

CAPITAL MARKETS UNION:
The Road to Sustainable Growth in Europe



Executive Summary

In February 2015, the European Commission launched a consultation on the measures needed to unlock investment in the EU and create a single market for capital. More than 700 responses were received reflecting broad support for the Capital Markets Union (CMU). In September, the Commission released the Action Plan on Building a Capital Markets Union built around creating more opportunities for investors, connecting financing to the real economy, fostering a stronger and more resilient financial system, deepening financial integration and increasing competition. The Action Plan contains an indicative time line that extends from now until 2018.

Exchanges and clearinghouses are part of Europe's critical financial infrastructure. As a key stakeholder, Nasdaq welcomes the opportunity to provide input and be part of the solution.

Financial stability and getting Europe back to sustainable growth is a top priority, and boosting the capital markets is essential to allowing Europe to reach its full potential. The capital markets enable savings to be put to productive use as well as drive innovation and job creation.

Instead of issuing debt, some companies choose to raise equity capital from investors who take an ownership interest in the company. The capital that companies raise through the public equity markets is theirs in perpetuity, and it can be used for a variety of purposes.

Initial public offerings (IPOs) enable companies to move from private to public funding and allow venture capital firms to recycle capital and fund new job creating businesses. Furthermore, listed companies have an opportunity to create public awareness, which could potentially increase revenue and enable them to attract the best employees.

Like other industries, the capital markets are currently witnessing a remarkable wave of disruption and innovation, driven by new technologies. From crowdfunding to smarter smartphones and the blockchain, changes are afoot that hold the potential to revolutionize the way we think about and interact with the world of finance as businesses, investors and consumers. And yet Europe's businesses – including SME growth companies – cannot fully exploit opportunities because they are over-reliant on bank financing and lack sufficient access to venture capital and the capital markets.

Lack of regulatory harmonization within the EU and with other countries, as well as unintended consequences of regulations, is problematic. Some regulations have been designed to make the capital markets safer, accessible and more transparent. Yet others prevent institutional investors including pension funds and insurers from investing in equities, essentially starving growth companies of financing. Meanwhile, we have yet to instill an investment culture, so individuals do not take full advantage of the equity markets to maximize long-term returns on their savings.

In Nasdaq's view, the concrete measures in the Action Plan focus on making it easier for large institutions to invest more and extend their product and service offerings rather than improving the capital markets themselves. **Instead, the Action Plan should focus on increasing transparency, making the capital markets more accessible to smaller businesses, incentivizing long-term private investment in listed equities, encouraging the development and use of disruptive technology and ultimately creating jobs.**

Growth companies typically start local, so it makes sense for them to tap the local capital market when they are ready to take the next step up the funding escalator. The single market for investment should then support local markets by channeling investment to the most promising companies in all corners of Europe.

Immediate action should be centered on incentivizing an equity-based culture and leveraging technology to remove remaining barriers to access for individual and institutional investors.

- Amending Solvency II to eliminate investment barriers for insurers and pension funds;
- Leveling the playing field in the taxation of debt and equity financing;
- Removing barriers to cross-border investment both within the EU and externally;
- Allowing local markets the flexibility to determine optimal tick sizes; and
- Eliminating the financial transaction tax.

Introduction

Recent events demonstrate the fragility of the European economy. Greece's long-term future in the Eurozone remains in doubt as well as a potential risk of a Brexit and the refugee crisis is challenging the solidarity to the European Union's founding principles. The recovery of the US economy has been cast in doubt and the viability of China as a global growth engine is increasingly questioned. The European economy continues to grow, largely backed by private consumption supported by the ECB's now extended and broadened quantitative easing program.²

Yet other data shows the picture is mixed. The UK announced in October 2015 that its unemployment fell to 5.3 per cent, the lowest rate since April 2008.³ Then in November Germany announced its third quarter 2015 GDP grew by a seasonally adjusted 0.3 per cent and 1.8 per cent year on year.⁴

Financial stability and getting Europe back to sustainable growth is a top priority, and boosting the capital markets is key to allowing Europe to reach its full potential. The capital markets channel the wealth of savers to those who can put it to long-term, productive use. They drive innovation, job creation and financial stability for countries, companies and individuals.

The free flow of capital is a fundamental principle on which the EU was built. While there has been clear progress toward this goal, Europe's capital markets are still relatively underdeveloped and fragmented because they are nationally based.

A top priority of the European Commission is to strengthen Europe's economy and stimulate investment to create jobs. Stronger capital markets are critical to attracting long-term investment, providing new sources of funding for business, increasing options for savers and making the economy more resilient.

A CMU for all 28 Member States establishes a path toward a true single market that will:

- Unlock more investment from the EU and the rest of the world;
- Better connect financing to investment projects across the EU;
- Make the financial system more stable;
- Deepen financial integration and increase competition.

1 Randow, Jana and Gordon, Paul. "Bruised Germany is Canary in a Coal Mine for Europe's Troubles". Bloomberg, October 8, 2015. <http://www.bloomberg.com/news/articles/2015-10-08/german-exports-slump-most-since-2009-recession-in-sign-of-risks>.

2 "ECB May Have to Broaden Pool of Bonds for QE - Market Talk." October 22, 2015. <http://iadweek.me/2015/10/22/ecb-may-have-to-broaden-pool-of-bonds-for-qe-market-talk/>.

3 "UK unemployment rate falls to lowest since April 2008." <http://www.bbc.com/news/business-34785758>.

4 Shimoni, Oded. "German 3Q GDP Confirms Moderate Growth, Domestic Demand Key". https://beta.dailyfx.com/forex/market_alert/2015/11/24/German-3Q-GDP-Confirms-Moderate-Growth-Domestic-Demand-Key.html

In February 2015, the Commission launched a consultation on the measures needed to unlock investment in the EU and create a single market for capital. More than 700 responses were received reflecting broad support for the CMU. In September 2015, the Commission released an Action Plan built around creating more opportunities for investors, connecting financing to the real economy, fostering a stronger and more resilient financial system, deepening financial integration and increasing competition. The Action Plan contains an indicative time line that extends from now until 2018.

As part of the critical financial infrastructure and a key stakeholder in Europe, Nasdaq welcomes the opportunity to provide input and be part of the solution.

