GEORGETOWN LAW

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C., 20549-1090

Re: Investor's Exchange LLC Notice of Filing of Proposed Rule Change to Establish a New Optional Listing Category on the Exchange, "LTSE Listings on IEX" (Release No.34-82948; File No. SR-IEX-2018-06)

April 22, 2018

Dear Mr. Fields,

I appreciate the opportunity to comment on Investor's Exchange LLC's ("IEX") proposed rule change to establish a new optional listing category, "LTSE Listings." I am a law professor and faculty director of the Institute of International Economic Law at the Georgetown University Law Center, and I recently concluded a three-year term as a member of the National Adjudicatory Council of FINRA. I am not a consultant or employee of IEX and do not work for them in any capacity. My research focuses on finance and global governance, public and private international law, market microstructure and international trade.

I write to express my support for IEX's proposed rule change to adopt a new optional listing category. I believe that the proposed rules for companies listed under LTSE Listings ("LTSE Listing Rules") offer a thoughtful listing alternative for market participants who prefer listing standards explicitly designed to promote long-term value creation.

Long-term Value and IEX's Optional Listings Category

In recent years, there has been a growing movement among issuers, investors and stakeholders for corporate management to place more emphasis on long-term value creation. According to McKinsey's 2017 discussion paper, "Measuring the Economic Impact of Short-termism," a majority of directors and executives expressed a desire to focus more on long-term value creation.[1] In his 2017 letter to CEOs, Larry Fink, CEO of BlackRock, expressed a strong desire by shareholders who are BlackRock clients to see companies engage in more frequent and transparent long-term strategic thinking.[2] Indeed, even several current and former SEC commissioners have expressed views in favor of greater long-term strategic thinking by companies.[3]

In addition to market participants' increased interest in opportunities for long-term value creation and investment opportunities, there is compelling evidence of economic benefits associated with long-term strategic thinking. Influential studies in the academic literature have long suggested that short-termism, whether from managers or shareholders, can lead to myopic behavior[4]—and that while long-termism is, by itself, no silver bullet,[5] it can enable value creation through reiterative engagement, value

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[1] McKinsey & Company, McKinsey Global Institute, Measuring the Economic Impact of Short-Termism (February 2017), available at https://www.mckinsey.com/~/media/mckinsey/global%20themes/long%20term%20capitalism/where%20companies%20with%20a%20long%20term%20view%20outperform%20their%20peers/measuring-the-economic-impact-of-short-termism.ashx.

[2] Larry Fink, Larry Fink's Annual Letter to CEOs: A Sense of Purpose (January 16, 2018), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[3] Jay Clayton, Hearing before the Senate Banking Committee on the Nomination of Jay Clayton, of New York, to be a Member of the Securities and Exchange Commission (March 23, 2017), available at https://www.gpo.gov/fdsys/pkg/CHRG-115shrg24998/html/CHRG-115shrg24998.htm; Commissioner Daniel M. Gallagher, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College (June 23, 2015), available at https://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html; Commissioner Kara M. Stein, Toward Healthy Companies and a Stronger Economy: Remarks to the U.S. Treasury Department's Corporate Women in Finance Symposium (April 30, 2015), available at https://www.sec.gov/news/speech/stein-toward-healthy-companies.html.

[4] *See* Jeremy C. Stein, Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior, 104 Q.J. Econ. 655, 655–56 (1989); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. Pa. L. Rev. 653, 696-703 (2010); Justin Fox & Jay W. Lorsch, *The Big Idea: What Good Are Shareholders?*, Harv. Bus. Rev., July-Aug. 2012; Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, Harv. Bus. Rev., Sept.-Oct. 1992.

[5] Jeffrey Fried in particular has argued that in a firm that transacts heavily in its own shares, managers serving long-term shareholders will not necessarily generate more value over time than managers serving short-term shareholders. Jessie Fried, *The Uneasy Case For Favoring Long-Term Shareholders*, 124 Yale L. J. 1554, 1557 (2015). Yet he readily acknowledges, "[e]ven the staunchest proponent of shareholder empowerment must be prepared to accept the following proposition: *short-term* shareholder interests do not completely coincide with the goal of maximizing the economic value created by the firm over time. In particular, managers seeking to

investing, and returns from liquidity provision, among other things.[6] Along similar lines, McKinsey analysts recently found that firms emphasizing long-term strategy "exhibit stronger fundamentals" and "add more to economic output and growth."[7] Additionally, as detailed in IEX's rule change proposal, a long-term oriented listing alternative could spur more companies to engage in IPOs, and in the process create additional opportunities for investors.

Notably, there have been some individual efforts by U.S. companies to promote long-term corporate strategy by incentivizing longer-term share ownership through tenure voting systems. For example, The J.M. Smucker Company tenure voting program gives shareholders ten votes for each share of common stock if they have held their common shares for at least four years.[8] However, these tenure voting systems only apply to individual companies, which may have varied terms and could be rescinded.

