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Before the Joint Economic Committee
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Good afternoon Chairman Paulsen, Ranking Member Heinrich and all the members of the Joint Economic Committee.

Thank you for the opportunity to testify on the importance of capital formation and Nasdaq's view on how to maximize economic growth and job creation – as well as providing quality, high-growth investment options for investors who need to grow their savings.

Maximizing economic vibrancy is best achieved, in our view, if we modernize the public company model, while preserving critical investor protections.

Nasdaq recently noted the one-year anniversary of launching its Revitalize Initiative (business.nasdaq.com/revitalize) in which we highlighted a set of ideas that our listed companies, stakeholders and investors tell us will restore the vibrancy of the capital markets.

These ideas are broadly grouped around three areas of the securities law: the proxy process, the disclosure rules, and the market structure that applies to the U.S. equity markets. Over the past year, we have seen many positive developments within Congress, federal agencies, and the business community at large, including:

1. Changes by the SEC to the process for removing repetitive, unsuccessful proposals from proxies
2. Movement in Congress to enhance transparency and fairness in the proxy advisory industry
3. Growing support from the business community to streamline and allow flexibility in quarterly reporting obligations for small and medium growth companies
4. Interest at the SEC in helping smaller public companies by consolidating displayed liquidity onto a single trading venue
5. The U.S. Treasury Department's 2017 Report, "A Financial System That Creates Economic Opportunities - Capital Markets"

As you know, the House Financial Services Committee has also worked on these ideas and they have embraced the need to improve capital formation. In fact, Chairman Jeb Hensarling and Ranking Member Maxine Waters have crafted a very good package under the moniker of JOBS Act 3.0. and

sent it to the Senate with a commanding vote of 406-4. We look forward to the Senate moving forward to pass this critical bipartisan legislation.

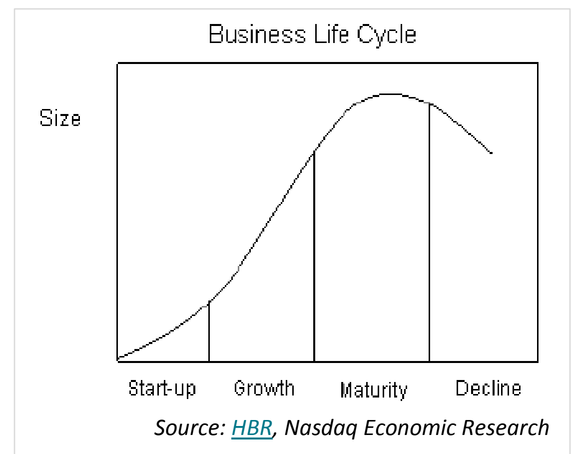
Today I will be focused on why Capital Formation is important not only to help grow the American economy but also to provide retirement security to Americans while reducing the burden on social security in the decades ahead.

Many of the solutions we propose are included in the Revitalize paper. One issue that I will not focus on today, but would like to commend Congress on, is the passage of important tax reform legislation late last year to ease the burdens on all corporations and move to a more territorial tax system for global companies. These reforms are having a positive impact on the ability of small companies to grow and expand.

For example, increased net revenues have allowed many companies to pay additional employee bonuses, while others are choosing to distribute wealth back to shareholders via dividends and buybacks – adding to the retirement wealth of US investors.

How do companies access capital for growth?

It is well documented that companies move through a variety of stages in their lifecycles. Early stages, sometimes referred to as "start-up" and "growth" phases are often capital intensive – requiring the injection of cash from owners and investors to help build and brand new products before sales take off.



Source: HBR, Nasdaq Economic Research

There are a number of places that entrepreneurs can go for cash during these growth phases. Start-ups often use crowdfunding or angel investors, in addition to their own funds. Perhaps in the not-too-distant future ICO's (initial coin offerings) on the blockchain might also be a popular option.

As the company grows, and the required investments get larger, better organized and deeper sources of funds are often used – like private equity or public equity markets.

Why are public companies important to the US?

There are two key reasons why it's important that public markets are a competitive and attractive source of funding for these companies:

1. **American Investors will benefit:** This is the growth phase of their lifecycle, when their valuation is increasing the fastest. So it's important that American investors can benefit from this wealth effect.

2. **US Economy will benefit**: Companies that list in the US almost always have head offices in the US. This means they hire more Americans, not only paying more US taxes, but also deepening the US workforce and economy.

How US public companies benefit the economy

Studies[1] have shown that economic benefits when more companies are willing to go public are significant.