European Funding Gap

The funding gap that European businesses have faced over the last few years appears to be abating. According to the recent euro area bank lending survey, credit standards on loans to enterprises eased during the third quarter of 2015. However, the OECD noted recently that lack of investment by governments and business has left the global economy vulnerable to a renewed slowdown. The CMU tackles this issue by easing access to, and diversifying the sources of, business finance across Europe.

Current Sources of Funding

The proportion of European company finance that comes from banks is high, at around 80 per cent – with less than 20 per cent coming from investors. In the US the numbers are reversed.⁵ From a resilience and growth perspective this is problematic, especially because new constraints on banking activity have placed further strain on the system.

Europeans lack sufficient access to venture capital. Data from KPMG and CB Insights show that Europe-based venture capital firms raised US\$3.2 billion in 284 deals during the second quarter of 2015. By comparison, US-based venture capital firms raised US\$19 billion in 1,180 deals, and Asian firms raised US\$10.1 billion in 313 deals during the same period. The study also notes that Europe's deal count was down from its four-year high of 357 in the first quarter of 2015.⁶

5 Deutsche Bank Research. "Tight bank lending, lush bond market – New trends in European corporate bond issuance". April 15, 2014.

6 KPMG and CB Insights. Venture Pulse Q2 2015. Global Analysis of Venture Funding. July 23, 2015.

Other data from Invest Europe show that European venture capital activity is down from its peak in 2006. During that year, firms raised €112 billion (about US\$146 billion) and invested €71 billion (about \$92 billion). In 2014, they raised €45 billion (about US\$59 billion) and invested €42 billion (about US\$55 billion).⁷

Generally, venture capital-backed companies in the US outperform their counterparts in Europe. No formal studies have been conducted to determine the reasons, but some attribute it to the amount of money that comes from the European Investment Fund, which has strings attached to further the Fund's agenda.⁸

An objective of the CMU is to complement the EU's high dependency on bank funding with deeper, broader and more integrated capital markets. Measures will be introduced to support venture capital and equity financing, including the use of EU resources to catalyze private investment through pan-European funds-of-funds, regulatory reform and promote best practice on tax incentives.

ROLE OF EXCHANGES AND CLEARINGHOUSES

Exchanges and central counterparty clearinghouses (CCPs) are the engines at the core of capital markets. Exchanges are an important mechanism for price discovery and executing transactions in a transparent manner. Investment professionals with the expertise to spot trends use them to invest and trade in an array of assets – from equities and interest rate instruments to derivatives. Other market participants use them to hedge the risk that prices will move against them. Ultimately, exchanges provide a regulated environment for mobilizing savings for investment, raising capital through IPOs, facilitating company growth and managing risk.

Importantly, CCPs take a prudent approach to securing transactions with margin payments and play a key role in mitigating counterparty credit risk. They diversify risk bearing, build buy-side confidence, provide a systematic approach to risk measurement and standardize collateral requirements. Less obvious but equally important is the role CCPs can play in stimulating the economy by releasing bank capital, driving competition among financial institutions, and providing an early warning system to firms' senior managers and regulators. In a central counterparty market, there is strength in numbers, and each participant adds to the strength of the marketplace.

7 European Private Equity and Venture Capital Association/Invest Europe. 2014 European Private Equity Activity.

8 <http://www.economist.com/news/finance-and-economics/21602247-well-meaning-governments-are-killing-continents-startups>.

Opinions vary, but most observers agree on one thing. If clearinghouses – with proven risk management practices: had a role in the OTC derivatives markets, the financial crisis would not have been as severe. Furthermore, clearinghouses can accelerate the pace of recovery. Therefore, these organizations must be part of any capital markets solution.

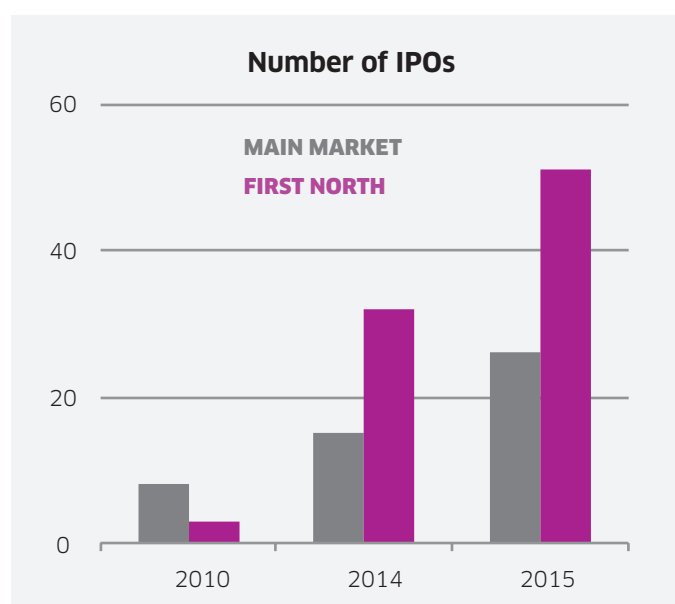
Significance of Active IPO Markets

Active IPO markets are good for economies because they generate capital for new investment, R&D and job growth at the time when young companies need it the most. They enable companies to move from private to public funding and allow venture capital firms to recycle capital and fund new job creating businesses. Furthermore, listed companies have an opportunity to create public awareness, which could potentially increase revenue and enable them to attract the best employees.

Successful IPOs stimulate interest in the equity markets and drive trading volume in both the IPO and mature companies in related industries. Helsinki School of Economics research published in the *Journal of Financial Markets* shows that turnover increases significantly when the IPO share price surpasses the original offer price. The increased volume generally lasts for two weeks.

There is an additional surge in volume around the end of the lock-up period.⁹ Increased interest, trading volume and liquidity could potentially encourage long-term investment by individuals and institutions, which is good for the economy.

The IPO climate in the Nordics has been at record levels. On Nasdaq's main market, the number of IPOs increased from 8 in 2010 to 15 in 2014, and 26 IPOs in 2015. On First North, Nasdaq's European growth market, the number of IPOs increased from only three in 2012 to 51 in 2015. First North companies often upgrade to the main market and few delist.



