



California State Teachers'
Retirement System
Sustainable Investment & Stewardship Strategies
100 Waterfront Place, MS 4
West Sacramento, CA 95605

April 6, 2022

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick T. McHenry
Ranking Member
Committee on Financial Services
United States House of Representatives
4340 O'Neill House Office Building
Washington, DC 20515

Re: Legislation to amend the Securities Exchange Act of 1934 to improve the governance of multi-class stock companies.

Dear Madam Chairwoman and Ranking Member McHenry:

We write on behalf of the California State Teachers' Retirement System (CalSTRS) to reiterate¹ our support for provisions that align with our one-share, one-vote principle within CalSTRS' Corporate Governance Principles.² The Teachers' Retirement Board's policy provides guidelines to support legislation that is "consistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan."³ We are aware that the Committee on Financial Services (Committee) may be considering legislation to improve the governance of multi-class stock companies. As a long-term shareholder, improving the governance of multi-class stock companies is an issue that CalSTRS cares about deeply.

¹ See Letter from Aisha Mastagni, Portfolio Manager, Sustainable Investment and Stewardship Strategies, California State Teachers' Retirement System to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives (Oct. 5, 2021), <https://calstrs-pensionx-web.specialdistrict.org/files/4609fa6e1/commentletterondual-classsharesanddiversity.pdf>.

² California State Teachers' Retirement System, Corporate Governance Principles, 4. Other Governance Matters, Section d. Unequal Voting Rights, page 15, Updated January 27, 2021, https://www.calstrs.com/files/885d7b73b/corporate_governance_principles_1.pdf.

³ CalSTRS. (Mar. 2022). Board Governance Manual. Retrieved from <https://www.calstrs.com/files/c62549ced/BoardGovernanceManual-March2022.pdf>.

Established in 1913, CalSTRS is the largest educator-only pension fund in the world with a global investment portfolio valued at approximately \$327 billion as of December 31, 2021 and pays approximately \$16 billion in retirement benefits each year to our members and their families. As administrators of both a defined benefit plan and a defined contribution plan, our mission is to secure the financial future and sustain the trust of more than 975,000 Californian educators. The long-term nature of CalSTRS liabilities and our responsibility as a fiduciary to our members, make the fund keenly interested in the rules and regulations that affect shareholders.

CalSTRS strongly urges the Committee to prioritize the adoption of provisions to effectuate the sound policy recommendations of the United States Securities and Exchange Commission's Office of the Investor Advocate⁴ to establish improved stock exchange listing standards for companies going public with multiple classes of common stock with unequal voting rights.⁵

⁴ U.S. Securities and Exchange Commission, Office of the Investor Advocate, Report of Activities, Fiscal Year 2020 at 2, 10-11 (filed Dec. 29, 2020), <https://www.sec.gov/advocate/reportspubs/annual-reports/sec-investor-advocate-report-on-activities-2020.pdf>.

⁵ *Id.* at 10 (“If a company chooses to issue multiple classes of stock with differing voting rights, then the dual-class stock must contain a “sunset” provision.”).

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The Committee's March 2022 Discussion Draft bill on this topic⁶ contains the key elements that CalSTRS, many other investors,⁷ and many other market experts⁸ believe would be appropriate and would strongly support.

⁶ To amend the Securities Exchange Act of 1934 to improve the governance of multi-class stock companies, and for other purposes, H.R. ____, 117th Cong. (discussion draft Mar. 26, 2022), https://financialservices.house.gov/uploadedfiles/033022_bills-117pih-hr_toamendthesecond.pdf.

⁷ See Letter from Marcie Frost, Chief Executive Officer, California Public Employees' Retirement System to The Honorable Maxine Waters, Chair, House Committee on Financial Services, U.S. House of Representatives (Oct. 1, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Letter%20to%20HFSC%20Final.pdf; Letter from Lucy Nussbaum, Senior Research Analyst, Council of Institutional Investors to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Apr. 5, 2022), <https://www.cii.org/files/April%202022%20Letter%20to%20HCFS%20on%20hearing%20and%20bill%20final.pdf>; Letter from Joanne Beatty, Director – Engagement, Hermes Equity Ownership Services Limited to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 11, 2021), <https://www.cii.org/Files/Hermes-CII%20governance%20and%20diversity%20disclosure-October%202021-PUBLIC.pdf>; Letter from Jonathan Grabel, Chief Investment Officer, The Los Angeles County Employees Retirement Association to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives (Oct. 4, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/LACERA%20letter%20to%20House%20Financial%20Services%20Committee%20regarding%20CII%20bill%209%204%202021.pdf; Letter from Karen E. Carraher, Executive Director, Ohio Public Employees Retirement System to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services (Oct. 1, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/OPERS%20Letter%20-%20Financial%20Services%20Committee%20-%20Draft%20Bill%20-%2010012021.pdf; Letter from Michael Marshall, Head of Sustainable Ownership, Railpen et al. to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 1, 2021), [https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Railpen%20letter_SEC%20Bill%20011021%20\(002\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Railpen%20letter_SEC%20Bill%20011021%20(002).pdf); Letter from Thomas P. DiNapoli, State of New York, Office of the State Comptroller to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives et al. (Oct. 1, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/Letter%20from%20NYS%20Comptroller%20Thomas%20P.%20DiNapoli.pdf.

