RE: Possible Listing Framework for Dual Class Share Structures

Dear Sir/Madam,

BlackRock, Inc. (BlackRock)\(^1\) is pleased to have the opportunity to respond to the “Possible Listing Framework for Dual Class Structures” consultation paper, issued by Singapore Exchange Limited.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this discussion paper and will continue to contribute to the thinking of Singapore Exchange Limited on any issues that may assist in the final outcome.

Executive summary

BlackRock is focused on the protection of the value of clients’ assets over the long term as part of our fiduciary duty. In the last decade, we have seen many young companies with strong leadership attracting a lot of attention and capital with IPO under a Dual class share (DCS) structure. However, we do not agree with the proposed DCS structure in the Paper. We believe the principle of one-share, one-vote is the core of good corporate governance practice and equitable treatment of investors. Companies with a large disconnect between ownership and control can have tremendous challenges in not just corporate governance, but also valuations, if their boards are entrenched. The average Total Shareholder Return (TSR) offered by multi-class companies in the long term also underperforms that of single-class companies. We strongly believe DCS structure is a poor corporate governance practice and is injurious to Singapore’s reputation in shareholder protection.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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\(^1\) BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.
Responses to questions

Question 1: DCS Framework

Do you think that the introduction of the DCS Framework will be beneficial to companies, investors and the Singapore economy? Please give reasons for your views.

In BlackRock’s view, the introduction of a DCS framework will not be beneficial for either shareholders or listed companies in Singapore. Overall, we think having a DCS framework is likely to worsen the corporate governance standards of Singapore.

The proportionality principle

The proportionality principle, a critical rule in corporate governance practice, is based on two premises:

- Shareholders as the residual claimants have the strongest interest in maximising firm value; and
- Voting power should match economic exposure

It is at the core of corporate governance that to reduce the agency problem, all shareholders need to effectively monitor companies. As regulators call on investors to further engage with issuers in a deeper and more responsible way, this can only be effectively implemented if shareholders’ voting rights, particularly those of minority shareholders, are protected under the proportionality principle. Indeed, the adaptation of a DCS framework can result in an over-concentration of power in the hands of majority shareholders, thus disenfranchising other shareholders and amplifying the risks of extraction of private benefits by the majority shareholders.

Shareholders provide capital in exchange for the entitlement to the future cash flows of a company. This entitlement should be proportionate to the amount of capital they invest. As a safeguard to the entitlement, in light of the separation of ownership and management in a listed company, shareholders are granted with voting rights to elect directors who in turn select the senior management of the company for the purpose of producing future capital gains and cash flows for the benefit of all shareholders. Therefore, voting rights ought to be proportionate to the economic interests in the company (and thus risk exposure) of a shareholder. The introduction of a DCS structure will separate voting rights from economic interests, exacerbating the agency problems that arise from a separation of ownership from management. Under a DCS structure the majority of shareholders lose the ability to elect directors and hold the board and senior management accountable for decisions or behaviours that may be detrimental to the company’s long-term value.

As a broadly diversified global investor, BlackRock looks to board directors to act independently and objectively to protect the interests of all shareholders, not just the majority ones. This is even more important in a market such as Singapore, where the rights of shareholders to remove directors are limited given the dominance of large block shareholders, such as families and state-owned enterprises.

While the provisions relating to shareholder approval of connected party transactions in the Singapore Listing Rules provide some protection to ensure that connected transactions are in the economic interests of all shareholders, boards of controlled entities can still take action in a number of areas of material significance such as a change in strategy, making acquisitions or divestments, and balance sheet management where minority shareholders have little say. However, the current provisions do not protect minority shareholders against poor practice in relation to the matters on which shareholders do not get a vote, such as implementation of an ill-conceived strategy. The problem is further compounded by the potential influence of the block shareholder over the director nomination process. This raises the question of whether the directors whom the company determines to be independent are, and are seen to be, independent from the perspective of the unaffiliated shareholders and there may be the perception that the directors are not acting in the interests of all shareholders.
Jurisdictional comparisons
A number of jurisdictions allow dual class share structures under limited circumstances while others specifically do not allow such structures. The United States and Canada allow DCS structures while Hong Kong and Australia do not. In June 2015, Securities and Futures Commission of Hong Kong did not support the introduction of weighted voting rights.\footnote{1}

Remedies if things go wrong
It is worthwhile to mention in the US shareholders are able to take class actions on a contingent fee basis if they are treated unfairly by companies entrenched by the DCS structure. As an example, when Google announced its plan to create a new class of ordinary shares with no voting rights, which would allow its founders to cash out while maintaining their voting rights, a group of shareholders sued the company and eventually achieved concessions by the founders to restrict their ability to sell their non-voting shares. \textbf{Such remedies are not currently available in Singapore.} Shareholders in Singapore will be exposed to entrenchment and expropriation risks if the DCS structure is adopted, without affordable legal remedies to protect their investment. This is why BlackRock fundamentally believes that the protection embedded in equal voting rights is essential to constitute protection against abuse.