The number of IPOs globally has been less robust. According to an IPO Task Force report, during 1993-2000 the OECD area had an annual average of about 1,170 IPOs. During 2001-2011, this number fell to about 670. It notes that during the “recovery” period before the financial crisis, the annual number of IPOs never reached the average number of IPOs during the 1990s. The average total value of capital raised annually decreased from US\$132.7 billion during 1993-2000 to US\$69.9 billion during 2001-2011. This decline could be attributable to the decline in the number of smaller companies going public.¹⁰

Pathway for SMEs

Startup companies are critical to driving growth in the economy. Across the EU, SMEs employ two in every three people and produce 58 cents in every euro of value added or net contribution of the company to the economy. Large SMEs that have more than 250 employees employ 33 per cent of the total number of people who work for these businesses. In the period 2008-2014, SMEs’ value added increased by 2.4 per cent, and the number of enterprises has grown by 3.6 per cent. Employment in this sector has declined by 1.3 per cent over the period, although it increased by 1.2 per cent between 2013 and 2014.¹¹

The digital economy is rapidly emerging as a key driver of global growth. Europe is strong in this area, and most of the promising firms in this sector are SMEs. Yet compared to the US, European SMEs receive five times less funding from the capital markets.¹²

Some notable success stories illustrate the potential of SMEs that have accessed the capital markets. Tobii, for example, is headquartered in Sweden and is listed on Nasdaq Stockholm (TOBII). The company is a global leader in eye tracking and operates with about 600 employees through three business units. Tobii has grown organically each year since its inception in 2001, but it also has made a few strategic acquisitions, including DynaVox Systems in May 2014. Since 2008, net sales have grown by a compound annual growth rate of 21 per cent and around 16 per cent excluding acquisitions.¹³

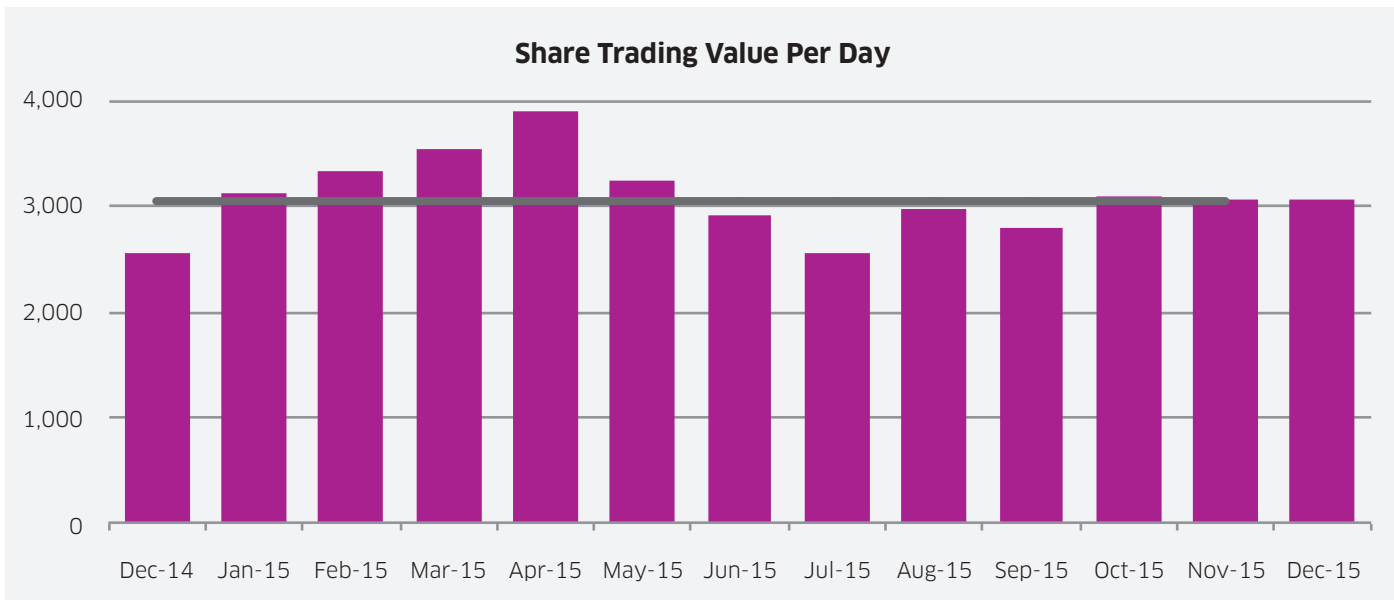
During the period 2006-2012, the annual turnover of companies listed on First North grew by 25.4 per cent, and 22.6 per cent in 2014. For companies not listed on First North, however, annual turnover grew by 10.1 per cent and 7.6 per cent respectively.

10 European IPO Task Force. EU IPO Report. Rebuilding IPOs in Europe. Creating jobs and growth in European capital markets. 23 March 2015. Page 8.

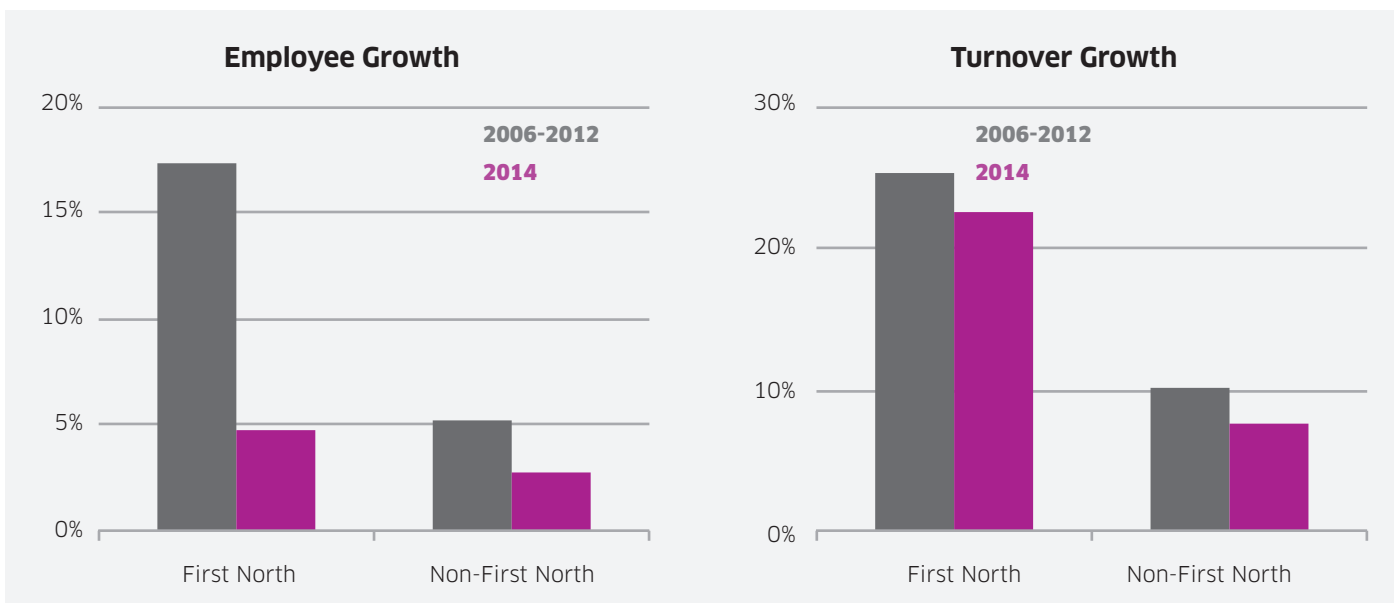
11 European SMEs according to Annual Report on European SMEs 2014/2015.