I believe that the LTSE Listings option offers a differentiated and unique listing alternative for market participants that prefer greater emphasis on long-term value creation. In particular, the LTSE Listing Rules promoting the development and disclosure of (i) long-term growth strategies, (ii) transparency into human capital and R&D, (iii) long-term alignment of executive compensation and (iv) the long-term shareholder voting structure could help enable a corporate governance environment that allies the long-term strategic goals of issuers, shareholders and stakeholders and expands on existing efforts to promote long-term value creation through tenure voting systems.

<u>(i) Long-term Growth Strategy</u>

The LTSE Listing Rules require listed issuers to "maintain a committee specifically dedicated to overseeing the … Issuer's strategic plans for long-term growth" (the "LTSP Committee"), whose responsibilities include oversight and approval of the issuer's long-term growth strategy. In addition, the LTSE Listing Rules require explicit disclosures of the issuer's long-term growth strategy, including quantitative metrics used by management to forecast and measure the effectiveness of the long-term growth

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serve short-term shareholders may engage in "short-termism": taking steps that boost the short-term stock but reduce the size of the pie." *Id*. at 1567.

[6] Geoff Warren, Benefits (and Pitfalls) of Long-Term Investing, CIFR Research Working Paper, No. 40/2014, October 2014 (T003, Paper #2). Warren also notes the distant future can be hard to predict, and by implication, the increased importance of corporate governance. However, along with the advantages mentioned above, he asserts that long-termism allows firms to capture returns from pricing discrepancies across segmented markets, long-term thematic investing, investing in complex assets, and certain types of dynamic strategies.

[7] McKinsey & Company, *supra* note 2.

[8] The J.M. Smucker Company, Registration Statement (Form S-3), at 7 (Sept. 28, 2017).

strategy. I believe that requiring issuers to have a dedicated board committee focused on long-term growth strategies and the disclosure of a detailed, measurable long-term growth strategy could help foster a long-term relationship between issuers and their shareholders by providing shareholders with vital information for understanding the issuer's long-term plans.

(ii) Transparency of Human Capital and R&D Investments

To help give investors a more complete picture of the issuer's long-term strategy, the LTSE Listing Rules also require separate disclosure of expenses related to investment in human capital and a distinction between short- and long-term R&D spending. These disclosures, especially where accompanying narratives provide a sense of the expenditures' aims and productivity, can provide valuable insight into how issuers are effectively investing in their long-term growth.[9] They could also provide a helpful signal for investors as to issuers' commitment to long-term strategies and help investors feel more comfortable with short-term fluctuations in earnings.

(iii) Long-term Alignment of Executive Compensation

LTSE Listing Rules will also require that incentive-based compensation for executives be aligned with the issuer's long-term growth strategy and prohibit such incentives from being "tied to a financial or performance metric that is measured over a time period of less than one year." While it is important for issuers to develop and disclose long-term strategies, those actions must be implemented by management whose incentives are aligned with, and whose performance is at least in part measured against, the same long-term horizons. From this vantage point, I believe that the LTSE Listing Rules for executive compensation schemes could better-align management incentives with long-term corporate health.

(iv) Long-term Voting Program

Realization of the full benefits of the LTSE Listing Rules requires not only a commitment by an issuer's management to a long-term strategy but also shareholders committed to long-term strategies. The optional tenure voting program, which over time increases the voting power of long-term shareholders opting into it, gives shareholders investing for the long-term a greater say in corporate governance matters, and long-term shareholders are more likely to exercise voting rights in ways that prioritize long-term

[9] *See* Lucian Bebchuk & Lars Stole, Do Short-Term Managerial Objectives Lead to Under- or Over-Investment in Long-Term Projects?, 48 J. Fin. 719, 719–20 (1993) (surmising that when investors cannot observe the level of investment in a long-run project, suboptimal investment is likely, but when investors can observe investment but not its productivity, overinvestment is possible).

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growth strategies. By implementing tenure voting through exchange rules, the LTSE Listing Rules build on prior individual efforts to implement tenure voting by creating a set of consistent, minimum tenure voting standards that all issuers may use. I think this should be done carefully in order to minimize agency risks, but when coupled with enhanced disclosure of long-term strategy and investments, investors should enjoy better information and greater tools with which to work with issuers to pursue long-term growth strategies.

Conclusion

Market participants are increasingly expressing a desire for issuers to pursue more long-term oriented strategies. The LTSE Listing Rules, particularly those highlighted above, give them the option to opt-in and do so. Accordingly, I understand the Listing Rules as aspiring to a different kind of investment environment in which value-creating, long-term growth strategies can be more explicitly and forthrightly pursued. For these reasons, I support IEX's proposed rule change, as well future efforts by the Commission to glean lessons from this novel market—and policy—venture.

Yours sincerely,

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