential share ownership structures*, February 2017.

³ <https://www.icgn.org/differential-share-ownership-structures>

MSCI could operationalise the principle by proportionally adjusting the weight of individual share classes of a company that undercut the proportionality principle: the lower the effective voting power of a share class, the lower its weight in an index. We define the effective voting power of a common share class as:

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

Ideally, all shares have an effective voting power of 1 (i.e. effectively one share, one vote). This also implies that non-voting shares (effective voting power of 0) should not be eligible for inclusion in indexes. Shares with an effective voting power that equals or exceeds 1 do not undercut the effective voting power of 1 and therefore their weight is not adjusted or increased.

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)	(b) = (a) / total (a)	(c)	(d) = (a) * (c)	(e) = (d) / total (d)	(f) = (e) / (b)	(g) = 1 - (Minimum of 1 and (f))
	Shares issued	% of total common shares	Votes per share	Votes per share class	% of total votes	Effective voting power (one share, x effective votes)	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						
	(g)	(h)	(i) = (h) - 1	(j)	(k) = (a) * (j)	(l) = (k) * (1 + (g)) * (1 + (i))
Common share class	Effective Voting Power adjustment in index weight	Free float (%)	Free float adjustment	Share price (EUR)	Market cap (EUR mln)	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

Minimum threshold for voting shares in free float

We suspect that minority shareholders typically are the primary customers of index services. If a company floats only a fraction of its shares in the public market, meaningful minority shareholder involvement in the governance of the entity is nearly impossible. Institutional investors are increasingly confronted with the floating of a rather small proportion of the equity of a company on public markets. Especially companies in the technology sector and/or that have a high public profile sometimes prefer a listing less than 25% of the shares on Initial Public Offering (IPO). Such IPOs too often result in inflated valuations and high volatility that bear no relation to the underlying economics and risks of the

company. Inflated valuations and excessive volatility are not in the interest of thoughtful capital allocation decisions, or the general public's trust in a well-functioning market, nor is it in the interest of the economy as a whole. Including such companies in indexes significantly aggravates the described problems. We call on MSCI to look further into how it can mitigate the described problems by for example by only including companies that at least float 25% of their voting shares to minority shareholders. This would ensure sufficient free float on IPO and gives investors a basic prospect for meaningful minority shareholder involvement.

Facilitating inclusion of ESG factors in customised indexes

The Environmental, Social and Governance characteristics of listed entities are of material interest to institutional investors and their ultimate beneficiaries. If anything, importance of these factors will continue to increase. We consider the suggested adjustments above as an appropriate starting point for all major indices of MSCI. However, we would like MSCI to take the lead in allowing their clients to make further selections based on such criteria. In relation to adjusting index weight for the effective voting power of shares, we therefore strongly call on MSCI to facilitate institutional investors that wish to compose custom benchmarks that exclude companies with any deviation from the proportionality principle, or set their own custom thresholds for the minimum effective voting power of listed share classes.

Please find below our response to the specific questions in the consultation.

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, +31 70 2040 304).

Yours sincerely,

Rients Abma

Executive Director

Eumedion

Zuid Hollandlaan 7

2596 AL THE HAGUE

THE NETHERLANDS

Answers to the questions in the consultation document

MSCI Consultation document – page 2:

Discussion points:

- a) Should MSCI exclude companies with only non-voting listed shares, like SNAP?*
- b) Do you agree with excluding non-voting shares in cases where listed voting power is low?*
- c) Is the proposed threshold of 25% for new constituents appropriate?*

MSCI Consultation document – page 10:

- d) Should securities with very low voting rights compared to the other share classes be treated similarly to non-voting shares and potentially excluded? (e.g. Universal Health Services listed B shares have 0.1 vote per share, while unlisted C shares have 100 votes per share)*

Eumedion response:

- a) Yes, MSCI should exclude companies with only non-voting listed shares, like SNAP.
- b) Individual non-voting share classes should never be included in indexes. This is irrespective of whether there is a free float of other listed share classes that may have voting rights.
- c) There should be no threshold that somehow allows for including non-voting shares in indexes. As discussed in detail in our introduction, we would like to suggest a different threshold: a minimum threshold for the voting power of the free float that needs to be met before including a company in the MSCI indexes of 25%.
- d) As detailed in our introduction, the index weight of share classes should be adjusted proportionally to the extent that the effective voting power is less than 1. Please note that shares with an effective voting power higher than 1 are not rewarded with extra index weight.