12 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan on Building a Capital Markets Union. 30.9.2015. Page 5.

13 <http://www.tobii.com/group/investors/financial-overview/>.



First North listed companies grew their employee base by 17.3 per cent annually during the period 2006-2012, and 4.7 per cent in 2014. By comparison, non-listed companies grew their employee base 5.2 per cent and 2.7 per cent respectively. The lower employee growth in 2014 likely reflects the lower turnover growth and possibly the current economic environment in Europe.¹⁴



¹⁴ Employee growth is not statistically significant.

If micro-cap companies do not grow, their limited value added per employee could put the economy at risk. The European countries with the highest share of micro-cap companies (companies that employ less than 10 people) are Greece, Italy, Portugal and Spain – all have more than 40 per cent of the total number of employees working in micro-caps.

It is critical for the CMU to remove barriers so many more SMEs can reach their full potential by listing on exchanges. It is also essential to provide a pathway to nurture and prepare SMEs for a successful IPO.

A BRAVE NEW WORLD

Like other industries, the capital markets are currently witnessing a remarkable wave of disruption and innovation, driven by new technologies. From crowdfunding to smarter smartphones and the blockchain, changes are afoot that hold the potential to revolutionize the way we think about and interact with the world of finance as businesses, investors and consumers.

Crowdfunding

With crowdfunding, startups can fund a project or venture by raising money from a large number of people often via the Internet. Indiegogo reports on its website that as of November 2015 over 10,000 entrepreneurs have used its platform to bring their ideas to life. Tech campaigns alone have raised over US\$208,383,216.¹⁵ Axent Wear, for example, raised

over \$3 million from more than 20,000 backers to develop unique headphones, and it has now teamed up with Brookstone to manufacture and deliver them.¹⁶ As of November 2014, UK-based Blocks Wearables, a modular smartwatch manufacturer, has attracted over 5,000 backers and raised more than US\$1.6 million on Kickstarter.¹⁷ In addition, Sweden's FundedByMe platform has attracted nearly €15 million to fund 426 companies.

Ironically, many people are willing to support crowdfunding without expecting a return, and yet they are reluctant to support growth companies listed on public markets. Meanwhile, studies show that a diversified portfolio in listed equities yields the best returns over the long term. More needs to be done to inspire confidence and enhance trust in the financial markets, and importantly whet investors' appetite for growth companies.

Smartphones

Today's smartphones put huge amounts of computing power into the hands of their users. According to Statistica, over a third of the world's population is projected to own a smartphone by 2017, up from just under 10 per cent in 2011.

Western Europe is due to become the largest regional market: almost 65 per cent of its total population is forecast to own a smartphone by 2017, over twice the figure in 2012. Within North America, around 64 per cent of the population will own a smartphone in 2017, an increase of 13 per cent on the figure from 2014. The smallest regional

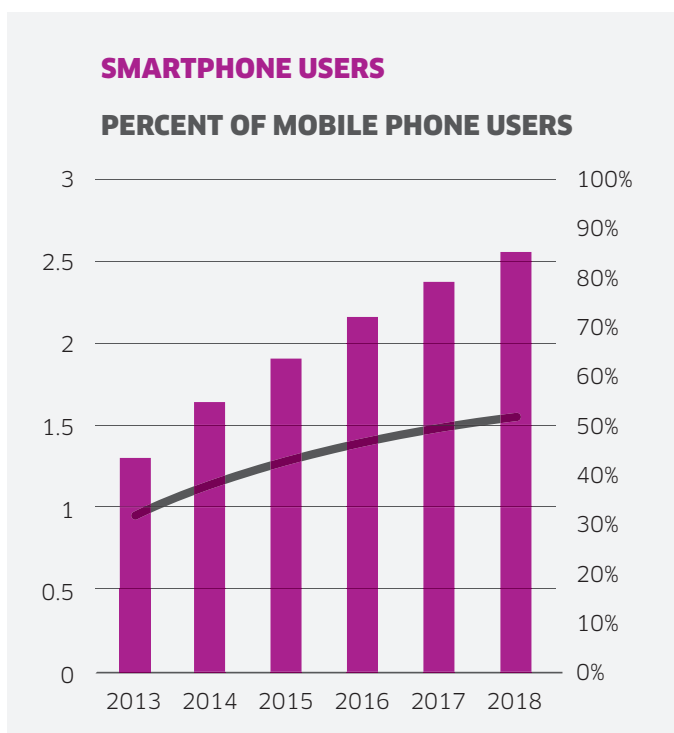
15 <https://learn.indiegogo.com/crowdfunding-on-indiegogo/>.

16 <https://www.indiegogo.com/projects/axent-wear-cat-ear-headphones#/>.