⁸ See *Oversight of America's Stock Exchanges: Examining their Role in our Economy: Hearing Before the H. Subcomm. on Investor Prot., Entrepreneurship, & Capital Mkts. of the Comm. on Fin. Servs.*, 117th Cong. (Mar. 30, 2022) (Testimony of Professor Robert J. Jackson, Jr., N.Y.U. Sch. of L. at 7), <https://financialservices.house.gov/uploadedfiles/hhr-117-ba16-wstate-jacksonr-20220330.pdf> (“The bill before you that would require an accountability vote at dual-class firms seven years after an IPO offers an attractive balance between accountability and the freedom visionary founders need to grow our most exciting young companies.”); Letter from Americans For Financial Reform to Chairwoman Waters, Ranking Member McHenry, and Members of the Committee (Oct. 5, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/10_05_21-AFR-Support-Letter-to-HFSC-for-Hearing.pdf; Letter from Dylan Bruce, Financial Services Counsel, Consumer Federation of America to The Honorable Maxine Waters, Chairwoman, Committee on Financial Services et al. (Oct. 5, 2021), <https://consumerfed.org/wp-content/uploads/2021/10/CFA-Supports-House-Bills-to-Strengthen-Investor-Protections-Letter-10.5.21.pdf>; Letter from Tyler Gellasch, Executive Director, Healthy Markets Association to The Honorable Maxine Waters, Chairwoman, House Committee on Financial Services et al. (Oct. 5, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/HMA%20Letter-to-HFSC-re-Markup-10-5-2021-1.pdf; Letter from Melanie Senter Lubin, NASAA President, Maryland Securities Commissioner to The Honorable Maxine Waters, Chairwoman, House Committee on Financial Services et al. 4-5 (Oct. 4, 2021),

Corporate Accountability

One share, one vote is foundational to good corporate governance. CalSTRS' principles reflect that an essential right is the ability to vote on companies' governing structures. A shareholder vote is an important check and balance in the investor – issuer relationship, particularly for many investors that use passive investment strategies for significant portions of their portfolios and cannot simply avoid purchasing dual-class stock companies. CalSTRS fundamentally believes shareholders should have a say in transactions that materially affect their investments. A single class of common stock with equal voting rights ensures accountability to shareholders and the community. Public shareowners like CalSTRS rely on the board of directors they elect to be engaged and to push for change when management is failing.

However, disproportionate founder control presents substantial risk of impeding strategic changes, managerial changes, or both in circumstances where change is critical to ensure long-term performance. The lack of accountability at the top that results from dual-class share structures can also harm corporate culture and the community at large. Consider the embarrassing and costly blunders over data privacy, sexual harassment and political bias at companies where insiders have voting power that dwarfs their equity stakes, such as Meta (formerly Facebook) and Alphabet, the parent company of Google.

As more companies have gone public with unequal voting rights, global competition has continued to erode corporate governance standards. Time-based sunsets on U.S. exchanges could help stop this "race to the bottom" pressure, which presents a meaningful risk to long-term performance and could have reputational risks for the U.S. financial markets, which lag behind other markets in maintaining high governance standards.

Empirical Research

From CalSTRS' perspective, the performance record of dual class companies is decidedly mixed in the long-run and even in the medium term, notwithstanding selection bias affecting which companies pursue the dual class experiment. Academic research indicates that while dual-class companies may have a premium in the early years after their initial public offering (IPO), over time that stock price advantage wanes.⁹ Of companies that go public with

https://www.cii.org/files/issues_and_advocacy/correspondence/2021/NASAA-Letter-to-HFSC-Re-10_5_21-Hearing-FINAL.pdf; Letter from Public Citizen to Chair Maxine Waters, Honorable Members of the Committee, U.S. House of Representatives Financial Services Committee (Oct. 5, 2021), <https://www.cii.org/Files/Public%20Citizen%20comment%20on%20HFS%20bills%20Oct%205%20%202021.pdf>.

