

FSB CONSULTATION ON THE EFFECTS OF FINANCIAL REGULATORY REFORMS ON SME FINANCING

REPLY OF NASDAQ

Nasdaq welcomes the opportunity to give feedback on the effects of financial regulatory reforms on SME financing. In general, we consider that regulatory reforms, both international and national, play a crucial role in the functioning of capital markets and can affect significantly their effectiveness and relevance for the growth of companies and economic development. Hence, assessing the consequences of the G20 regulatory reforms, which have been extensive, appear to us very relevant. At the same time, we also recognise that regulatory measures on their own cannot necessarily develop well-functioning capital markets. Other aspects also have an essential role such as comprehensive ecosystems which prompt, support and advance capital markets.

- 1. What have been the main trends in SME financing (i.e. types of financing, volumes, prices and maturities) since the financial crisis? How do these trends differ across jurisdictions (e.g. advanced vs emerging market economies) and sectors (e.g. high-tech vs traditional firms), as well as by firm size (micro vs small vs medium-sized firms) and age (e.g. start-ups vs mature firms)?**
- 2. What have been the main drivers of the observed trends in SME financing in recent years? How do they differ across jurisdictions, sectors, size and age of firms?**
- 3. Have financial regulatory reforms such as Basel III affected bank financing to SMEs (e.g. in terms of loan volumes, prices, maturities and collateralisation)? If so, how? How important have been their effects vis-à-vis other types of bank lending and compared to the main drivers identified in question 2?**
- 4. How does the impact (if any) of financial regulatory reforms vary across banks operating in different geographies and with different size and business models?**

5. What other G20 financial reforms or other domestic financial regulations (if any) may have impacted financing to SMEs and how?

From revised prudential requirements to more central clearing, all regulatory reforms supporting the strengthening of financial markets and increased their resilience have helped restore the confidence of investors in capital markets, which was much needed after the recent financial crisis. At European level, the reform of capital markets regulation done in particular through MIFID II and EMIR has been essential. The deployment of the capital markets union (CMU) action plan has also been important. All these actions has been useful and already active financial ecosystems have benefitted from such reforms and strengthened the financing of companies through public markets. This has been the case in the Nordic region.

Nordic markets, operated by Nasdaq, have seen a record inflow of new listings in recent years, with 301 new listings (capital raised: €14.4 billion) across the Main Market and the junior growth market, Nasdaq First North, since 2016. The majority of all new listings are small and medium sized companies (SMEs).

6. Have financial reforms prompted a shift in the provision of SME financing, e.g. between banks and other financial institutions (substitution effects)? If so, how?

We believe that financial reforms have indeed restored confidence in the Nordic region and helped companies to decide to finance on public markets and investors to invest in such markets.

While the global IPO activity has been far from robust since the 2008 financial crisis, the Nordics have a different story, in particular for SMEs. In 2017 alone, Nasdaq Nordic accounted for 28% of all listings in Europe, or 100 IPOs.

The number of new listings on Nasdaq's Nordic main markets went from nine in 2012 to an average 35 in the last three years (2016-2018). The situation is even more remarkable on Nasdaq First North, where the number of new listings went from nine in 2012 to an average of 65 for the same period, thereby outperforming other major European growth markets despite the relatively modest size of the Nordic region.

This success is largely due to Nordic countries having well-functioning ecosystems, in particular Sweden: innovative companies, financial advisors helping companies to list and a strong equity culture where both professional and retail investors are willing to take risk.

One feature of the Nordic markets is a relatively high portion of direct retail participation. Online brokers offer direct access and there is a broker interest also in Small Cap segments. A commercially sustainable business case for intermediaries and professional investors to operate in the market is key to ensure liquidity. This facilitates SMEs' opportunities for sourcing the retail investor segment via public markets.

However, more can be achieved. Continuous reforms are needed to boost European capital markets. The Capital Markets Union project has to be starkly reinforced, both at EU and at national levels, in order to reimagine the European markets and ignite the growth of SMEs. Nasdaq sees a number of areas where policy makers should act to positively impact on SME markets and investments (see replies to question 7 for specific suggestions)

7. Are there any other issues or relevant factors that should be considered as part of the evaluation?

In order to boost the financing of companies, especially SMEs, through public markets as a complement to bank financing, we consider that further actions are needed from policy makers.

The following are suggested as actions to be considered:

1. Tax Policies

Tax incentives for investments in SMEs are in place in many jurisdictions and could be further reinforced by sharing best practices. The Swedish model of the investment savings account (ISK) is an excellent example and has proven very successful – since its launch in 2012 more than two million individual accounts have been opened. The ISK allows the account holder to buy and sell shares actively with a simple annual taxation on the total value of the portfolio (2018: 0,45%).

Disincentives to capital markets financing need to be abolished. This includes achieving tax neutrality between equity and debt financing. Also a financial transaction tax would be a tax on liquidity, and will therefore have significant negative effects on the efficiency of capital markets, directly contradicting action like the CMU project.

2. Education and Awareness

Financial literacy is key to transform savers into investors. Educational programs should include information on the functioning and benefits of capital markets. Pension systems can also foster awareness. The Swedish pension system, which allows individuals to allocate a certain portion of the pension money at his or her own discretion increases the awareness of equity investments.

3. Lowering the Barriers for Intermediaries and for Research

Smaller intermediaries, such as analysts, financial advisers and accountancy firms, need an adequate environment to be able to maintain their business. If the regulatory costs become too high, the smaller actors will disappear, harming the local ecosystem. Especially SMEs will struggle to find advisors and partners willing to support them through the funding escalator. For instance, The MiFID II requirement on how research is shared and purchased threatens to decrease SME research and bring with it challenges for smaller companies seeking visibility. A review and modification of these rules is important.

4. Promoting Long-Termism

Companies and investors need to trust that capital markets deliver in the long-term. While supporting necessary regulation, we also witness market fragmentation caused by regulatory measures such as MiFID. Financial regulation and tax policies needs to consistently support long-termism.

Sustainability and long-termism go hand in hand. Exchanges strive to further engage, encourage and support listed companies in reaching more broad-based ESG reporting and hence even better markets. We see significant development, driven by demand. Maintaining a certain level of self-regulation and guidelines in this area is recommended, in view of the complexity of these reports for companies.

5. Evolving Market Structure

The implementation of MiFID needs to defend an efficient and transparent price formation process in listed shares and a level playing field between transparent markets and other forms of order execution. However, in Europe, there is currently a lack of control around what type of activity is allowed in a Systematic Internaliser (SI) – an investment firm which organizes frequent, systematic and substantial dealings on own account outside a trading venue.

If an SI operates on a riskless principal basis, this essentially replicates a multilateral venue, however with a fraction of the transparency that is in place on multilateral venues to protect and benefit investors. This will not support the further development of capital markets as an alternative source of finance for European companies.

6. Fintech and Innovation

New technologies open up opportunities for investment. Mobile apps connect investors and markets more easily and cheaper. E-voting facilitates shareholder engagement. Automated translation breaks down language barriers, increasing crossborder investments. Standardization facilitates automation, translation and comparability. Machine learning in surveillance system ensures resilient markets.

Policymakers should embrace these opportunities and ensure that regulatory intervention does not stall the use of these new technology as well as forthcoming innovation. Regulation should remain technology neutral and any current regulatory barriers impeding the use of these technologies as well as innovation in general must be swiftly lifted.

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