17 <https://www.kickstarter.com/projects/2106691934/blocks-the-worlds-first-modular-smartwatch?ref=category>.

market for smartphones is the Middle East and Africa, where smartphone penetration will stand at an estimated 13.6 percent by 2017. Almost one billion of these devices were sold to end users in 2013, an increase from less than 300 million units in 2010.¹⁸

By the end of 2016, the number of people owning smartphones will likely have passed the 2 billion mark. This level of penetration should prompt some radical thinking about how we can make markets more accessible in tune with the modern lifestyles.



Source: <http://www.emarketer.com/Article/2-Billion-Consumers-Worldwide-Smartphones-by-2016/1011694>

Blockchain

Finally, there is blockchain, an immutable record of title that describes the ownership of any type of asset. Similar peer-to-peer technology approaches have emerged as well, known as distributed ledger systems, which also facilitate the movement of value and capital without going through an intermediary. Blockchain and distributed ledger technology could offer an entirely different way of engaging in commerce and reinvent the way value and risk are shared between counterparties. There are potential applications in areas such as payments, trade finance, trading, clearing and settlement, physical property title transfers and more.

For example, Nasdaq launched blockchain-enabled digital ledger technology that will be used to expand and enhance the equity management capabilities offered by its Nasdaq Private Market platform. We also recently announced a new project focused on streamlining the proxy voting process in the Estonia market via blockchain. If the project succeeds, it will be applied across the other Nasdaq markets.

However, more needs to be done within the scope of the CMU to explore the opportunities offered by this technology.

NEED FOR HARMONIZATION

Since the financial crisis the legislative burden on the capital markets has swelled. The new regulations have a good purpose: to make capital markets more transparent, well-regulated and robust. The *Action Plan on Building a Capital Markets Union* notes that risks in derivative markets are to be reduced through EMIR. The markets are to be made safer, and more transparent trading rules are being introduced in MiFID II. Moreover, AIFMD ensures all alternative fund managers in the EU are regulated. Further reforms include the Securities Financing Transactions Regulation (SFTR), the proposal on Money Market Funds and the forthcoming legislative proposal on CCP recovery and resolution.¹⁹

Nasdaq welcomes the CMU measures to leverage these regulations to facilitate SME's access to capital markets, including the introduction of SME Growth Markets under MiFID II and the modernization of the Prospectus Directive. But the lack of regulatory harmonization and a holistic perspective is concerning. Some observers believe this could cause regulatory arbitrage within the EU and between EU and other countries including the US.

The Way Forward

There is no easy fix for many of the issues that stand in the way of the CMU. Barriers have formed over generations, and they will take time to eliminate. That being said, it is critical to force action and avoid inertia.

Overall, Nasdaq fully supports the CMU, but we recommend addressing certain shortcomings. The CMU needs a much bolder, forward-looking vision for the best capital market in the world, built on advanced technology and in tune with life in the 21st century.

Specifically, the concrete measures focus on making it easier for large institutions to invest more and extend their product and service offerings rather than improving the capital markets themselves. Instead, the measures should focus on increasing transparency, making the capital markets more accessible to smaller businesses, incentivizing long-term private investment in listed equities, encouraging the use of disruptive technology and ultimately creating jobs.

Immediate action should be centered on incentivizing an equity based culture, leveraging technology to remove barriers, reducing entry costs and reconciling laws and regulations that conflict with CMU objectives.

¹⁹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan on Building a Capital Markets Union. 30.9.2015. Page 26.

Incentivize an Equity-Based Culture

The CMU Action Plan points out that retail investors in Europe have significant savings in bank accounts, but are less directly involved in capital markets than in the past. Direct share ownership of European households has dropped from 28 per cent in 1975 to 10-11 per cent in 2007. The proportion of retail investors among all shareholders is less than half the level it was in the 1970s.²⁰

Memories of the financial crisis are still fresh, so individuals may be reticent to assume more risk. If the CMU is to succeed, savers need to be transformed into investors. Barriers need to be removed, and they need to be incentivized appropriately to actively invest in growth companies.

Introduce a "Long-term Ownership" Asset Class in Equities

European households, insurers and pension funds have reduced their equity exposures over the last several years. During the 1990s European stock market capitalization rose by more than 600 per cent,²¹ driven partially by government privatizations and massive IPOs. Investors retrenched when the stock market bubble burst in the early 2000s, then started to rebuild their positions only to reduce them again when the financial crisis hit.

Insurers have been reducing their equity exposures in preparation for Solvency II, which increases the capital charges for holding equities and certain types of corporate bonds. (Please see the section on Solvency II Capital Requirements for further discussion.) To some degree, legislation has discouraged pension funds to invest in equities as well. For example, after the UK implemented a minimum-funding requirement in 1987, UK pension funds cut equity allocations from nearly 70 per cent to 48 per cent over the next 13 years.²² Generally, the countries with the largest private pension funds including the UK, the Netherlands and Germany have reduced their equity allocations.