⁹ Lucian A. Bebchuk and Kobi Kastiel conducted an economic analysis indicating that the benefits of multi-class structures can be expected to decline, and the costs to rise, over time. Lucian A. Bebchuk and Kobi Kastiel, "The Untenable Case for Perpetual Dual-Class Stock," 103 Va. L. Rev. 585-631 (June 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2954630. Bebchuk and Kastiel presented the first version of their paper in 2015. Empirical studies following this framework include: Martijn Cremers, Beni Lauterbach and Anete Pajuste, "The Life Cycle of Dual-Class Firms," *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3062895; Lindsay Baran, Arno Forst and M. Tony Via,

differential voting rights, a growing number incorporate time-based sunsets into those structures.¹⁰

We believe the academic research and developing market practice suggest a logical compromise. We recommend a simple, effective sunset mechanism on common stock structures with unequal voting rights, so that markets do not suffer long-term damage from perpetual or long-lasting multi-class stock structures. We believe that time-based “sunsets” are the way forward, requiring multi-class structures with unequal voting rights to collapse to one-share, one-vote within a reasonable and specified period after the IPO. A sunset of no more than seven years offers an appropriate period to harness whatever benefits of innovation and control a multi-class structure may provide while mitigating the agency costs it incurs over time.

Flexibility

As indicated, the provisions CalSTRS, many other investors, and many market participants would support is not a “one-size fits all” approach, but rather offers flexibility and adaptability for companies. The legislation would not affect companies that are already trading with dual-class shares. In addition, the legislation would continue to permit companies to go public with dual-class stock structures and allow those structures in perpetuity, so long as shareholders of each class, voting on a one-vote per share basis, approve extending the structure at least once every seven years.

We once again express our support for provisions that align with our one-share, one-vote principle within CalSTRS’ Corporate Governance Principles.¹¹ We welcome the Committee’s

“Dual Class Share Structure and Innovation,” *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3183517; Commissioner Robert J. Jackson Jr. “Perpetual Dual-Class Stock: the Case Against Corporate Royalty,” *available at* <https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty>; Hyunseob Kim and Roni Michaely, “Sticking Around Too Long? Dynamics of the Benefits of Dual-Class Structures,” *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3145209. Notably, Cremers, Lauterback and Pajuste find that even at innovative companies where multi-class structures correlate to a value premium at the time of the IPO, that premium dissipates within six to nine years before turning negative. Baran, Forst and Via find that multi-class structures correlate with more innovation and value creation in the period shortly after an IPO, but within six to 10 years, the costs of unequal voting structures come to outweigh the benefits. Jackson finds that by seven years after an IPO, perpetual multi-class firms exhibit valuations that are significantly lower than firms with sunset provisions. Kim and Michaely find a similar result as multi-class structures become increasingly value destroying by 11 years after an IPO. Baran, Forst and Via conclude that “[o]ur findings lend credence to the recent call from shareholder advocacy groups that if dual class structures should be allowed at all, they should face rigorous sunset provisions and be eliminated in a certain period post-IPO.”

¹⁰ See “Companies with Time-Based Sunsets on Dual-Class Stock,” Council of Institutional Investors (updated Jan. 19, 2022), *available at* https://www.cii.org/Files/issues_and_advocacy/Dual%20Class%20post%206-25-19%20Time-based%20Sunsets.pdf.

¹¹ California State Teachers’ Retirement System, Corporate Governance Principles, 4. Other Governance Matters, Section d. Unequal Voting Rights, page 15, Updated January 27, 2021., https://www.calstrs.com/files/885d7b73b/corporate_governance_principles_1.pdf.

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and the United States Congress' efforts to promptly adopt legislation consistent with the Committee's March 2022 Discussion Draft bill. We welcome the opportunity to work with you and your staff on this issue of critical importance to CalSTRS, other long-term investors, and the capital markets.

Sincerely,



Aeisha Mastagni
Portfolio Manager, Sustainable Investment and Stewardship Strategies
California State Teachers' Retirement System

cc:

The Honorable Brad Sherman, Chair, Subcommittee on Investor Protection,
Entrepreneurship and Capital Markets, Committee on Financial Services, United
States House of Representatives
The Honorable Juan Vargas, United States House of Representatives
The Honorable Nancy Pelosi, Speaker of the United States House of Representatives
The Honorable Kevin McCarthy, Minority Leader of the United States House of
Representatives
The Honorable Diane Feinstein, United States Senate
The Honorable, Alex Padilla, United States Senate
The Honorable Kamala D. Harris, Vice President of the United States and President
Pro Tempore, United States Senate