Performance of dual class shares
Many of the studies done in the 1980s on dual-class companies showed some of the benefits of creating a dual class of shares. The structure allows those with controlling interest and limited funds to retain control while also accessing the equity markets for additional financing.\footnote{2} This may be especially beneficial for firms which require large amounts of organisation-specific human capital, whose projects are difficult for outsiders to value due to high levels of information asymmetry, or for firms with high amenity potential, like media outlets.\footnote{3} In line with this research, studies have found positive announcement effects to the implementation of the dual-class structure,\footnote{4} positive industry-adjusted operating performance after the structure’s implementation,\footnote{5} and positive long-term abnormal stock performance following the implementation.\footnote{6}

\textbf{United States}
A study by ISS and IRRC on the S&P1500 universe found that controlled companies outperformed non-controlled ones over a one-year, three-year, five-year and 10-year-period. However, this was true only for single-class controlled companies; \textbf{multi-class companies had a lower average TSR than non-controlled companies over the three-year, five-year and 10-yearperiods}.\footnote{7} A robust corporate governance structure could serve as an offset against the problem that the multi-class structure creates. However, these companies tend to show poorer corporate governance practice. A 2009 US study concluded that in dual-class companies “CEOs receive higher compensation, managers make shareholder value-destroying acquisitions more often, and capital expenditures contribute less to shareholder value”. Multi-

\begin{itemize}
  \item \footnote{2}{DeAngelo, Harry, and Linda DeAngelo, 1985, Managerial Ownership of Voting Rights, Journal of Financial Economics 14, 33-69}
  \item \footnote{6}{Dimitrov, Valentin and Jain, Prem C., Recapitalization of one class of common stock into dual-class: Growth and long-run stock returns, Journal of Corporate Finance, 2006, vol. 12, issue 2, pages 342-366}
  \item \footnote{7}{ISS and IRRC, Controlled Companies in the Standard & Poor’s 1500: A Ten Year Performance and Risk Review, 2012, p. 8}
  \item \footnote{8}{R.W. MASULIS, C. WANG et F. XIE, Agency Problems at Dual-Class Companies, Journal of Finance, Volume 64 Issue 4 (August 2009)}
\end{itemize}
class companies also demonstrated higher share price volatility in all time periods than non-controlled companies while single-class controlled companies showed the least volatility of the three groups9.

Europe
The results of a 2010 research conducted by Bennedsen and Nielsen on 4,000 European issuers10 draw a similar conclusion. They found that companies with dual class shares have higher discount in firm values (as measured by the market-to-book ratio). These companies also showed “a lower takeover frequency, operating performance, payout ratio, and growth in assets”. Firm value of an average European firm with dual class shares is around 19% lower than the average firm with a proportional ownership structure9. Therefore, the misalignment between the voting power and the cash flow rights of the controlling shareholders should serve as a deterrent to minority shareholders.

In view of the companies’ underperformance under the DCS structure, it is not surprising that investors often declare in surveys that they apply a discount to companies not respecting the one-share one-vote principle. Dual-class companies usually have fewer institutional shareholders and even fewer long-term investors than other companies11. This discrepancy disappears when these companies unify the different classes of shares12. A survey of investor policies shows broad favour towards the one-share one-vote principle stemming from the view that voting power should match economic exposure. For index-tracking investors who cannot sell their positions the voting rights are one of the few ways to protect their interests. With these, we are doubtful about the rationale behind allowing a DCS, given it does not help boost performance from a TSR perspective but worsens corporate governance standard of companies.

No extra economic rights
According to the Paper13, the concept of DCS structure is not new and investors may be ready for DCS structure given investment instruments like preference shares already exist in the market. It is also mentioned in the Paper that investors in Singapore are already investing in warrants and derivatives for economic rights rather than voting rights. This comparison is flawed as dual class shares do not offer extra economic rights for shareholders, unlike preference shares where shareholders may enjoy higher dividends or warrants which have the option value embedded in the derivatives.