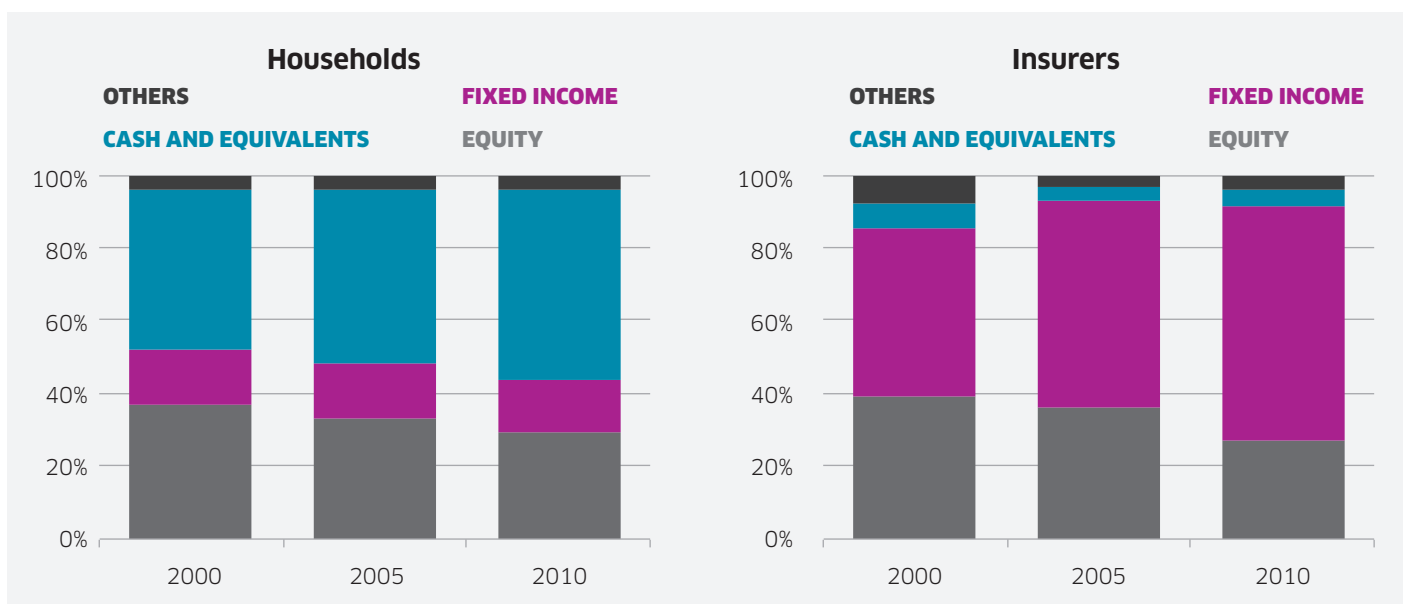
Nasdaq's view is that the CMU Action Plan should call for the establishment of a new asset class: long-term ownership investment. This would allow institutions including insurers, pension funds and individuals to reserve part of their capital to make long-term investments in smaller emerging and established small-cap companies.

20 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan on Building a Capital Markets Union 9/30/15. Page 18.

21 The emerging equity gap: Growth and stability in the new investor landscape. McKinsey Global Institute. December 2011. Page 13.

22 Ibid. Page 14.

Pension funds should be incentivized to increase their ownership stake on the broader market as well. Currently, the Swedish Pension Insurance Funds holdings amount to only a few per cent of the companies' shares, for example. Moreover, institutional investors tend to lean toward passive index investing: some will not even invest in large cap companies that are not a component of an index. That trend is a barrier for growth companies that are not part of an index and want to attract investors.



Offer Tax Incentives

Nasdaq encourages tax reform to encourage personal saving and investing, including tax incentives. One possibility is to offer lower tax rates for equity investors whose holdings extend over longer periods. Perhaps the tax rate could be reduced in increments over time. Some EU member states, including the UK and Sweden, have already implemented similar structures, and their models could serve as best practice.

As another example, Denmark has taken steps to use tax incentives to improve the investment climate, induce entrepreneurship and stimulate innovation. It cut corporate income tax, improved

the possibilities for pension funds to invest in unlisted shares and made research costs tax deductible for small businesses.²³

The tax treatment of unlisted and listed companies and their shareholders should be neutralized. Employee stock options programs for startups and micro companies should be given preferential tax treatment. In addition, Nasdaq supports neutral tax treatment of debt and equity financing. Today, debt financing is favored because companies can deduct interest expenses, whereas they cannot deduct expenses related to equity financing, including dividends. (Please see the section on Unfavorable Tax Treatment of Equity vs. Debt for further discussion.)

Educate Potential Investors and Streamline Intermediary Services

In some countries, investing directly or indirectly is not on people's radar screen. Where there is an investment culture, such as Sweden and the UK, there is a regional bias because broker-dealers and funds have local expertise and information is more obtainable.

In Nasdaq's opinion, this issue can be addressed partially through education. The exchanges and other financial institutions already have some local programs in place. However, it makes sense for the EU to drive a wider scale initiative within the scope of the CMU.

It is important to look at the experience in certain countries where the chain of intermediaries has been simplified to ensure that the investors, not intermediaries, are rewarded by companies' growth. Additionally, greater transparency of costs and charges in the investment chain may help to foster investment, as advocated by the Kay Review.

Leverage Technology to Remove Barriers

Short-term and long-term initiatives are underway to leverage technology to eliminate informational and operational barriers to investing in the capital markets. These include introducing common standards around disclosure, increasing the availability of market and reference data, and establishing a pan-European post-trade operational structure with T2S. In Nasdaq's view, additional measures within the scope of the CMU should be taken to leverage technology to address some significant challenges.

Simplify, Standardize and Automate Information

From 2017, MiFID II will introduce SME Growth Markets to prepare SMEs for eventual listing on a larger exchange. The Commission plans to ensure that the requirements applying to SMEs strike the right balance between providing sufficient investor protection and avoiding unnecessary administrative burden.²⁴

The Action Plan notes that many SMEs admitted to trading on multilateral trading facilities (MTFs) report financial information only on the basis of national accounting standards. This makes it difficult for international investors to compare results and performance. The Commission plans to explore with the International Accounting Standards Board (IASB) the possibility of developing a voluntary tailor-made account solution, which could be used for companies admitted to trading on SME Growth Markets.²⁵ Nasdaq believes mandatory compliance with International Financial Reporting Standards (IFRS) could deter SMEs from listing on exchanges supports, so we support voluntary compliance.

The Prospectus Directive harmonized the requirements to enable the comparison of investment opportunities across the EU. But as the CMU Action Plan points out, prospectuses are still costly and onerous to produce, particularly for SMEs, and typically run to hundreds of pages. For investors, they can be complex and excessively detailed, and the information which is critical for investment is hard to discern. The Commission plans to modernize the Prospectus Directive and explore how to support SMEs with the listing process through the European advisory structures

²⁴ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan on Building a Capital Markets Union 9/30/15, page 13.

²⁵ Ibid. Page 13.

such as the European Investment Advisory Hub (EIAH).²⁶

We agree there is the need to refocus prospectuses, especially for growth companies. The prospectus has morphed into an instrument that is mainly used to manage the risks of the companies and their advisors. The focus should be on providing meaningful information to investors in a concise manner, perhaps supplemented by a longer document. The concise document should contain the key information needed to make an investment decision, and it should be presented in a standardized format so it can be translated. However, it is important to ensure material information is not withheld from analysts and investors in the process.

Moreover, the EU should draw some lessons from the US experience. The US has been trying to streamline the disclosure process for some time through the XRBL initiative, but the number of fields and tags have exploded, and the initiative may never get off the ground.

