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Via Email – clientservice@msci.com

MSCI Equity Index Committee
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Dear Members of the MSCI Equity Index Committee:

Re: Consultation on the treatment of non-voting shares in the MSCI Equity Indexes

Legal & General Investment Management (LGIM), is one of the largest institutional investors globally with \$1.2 trillion* of assets under management and is a major user of MSCI indices. We have a long standing commitment to raising corporate governance and sustainability standards.

MSCI plays a critical role in protecting the market and the long-term interests of shareholders. We consider that the equal treatment of shareholders by allocating control of a company in proportion to economic interest is vital for a well-functioning market. Therefore, we would encourage MSCI to consider its response to the growing number of companies with low-vote capital structures such as those with dual or multiple voting rights, which are often designed to consolidate control to a certain group (e.g. founders or major partners). Perpetual control of a company without the corresponding capital at risk prevents the mechanisms of the market to hold management and the board to account for their use of capital.

We would support the requirement for low-vote capital structures to have a sunset provision so that within a set period of time post listing, the capital structure reverts back to a single share class with equal voting rights. The sunset provisions should be sufficiently long to allow the company to develop and mature, whilst not being prohibitive to effect change. We suggest three years.

Additionally, LGIM supports the concept of a minimum free-float for classes of shares listed on major indices. Having at least 25% of voting power in the hands of non-controlling shareholders ensures there is some influence by non-controlling shareholders to distinguish the company from privately held firms.

Where local MSCI indices have more rigorous rules already in place, we believe that these should remain rather than be weakened in line with your current proposals.

LGIM response to MSCI discussion items

MSCI: Should MSCI exclude companies with only non-voting listed shares, like SNAP?

LGIM is concerned about a trend in initial public offerings (IPOs) toward unequal voting rights and especially non-voting shares.

We believe in the principle of one-share one-vote where each investor is treated in an equitable manner. In addition, unequal voting rights diminish corporate accountability and are detrimental to public markets over the long-term.

* as at 30 June 2017. This figure shows the total assets managed by Legal & General Investment Management and includes assets managed by LGIMA, an SEC Registered Investment Advisor. Data includes derivative positions.

MSCI, as a leading provider of high-quality market indices, has an important role to play in protecting investors by mitigating the long-term risk that low-vote and no-vote shares pose to public shareholders.

Therefore, we consider that securities of a company with no voting rights should not be eligible for inclusion in an index.

MSCI: Do you agree with excluding non-voting shares in cases where listed voting power is low? Is the proposed threshold of 25% for new constituents appropriate?

LGIM believes that all listed shares should have voting rights attached. Therefore, companies listed with non-voting share classes should be ineligible.

LGIM supports the concept of a minimum free-float for classes of shares listed on major indices. Having at least 25% of voting power in the hands of non-controlling shareholders ensures there is some influence by non-controlling shareholders to distinguish the company from privately held firms. In addition, having a minimum free-float threshold of 25% provides a degree of investor protection from the potential misalignment of interests between the minority shareholder and the controlling shareholder.

Therefore, we support declaring all securities ineligible if a company does not comply with the 25% voting rights threshold. This approach would avoid companies creating multiple share classes, some with only nominal voting rights, to qualify for a listing and inclusion into the indices.

The 25% voting limit should be calculated including the voting rights of unlisted shares. If the voting threshold is less than 25%, then all shares associated with the company ought to be excluded from the index.

MSCI asks the following subsidiary questions in the Appendix of the consultation, to which we provide responses below:

MSCI: Should securities with limited voting rights (e.g. right to vote is only limited to certain circumstances) be considered as voting shares?

No, these securities should not be considered as having voting shares. Shareholders should have the ability to vote on all issues that affect the company to ensure full accountability and to reflect the economic holding of their investment. If such securities are considered voting shares there is a risk that companies will create multiple share classes with limited voting rights to qualify for a listing and inclusion into the indices.

MSCI: 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)

See above.

MSCI: 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)

Yes. The increase in low or no-vote capital structures, such as those with dual or multiple voting rights, being admitted to the MSCI indices may increase reputational risks for the index if shareholders are unable to use their full rights to hold companies to account.