Short-term pressure from the board
According to the Paper14, DCS structure empowers shareholders who have the long-term interests of the company at heart to build a disruptive business, instead of shareholders who are more interested in short term benefits. We want to point out that there are many reasons for executives’ short-termism, such as the culture of excessive focus on quarterly earnings and companies’ inability to articulate to investors about the ecosystem they are operating in and the competitive threats they face. Putting all the blame on investors is not right. A survey15 of more than 1,000 board members and C-suite executives conducted by McKinsey and the Canada Pension Plan Investment Board (CPPIB) shows that 46% of respondents said that the pressure to deliver strong short-term financial performance stemmed from their boards—they expected

http://media.terry.uga.edu/documents/finance/howell_no_more_share.pdf
13 Sections 3.8, 3.9 Not a new concept page 10
14 Section 3.6 Long term growth of companies page 9
15 https://hbr.org/2014/01/focusing-capital-on-the-long-term
their companies to generate greater earnings in the near term. Instances of boards yielding to
short-termism pressure do not provide the basis for curtailing the voting rights of all minority
shareholders, and it is a flawed argument to say that shareholders with majority voting rights
under the DCS structure will always be looking out for the long-term interests of the company.

Market competitiveness of SGX
According to the Paper the introduction DCS structure in Singapore could support the growth
of startup companies and attract high-quality companies that may not otherwise consider
Singapore as a listing venue. We have identified two issues here. First, based on the chart
below, despite Canada allowing DCS structure the number of listed tech and biotech
companies is less than that in Australia, where DCS structure is prohibited. Second, tech and
biotech stocks with DCS structures constitute only around 5% and 12% of the US and Canada
listed tech and biotech universe respectively, which demonstrates the limited interest such
structures have for these companies. We therefore do not believe there is enough evidence to
support the notion that DCS structure will attract startup companies, tech and biotech stocks
and that the DCS structure is a determination of listing locality.

Share class structure of listed tech & biotech stocks

![Chart showing share class structure of listed tech & biotech stocks]

We also reviewed a number of non-US technology companies which have listed in the US.
Companies incorporated outside of the US and listed on US exchanges are often classified as
a Foreign Private Issuer (FPI). FPI status offers the issuer exemption from a number of
requirements relating to corporate governance structures and disclosures that apply to issuers
under the US securities laws, as well as flexibility in relation to other requirements. These
benefits include the following:
- FPIs are not required to make quarterly filings of Form 10-Q (the “quarterly report”) and
  Form 8-K (the “current report” that companies must file with the US Securities and
  Exchange Commission to announce major events that shareholders should know about).
- FPIs have the flexibility to prepare accounts under their home country GAAP, US GAAP or
  IFRS. By contrast, domestic US issuers must prepare financial statements under US
  GAAP.

16 Section 3.3 Market competitiveness page 9
17 Source: Bloomberg. The analysis was based on all tech and biotech listed companies in the respective
countries as of 15 March 2017, based on GICS sector “information technology” and “biotechnology” in
Bloomberg’s universe of listed companies. Only companies with available data regarding their dual class
shareholdings were screened – this takes out companies that are not in Bloomberg’s ESG universe. List
of companies were also adjusted to remove double counting by only including primary listed tickers.
18 http://www.sec.gov/answers/form8k.htm
FPIs listed on the NYSE or NASDAQ are generally allowed to follow home-country practice in lieu of complying with corporate governance standards imposed by US exchange rules on listed issuers. An analysis of the recent US listings of Chinese companies indicated that most of them use the Variable Interest Entity (VIE) structure. VIEs incorporate a structure involving a holding company that is usually based in a tax haven, such as the Cayman Islands. The tax haven countries used generally have lax corporate governance standards.

Of the 30 non-US tech companies reviewed by BlackRock as being listed in the US with a DCS structure, our analysis shows that all are incorporated in the Cayman Islands. As such, the corporate governance standards of the Cayman Islands apply and these corporate governance standards are significantly lower than those required of companies incorporated in either Singapore or the US:

- No requirement to have a majority of independent directors;
- No requirement to have an audit committee;
- No requirement to have a compensation committee;
- No requirement to hold annual general meetings;
- No requirements to vote on amendments to the terms of equity compensation.

On the basis of the above, we believe there are factors other than the DCS structure that attracted these companies to list in the US and we do not agree with the Paper’s proposal that adopting DCS structure will help SGX attract listings of high-technology companies.