MSCI Consultation document - Page 3:

- e) ‘Should securities with limited voting rights (e.g. right to vote is only limited to certain circumstances*) be considered as voting shares?’*

MSCI Consultation document - Page 10:

- f) Should calculation of company listed voting power consider securities for which voting rights are limited to only specific matters as non-voting shares? (e.g. for Coca-Cola Femsa and Scripps Networks Interactive the resulting company listed voting power would be 0%, which may result in removal of the securities)*

MSCI Consultation document - Page 5:

- g) *Discussion point: Should all non-voting shares (including the above securities) be considered as “non-equity” and excluded even if the company listed voting power is high? Currently, around 60 securities in the MSCI ACWI Index (index weight of 2.4%) have no voting rights*

Eumedion response:

e) & f) We suggest MSCI does not discriminate between instruments with voting rights on limited topics and those with no voting rights at all. None of these voting impaired rights should be eligible for inclusion in MSCI indexes.

g) We would see no reason to make exceptions for special purpose non-voting instruments, such as NVDRs in Thailand or CPOs in Mexico.

MSCI Consultation document - Page 6:

Discussion points:

h) *Should companies with low listed voting power be consistently removed (both voting and non-voting lines)? Currently, around 20 securities in the MSCI ACWI Index (index weight of 0.3%) have voting rights but listed voting power below 25%.*

i) *Should calculation of voting power exclude shares held by strategic investors (even if listed)?*

Eumedion response:

h) The companies should be removed based on the 2nd criteria we described in our introduction that these companies do not even meet the minimum IPO threshold that the free float should at least represent 25% of all votes.

i) Yes, shares held by strategic investors should not be considered part of the minimum 25% voting power of the free float. Shares and votes held by strategic investors are not part of the free float, irrespective whether they are listed or not. These companies should therefore also be excluded from the MSCI indexes.

MSCI Consultation document - Page 3:

j) *‘For existing constituents: Existing non-voting index constituents would be maintained in the index if the company listed “voting power” is above 2/3rd of 25%, i.e., 16.67%. Such “buffer” would reduce potential reverse turnover resulting from borderline cases’*

MSCI Consultation document - Page 4:

k) *‘Existing constituents would remain in the indexes for a period of one year and be subsequently removed from the indexes, unless appropriate capital structure changes are implemented*

Discussion points:

l) *Is the suggested compliance period for existing constituents appropriate? Should MSCI retain securities if the company has announced plans to change the capital structure or to submit such*

change to shareholder vote?

m) Should MSCI apply grandfathering for existing constituents (i.e., retain existing constituents)?'

Eumedion response:

j), k) & m) We do not support the proposed lower threshold at 2/3rd of 25% for existing constituents as it would indefinitely grandfather existing breaches. The breaches are not less damaging just because they were initiated before 2017. Besides, it will soon become opaque what level of governance protection investors can expect from the index as it may for decades remain a mix of 16.67% and 25% thresholds. We can imagine that the current constituents are offered a grace period that is sufficient to allow management and existing (majority) shareholders to propose changes in their shareholding structure, before they are excluded for not meeting the 25% threshold or the weight of the company's shares is adjusted in the indexes of MSCI for deviating from the proportionality principle. We consider the suggested grace period of three to five years as appropriate.

MSCI Consultation document - Page 7 and 8:

n) Should the MSCI GIMI Indexes over time take steps towards reflecting potential ESG issues, such as corporate governance problems or specific unacceptable business involvement, such as controversial weapons? Should other global broad benchmarks be created that would address this emerging trend?

Eumedion response:

n) Yes, for unacceptable business involvement we agree that MSCI GIMI Indexes should exclude such entities. Amongst the mainstream institutional investment community in most cases already great care is taken to prevent investments in companies that are involved in child labour, controversial weapons such as cluster munition, or major breaches of United Nations treaties. In some jurisdictions there already are legal bans for investing on such companies. Instead of creating new global broad benchmarks, it would be more helpful if the main indexes simply exclude such companies.

We would like to highlight that in fact MSCI and other index providers already to some extent factors in governance issues in its indexes as adjustments for free float and holding companies already are common. Our proposal to reduce index weight proportionally to the deviation from the proportionality principle can be seen as a further necessary refinement. There may be scope for inclusion of other ESG factors that could affect index weight of the main indexes, but a detailed discussion on which factors and how to incorporate those seems to be beyond the scope of this specific consultation.