Such structures may also impact the cost of capital and empirical studies have shown there is no long-term benefit for public shareholders from the company being controlled¹.

Therefore, we would encourage MSCI to consider its response to the growing number of companies with low-vote capital structures such as those with dual or multiple voting rights, which are often designed to consolidate control to a certain group (e.g. founders). Perpetual control of a company without the corresponding capital at risk prevents the mechanisms of the market to hold management and the board to account for their decisions in the way capital is utilised.

The 25% voting limit calculation should include unlisted shares. Therefore, in the example of Universal Health Services, the unlisted C shares with 100 times voting rights would be included in the calculation. If the voting threshold owed by non-controlled shareholders is less than 25%, then all shares associated with the company ought to be excluded from the index.

In addition to the 25% voting threshold, we would support the requirement for low-vote capital structures to have a sunset provision. A sunset provision will ensure that within a set period of time post listing, the capital structure reverts back to a single share class with equal voting rights. Requiring economic interest and control to be aligned in the long-term will facilitate the functioning of the market. The sunset provisions should be sufficiently long to allow the company to develop and mature, whilst not being prohibitive to effect change.

In addition, investors will have enough time to review all relevant information, and consider the associated risks, to form an investment case. We suggest three years.

*MSCI: 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?
(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)*

Yes – we believe the proposed one-year compliance period for existing constituents is acceptable but could be lengthened to three years.

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

LGIM believes that there should be some form of grandfathering for companies with current dual/multiple voting or non-voting share lines. We believe giving existing constituents sufficient opportunity (such as three years) to comply with reaching the 25% voting threshold is the better approach than giving existing constituents an indefinite period to reach this reasonable threshold. Absolute grandfathering of existing constituents could lead new constituents and other market participants to question the integrity of the index over time, particularly if existing constituents' publicly held free float voting power erodes further.

Once the company is retained in the index due to meeting the 25% voting threshold, the voting structure should revert to 'one share one vote' after a certain period, and LGIM would suggest three years.

¹ <https://irrinstitute.org/wp-content/uploads/2016/03/Controlled-Companies-IRRCI-2015-FINAL-3-16-16.pdf>

MSCI: Should all non-voting shares (including the below 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.

Whilst LGIM believe in the principle of one share one vote, this needs to be balanced with the diversification and broad coverage objective of an index. We do not support the issuance of non-voting shares but believe the use of a minimum voting power calculation is sufficient at this time to exclude the worst offending companies in terms of low-vote capital structures.

LGIM would encourage index providers to collaborate to establish some common standards of calculating listed voting power.

MSCI: 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%.

We would support the requirement for low-vote capital structures to have a sunset provision so that within a set period of time after the company has listed (or post grandfathering) the capital structure reverts back to a single share class with equal voting rights. The sunset provisions should be sufficiently long to allow the company to develop and mature, whilst not being prohibitive to effect change. In addition, investors will have enough time to review all relevant information, and consider the associated risks, to form an investment case. We suggest three years.

Additionally, LGIM supports the concept of a minimum free-float for classes of shares listed on major indices. Having at least 25% of voting power in the hands of non-controlling shareholders ensures there is some influence by non-controlling shareholders to distinguish the company from privately held firms. Therefore, we support declaring ineligible all securities if a company does not comply with the 25% voting power threshold.

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

No, the calculation of voting power should INCLUDE shares held by strategic investors. The rationale for having a minimum threshold for voting power is that it differentiates the company from privately owned companies and is seen as a critically important step toward reclaiming the owner-oriented model for public companies. Excluding strategic investors from the calculation negates these benefits.

MSCI: 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?

We welcome that MSCI are considering these issues across all their Global Investable Market Indices. We think the aspects suggested above such as shareholder rights, corporate governance and the manufacturing of or involvement in controversial weapons are all worthy and important aspects to discuss in their own right through a public consultation.

Thank you for considering our views, and if you have any questions, please do not hesitate to contact us.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'S. Sadan', with a stylized flourish at the end.

Sacha Sadan
Director of Corporate Governance

A handwritten signature in blue ink, appearing to read 'C. Payn', with a stylized flourish at the end.

Clare Payn
Head of Corporate Governance, North America