Another argument for allowing DCS in Singapore is to attract family-controlled companies. Family controlled companies face specific governance risks as the conflicts and issues within families can negatively impact the company itself and minority shareholders. How the companies manage succession plans can also be an issue. These unique governance risks for family-controlled companies will be further complicated by having a DCS structure. If families are not able to put in place structured and well-managed succession plans and yet owning 10% of equity they can retain control of more than 50%, non-aligned shareholders’ interest will be greatly jeopardized.
The answers to the following questions are on the basis that BlackRock does not support a DCS regime, however if such a regime were to be introduced BlackRock would have the following views on the proposed protections for shareholders in companies with DCS structures.

**Question 2: Additional Admission Criteria**

Do you think there should be additional listing criteria for issuers using DCS structures? If the answer is yes, SGX seeks views on the following possible listing criteria for issuers using DCS structures:

(a) a minimum market capitalisation of S$500 million;
(b) the level of participation by sophisticated investors (i.e. 90% of the public float requirement), taking into account the existing public float and distribution requirements under Rule 210(1)(a) of the Mainboard Rules; and
(c) a compelling reason based on holistic assessment of various factors such as industry and operating track record.

You may indicate your preferred thresholds for any of the listing criteria and provide your reasons. For Question 2(c), if you are in favour of this admission criterion, please give your views on what constitutes a compelling reason. You may also propose additional listing criteria and provide reasons for your proposals.

We do not consider raising funds from sophisticated investors as a safeguard. Even though sophisticated investors will likely undertake a thorough due diligence and assessment prior to investing in the issuer, we think such an argument is flawed and potentially dangerous. Regulatory vetting should not be substituted with investors’ own due diligence. Moreover, it is difficult to effectively define the term “sophisticated”. Investors have different investment styles, strategies, and investment horizons. Normally, investors that participate in an IPO or in the secondary market are active investors that can exit the investment when they see signs of deteriorating performance or corporate mismanagement. Therefore, such investors do not rely primarily on voting rights to stop companies from wrong doing because they can exit the investment before things go really wrong. However, selling is not an option for index-tracking investments, which are becoming an increasing important form of investment for many types of investors, including the “sophisticated” ones. For such investments, proportionate voting rights are the only leverage investors have to drive positive long-term change in companies. As both investors following index-tracking strategies and the index providers themselves are encouraged to take a more active stance on corporate governance, it would seem counter-productive to limit their ability to do so.

The SGX/LAC also argues that sophisticated investors “could lead to the listing applicant adhering to higher corporate governance standards” because they have access to the management of the listing applicants. We find such argument contrary to our own experience. Companies are more willing to engage with and listen to shareholders when the shareholders carry an influential weight over the voting outcome. In certain markets where block shareholdings are common, companies are not as open to engagement let alone listening to investors’ concerns because the block shareholder can single-handedly approve almost all resolutions.

Also, we believe a holistic assessment should be applied in the evaluation of all listing applications and novel cases (DCS structure being only one of such novelties) should be referred to the LAC for advice.
**Question 3: Maximum Voting Differential**

SGX seeks views on the following:
(a) whether there should be a maximum voting differential between each MV share and OV share or a fixed ratio applied to all issuers; and
(b) the appropriate maximum or fixed ratio (as the case may be) of voting differential between each MV share and OV share.

A maximum voting differential of 10:1 will mean the owner-manager can control more than 50% of the voting rights while owning only 10% of the equity. In our view, this would be a severe misalignment between the economic interest and governance. As said above, the DCS structure exacerbates the agency cost created by any separation of ownership from management and it also removes the only mechanism that is designed to ensure conflicts of interest do not result in value-destroying corporate behaviour. Therefore, the key concern is not the maximum voting differential but the flaws of the overall DCS structure.

**Question 4: Restriction on Issuance of MV Shares Post-listing**

SGX seeks views on the following:
(a) whether issuance of MV shares post-listing should be prohibited; and
(b) whether a rights issue should be an exception to such prohibition.
(c) For Question 4(b), you may also propose, in substitution or in addition, other exceptional events where issuance of MV shares should be permitted, and provide reasons for your proposals.

If the DCS structure were to be allowed for Singapore listed companies we are of the view that the issuance of MV shares post listings should be prohibited, unless supported by a super majority of OV shareholders. Investors participating in the initial public offering and buying shares in secondary market should not be concerned about any increase in degree of control by the shareholders with MV. Therefore we are not supportive of the issuance of MV shares post listing without supermajority support from OV shareholders.

We would consider a rights issue an exception as long as the outcome was no increase in control for shareholders with MV.