We recognize the potential for technology to enable listed companies to share, and investors to access, standardized information. Yet investment is needed to develop better tools for translating companies' prospectuses and disclosures into various languages so companies can produce financial information in the language of their investor pool.

One reason for improving these tools is translation is extremely difficult to automate because of the nuances in languages. Even US, UK, Australian and South African English can be interpreted differently.

If translation could be automated, it would increase awareness amongst investors, improve transparency and allow investors to make more informed decisions including when it comes to exercising their voting rights. Ultimately, the increased awareness and transparency would drive more investment in listed companies.

Improve Connectivity

Technology can help remove operational barriers to accessing markets. Since the 1990s investors have taken advantage of the Internet to buy and sell financial instruments, and that has brought down costs significantly. Nowadays investors are using mobile devices including tablets and smartphones to access information and execute transactions.

Reduce Entry Costs for Smaller Companies

The CMU Action Plan points out that initial and ongoing fees are a barrier to listing on exchanges. It cites a recent EU IPO Task Force report, which estimates the cost of listing fees alone in IPOs of deal size below €6 million to be 10-15 per cent of the deal value. In comparison, for larger deals (€50-100 million) these fees are about 5-8 per cent.²⁷

²⁶ Ibid. Page 12.

²⁷ Ibid. Page 12.

Nasdaq agrees that reducing entry costs could allow more companies to raise capital on public markets. We would like to point out, however, that the cost of going public includes fees paid to an array of advisors including attorneys, auditors, underwriters and liability insurance coverage for directors and officers. The exchange's fees vary, but typically they do not represent the lion share of the costs.

Eliminate Legal and Regulatory Conflicts with CMU Objectives

The CMU Action Plan includes a call for evidence to evaluate the interactions between rules and the cumulative impact of the financial reform on the investment environment.²⁸ However, Nasdaq would like to highlight a few conflicts and inconsistencies that are a deterrent to developing the capital markets, particularly publically listed markets, and supporting SMEs.

Solvency II Capital Requirements

The high capital requirements imposed on insurers under the new Solvency II are a disincentive for insurers to invest in equities, according to a European IPO Task Force report.²⁹ It explains that insurers must hold a 39 per cent capital charge for owning shares in listed companies in the developed markets, and a 49 per cent capital charge for other categories of shares. Depending on the (exceptional) development of share prices, the regulatory authority has the power to adjust this capital requirement upwards or downwards by no

more than 10 per cent. A capital charge of 22 per cent applies to participations of a strategic nature. Debt-related instruments are potentially less expensive, and they are subject to a capital charge of 15 per cent.

There is no capital charge for treasury bonds issued by Eurozone Member States. In anticipation of the new rules, insurers are disposing of a significant volume of their equity investments, and some have completely stopped investing in equities, the report notes. That means equity funding via the capital markets may not be an option for as many companies – just at a time when bank funding may be scaled back.

The CMU Action Plan acknowledges that life insurance companies and pension funds are natural long-term investors, but they have been retrenching from investment in long-term projects and companies. The share ownership of insurers and pension funds dropped from more than 25 per cent of the EU stock market capitalization in 1992 to 8 per cent at the end of 2012. These firms typically hold a large share of their portfolio in a relatively narrow range of assets.³⁰

The CMU Action Plan recommends supporting institutional investors to allow their exposure to long-term assets and SMEs, while maintaining sound and prudent asset-liability management. The Commission intends to assess whether changes are warranted and, if so prepare amendments which could be brought forward in the context of the Solvency II review.

²⁸ Ibid. Page 17.

²⁹ European IPO Task Force. EU IPO Report. Rebuilding IPOs in Europe: Creating jobs and growth in European capital markets. 23 March 2015.

³⁰ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Action Plan on Building a Capital Markets Union 9/30/15. Page 20.

Nasdaq strongly supports the analysis and conclusion in the European IPO Task Force report, and we encourage the Commission to move forward with the review.

Unfavorable Tax Treatment of Equity vs. Debt

In most countries, interest payments on debt is tax deductible. However, equity financing does not receive any form of tax relief, and is subject to significant taxation both in terms of capital gains and dividend payments.

Equity financing vs. non-equity financing is a diversification issue; each has advantages and disadvantages. The capital that companies raise through the public equity markets is theirs in perpetuity, and in turn, investors expect companies to provide a return over time through growth and dividends. The flip side is that raising equity is more costly than raising debt because companies have a higher cost of capital.

Debt – loans, bonds and bank lines of credit – has to be repaid on maturity, and then companies run the risk of having to refinance at a higher interest rate. Another risk is that bank lending will be limited, as it was after the financial crisis. Anecdotal evidence suggests that companies that had less debt on their balance sheets were in a stronger position to survive the crisis even when their valuations collapsed.

The CMU Action Plan admits that the differences in the tax treatment of various financial instruments may impede efficient capital market financing. The preferential tax treatment of debt, resulting from the deductibility of interest rate payments, is at the expense of other financial instruments, in particular equity. It acknowledges addressing this tax bias would encourage more equity investments and create a stronger equity base in companies. From a financial stability perspective, companies with a stronger capital base would be less vulnerable to shocks.³¹

During 2016, the Commission plans to address the debt-equity bias as part of its work on a new proposal for the Common Consolidated Corporate Tax Base (CCCTB). Nasdaq fully supports this effort, but we believe it should be dealt with separately to ensure a swift resolution.

Barriers to Foreign Investment

Cooperation and convergence are essential to minimize regulatory arbitrage and prevent market participants from migrating to market centers with the weakest regulations. After the financial crisis, guidelines were produced by the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO), the G20 and the Basel Committee on Banking Supervision. Financial institutions and national regulators worldwide have been asked to comply with them.

³¹ Ibid. Page 14.

While regulations around the world have been designed to have the same end result, they are different in many ways. The lack of harmonization and mutual recognition is now becoming a major barrier for foreign investors. The OTC markets are already showing signs of bifurcation.

The Commission recognizes the EU's capital markets need to be open and globally competitive to thrive. It has committed to working closely with EU Member States and third countries through the FSB and IOSCO to achieve convergence and strengthen capital market integration. It will also continue to contribute to international work on the free movement of capital, including in the context of the OECD Codes of Liberalization of Capital Movements.³² Nasdaq fully supports these efforts to remove barriers to foreign investment.