**Question 5: Automatic Conversion of MV Shares**

SGX seeks views on the following:
(a) Who should be eligible to hold MV shares (e.g. executive officers or executive directors)?
(b) Do you think that it should be a mandatory requirement that MV shares will be automatically converted into OV shares upon the occurrence of certain events or should such conversion provision be left to issuers to adopt on a voluntary basis, bearing in mind that the Take-over Code will continue to apply if there is a change in control of the DCS company?
(c) If you are in favour of a mandatory automatic conversion requirement:
   i. Do you agree with the possible conversion events listed in paragraph 3.6 of this Part IV? Please indicate your preferred form and combination of the conversion events, and provide reasons for your views.
   ii. Do you agree that there should be flexibility for shareholders to waive such automatic conversion requirement?

As stated in the Paper, the underlying rationale for DSC structures is the confidence and trust reposed by investors in the owner manager. Therefore it is appropriate to restrict ownership of MV shares to executive officers, executive directors and those who contribute directly to facilitating long term strategic business decisions.

We believe it should be mandatory for MV shares to convert to OV shares in the following situations:
- Transfer of MV shares
In a takeover situation the MV shares to be sold to the takeover offeror should automatically lose their multiple voting rights upon acceptance of the offer. The offer should be consistent for MV and OV shares, i.e. the same price.

Where the holder of MV shares ceases to hold an executive position those shares should automatically convert to OV shares.

We are supportive of the suggestion in the Paper that shareholders be given the power to waive the automatic conversion requirement through the Enhanced Voting Process (as defined in paragraph 3.6(b) of Part IV). Such shareholder approval is granted specifically in each case and not a blanket removal of the mandatory conversion provision.

**Question 6: Sunset Clause**

SGX seeks views on the following:
(a) Do you think it should be mandatory for a DCS issuer to adopt a sunset clause?
(b) Should a sunset provision always be based on duration? If so, what length of time do you consider an appropriate duration? Should the issuer be allowed to continue having a DCS structure if shareholders allow the issuer to do so at a particular future date?
(c) Would other factors, such as change of principal business or ownership makeup (for example, where MV shares will be converted into OV shares upon the total number of MV shares falling below certain percentage), be considered appropriate as a sunset provision?

We believe sunset clauses should be mandatory, however, as with mandatory conversion provisions, shareholders should have the power to renew MV provisions for a new specified period of time. If management can put a cogent explanation for approval to shareholders we believe shareholders will support such a renewal based on management's track record. If a cogent explanation is not forthcoming from management shareholders should have the option to vote against renewal of the MV provisions.

Other factors such as change of principal business and the percentage of MV shares should be considered as part of sunset provisions.

We note that in both the US and Canada, there are no standardised sunset clauses for companies. The Paper mentioned in the US some companies with DCS structures have adopted sunset clauses with a 5 year duration. The Canadian Coalition for Good Governance (CCGG) recommends a dual class share structure remains for terms of up to 5 years as well. We think 5 years is a reasonable timeframe for management to clearly demonstrate to shareholders they have a long-term strategy for the sustainable growth of their company.

**Question 7: Independence Element on the Board**

SGX seeks views on the possible safeguard to enhance the independence element on the Board by mandating certain recommendations of the Code as set out in paragraph 1.2 of this Part V.

We think a board comprising a majority of competent independent directors is the cornerstone of good corporate governance..

To ensure an appropriate director nomination process it should be mandatory for the nomination committee to comprise solely independent directors. This view differs from the recommendation in the Paper that the nomination committee be comprised of a majority of independent directors with an independent chairman.

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19 Section 4.1 Sunset Clause page 18
Question 8: Enhanced Voting Process on Appointment of Independent Directors

SGX seeks views on the possible safeguard of requiring the implementation of the Enhanced Voting Process for the appointment of independent directors.

We are supportive of the Enhanced Voting Process.

Question 9: Risk Committee

SGX seeks views on the possible safeguard of requiring a risk committee and the composition of such committee.

We are supportive of the requirement for DCS companies to have a separate risk committee. However, such a committee should be comprised solely of independent directors.

Question 10: Coat-tail Provision

SGX seeks views on the possible safeguard of a coat-tail provision in a take-over situation. Do you think that a coat-tail provision is necessary in addition to the Take-over Code51 which will likely apply if there is a change in control of the DCS company?

If the listing of DCS requires that upon any sale of MVs they immediately convert to OVs and, in any takeover/change of control situation all shares are treated equally, there should be no need for coat tail provisions.

Conclusion

We appreciate the opportunity to address and comment on the issues raised by the “Possible Listing Framework for Dual Class Share Structure” consultation paper and will continue to work with the Singapore Exchange Limited on any specific issues which may assist in the dual class share structure discussion.