Inconsistent Implementation of EU Legislation

A key objective of the CMU is to allow the free flow of capital across borders in the EU. Yet inconsistent implementation of EU legislation discourages cross-border investment. National laws vary on insolvency, collateral and securities. Moreover, changes in the regulatory environment undermine the predictability of rules for direct investments.

Market participants are uncertain which national law applies to any given cross-border securities transaction. This is particularly an issue in light of the expected increase in cross-border securities transactions stimulated by the launch of T2S.³³

National property and insolvency laws, as well as national laws regarding securities holdings differ considerably. These differences can give rise to uncertainty as to who owns a security in the event of a default and whose rights take precedence in the event of insolvency. This poses important legal risks, for example, to the enforceability of collateral, and can threaten the resilience of cross-border settlement and collateral flows.³⁴

Many investors are currently penalized when investing cross-border by the application of local withholding taxes, which are near impossible to reclaim, in addition to their domestic tax. The problem stems from different national approaches in the application of withholding taxes and the complexity of procedures to claim relief from these taxes. The potential discriminatory taxation of pension funds and life insurance companies is also a barrier to cross-border investment.³⁵

The CMU Action Plan notes that investment funds increased their share of ownership of EU stock markets from less than 10 per cent in the 1990s to 21 per cent in 2012.³⁶ They have also become an increasingly important holder of corporate bonds. Still, discriminatory tax treatment, varying national requirements on the marketing of funds and fees for cross-border notifications restrict cross-border activity.

³² Ibid. Page 27.

³³ Ibid. Page 23.

³⁴ Ibid. Page 24.

³⁵ Ibid. Page 25.

³⁶ Ibid. Page 20.

Nasdaq welcomes the Commission's efforts to gather evidence on the main barriers that deter investors from geographically diversifying their portfolios and eliminate them through legislative means as necessary.

MiFID II Tick Size Regime

Research from the 1990s and early 2000s shows that a liquid asset has a lower cost of capital than an illiquid asset, all else being equal. Lower cost of capital enhances capital formation (where capital resources are utilized for investment purposes), which in turn drives economic growth and job creation.

One measure of liquidity is tick size. SMEs' securities tend to be more illiquid than larger companies' securities. The one-size-fits-all tick size regime in MiFID II will likely reduce liquidity in SME securities even further, therefore increasing their cost of capital.

Furthermore, when spreads are very narrow, market makers can only make a profit when trading volumes are high. Narrow spreads tend to work well in heavily traded, highly liquid blue chip equities, for example. SMEs' securities are not typically associated with high trading volumes, so narrower spreads will likely discourage intermediaries from making markets in them.

In Nasdaq's opinion, the CMU objective to develop SME markets conflicts with the tick size regime in MiFID II. Local markets should have the flexibility to establish the optimal tick size for any given security.

The Financial Transaction Tax

The purpose of the Financial Transaction Tax (FTT) is to make the financial sector pay for the recent crisis. However, the FTT will miss the intended target, and the burden will fall upon retail investors.

As a rule of thumb, taxes are used to encourage or discourage certain behaviors by altering the balance of supply and demand. In this particular case, it is believed that the FTT will curb speculation in the financial markets by making securities less attractive to professional traders.

While the supporters of the FTT argue that it could penalize speculators, it will also hurt retail investors and cycle through to the EU economy as a whole.

Securities' trading is a scale business: the higher the volumes, the more competition; the tighter the spreads, the cheaper it is to trade. The FTT is a tax on market liquidity. It will lead to a self-perpetuating cycle of lower volumes, higher transactions costs, lower share prices and diminished returns. Lower volumes and less liquidity make it more difficult to raise capital, and a diminished ability to raise capital hurts the ability of companies to invest, grow and create jobs.

Advancements in technology have driven economies of scale resulting in lower transaction costs that have been passed through to investors. Today, retail investors pay extremely low commissions through online brokers. Under MiFID, the structure of the EU financial markets encourages competition driving a tighter bid/offer spread and reducing costs for all market users. The FTT directly moves this process in the opposite direction.

France and Italy both imposed an FTT in 2012 and 2013 respectively. Research from Credit Suisse reveals that in France, the average daily value of shares traded since the tax was imposed has been almost 12 per cent lower than in 2011. But in the rest of Europe trading has fallen by almost 10 per cent. There is little indication that companies are unable to finance themselves or that much business has moved offshore. Italy has experienced a sharp decline in volume, however. Average trading on all Italian markets since the taxes were put in place was almost 12 per cent lower than in 2012, whereas

trading elsewhere in Europe increased by almost 7 per cent.³⁷

In its Impact Assessment, the European Commission itself estimates an FTT will reduce GDP growth by 1.76 per cent and have a negative impact on employment of -0.20 per cent.

Moreover, member states have not been able to agree on several technical aspects. These include the rate, the products that should be subject to the FTT as well as the collection mechanism – specifically, should the tax be levied where the company is listed or where the transaction occurs? Another issue is forging agreements with other Member States or third countries that do not have the FTT.

In Nasdaq's view, the FTT discourages investment in the products on which it applies, and increases the cost of capital for companies. Therefore, it contradicts initiatives to develop public markets.

CONCLUSION

Much progress has been made toward achieving a single market for people, goods and services, and capital in Europe, but there is still work to be done. Europe's capital markets are amongst the strongest in the world, and yet political, economic, social and technological barriers stand in the way of realizing the ultimate dream. The Action Plan on Building a Capital Markets Union addresses many of those issues, but it can and should go one step farther. We encourage the Commission to place more focus on the capital markets themselves to ensure there is a transparent, technology-enabled foundation that supports long-term investment Europe's growing companies.

37 "Still kicking – New life for a bad idea." The Economist, January 31, 2015. <http://www.economist.com/news/finance-and-economics/21641258-new-life-bad-idea-still-kicking>.



© COPYRIGHT 2016. ALL RIGHTS RESERVED. NASDAQ®
AND THE NASDAQ STOCK MARKET® ARE REGISTERED
TRADEMARKS, OR SERVICE MARKS, OF NASDAQ, INC. IN
THE UNITED STATES AND OTHER COUNTRIES. 2311-Q15