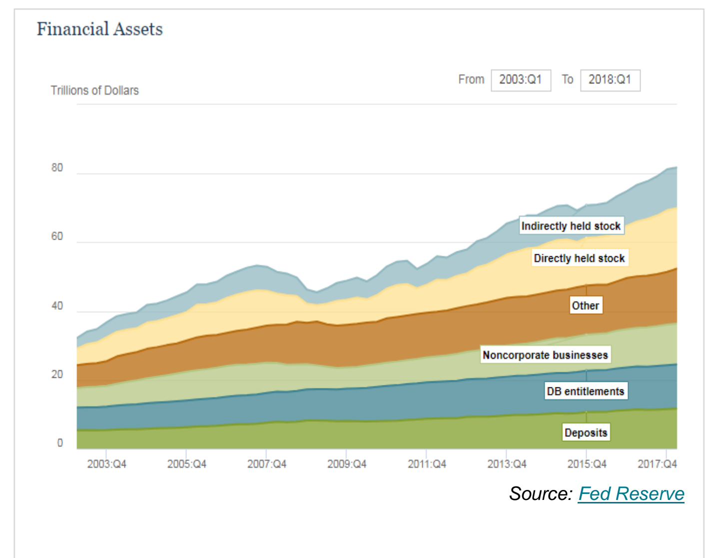
- A 2012 study by the Kauffman Foundation estimated that the 2,766 companies that went public from 1996 to 2010 collectively employed 2.2 million more people in 2010 than they did before they went public, while total sales among these companies increased by over $1 trillion during the same period.

- Another study by IHS Global Insight in 2010 found that 92% of a company's job growth occurs after it completes an IPO.

How public companies are important to investors

According to NY Fed, individual investors now have $29.4tr invested in stocks – both directly and indirectly.

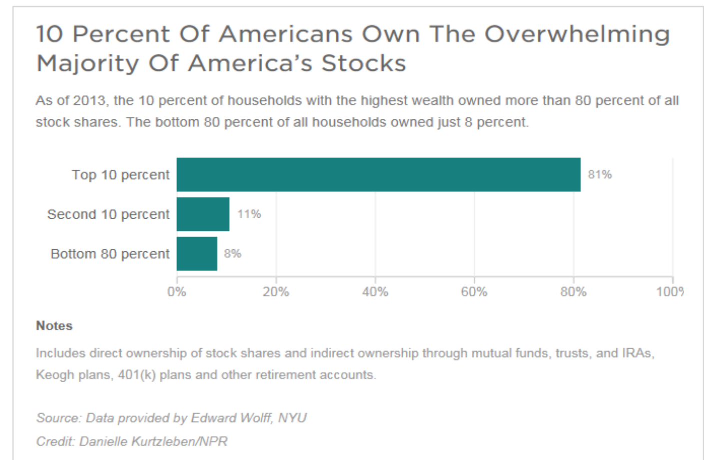
Statistics show that direct equity ownership is actually fairly concentrated, with the top 10% of Americans owning 80% of the assets. And many of those investors are likely "qualified investors", which means they can also invest in private equity and hedge funds.



Source: Fed Reserve

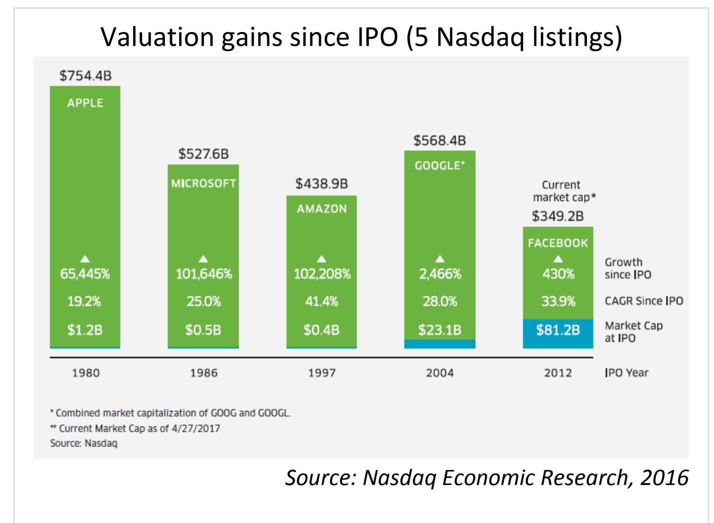
[1] Center for Capital Markets report: https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/04/IPO-Report_EXPANDING-THE-ON-RAMP.pdf

Consequently, the indirectly owned stocks are even more important to most Americans. As this $11.8tr is mostly invested in mutual funds and pension plans these naturally represent millions more Americans – many of who are veterans, retirees, teachers, nurses, firefighters, and city, state and federal workers. It's critical to their retirement security that these funds have strongest possible returns. And if we can deliver that, we will also reduce the burdens on social security in the decades ahead.



For these investors, getting growth companies into public markets is critical. That's because mutual funds are mostly restricted to invest in "listed" companies. In addition their risk and performance is measured against to established and transparent listed company benchmarks like the Nasdaq Composite or the S&P500.

But not all listed companies grow at the same rate. A recent study by Hendrik Bessembinder[2] showed that the returns from equity funds typically come from just a few high-performing stocks. For example, five Nasdaq listed companies (Apple, Microsoft, Amazon, Google and Facebook) have added more than $2.5tr to their combined valuation, and therefore the market valuation, since they IPO'd.



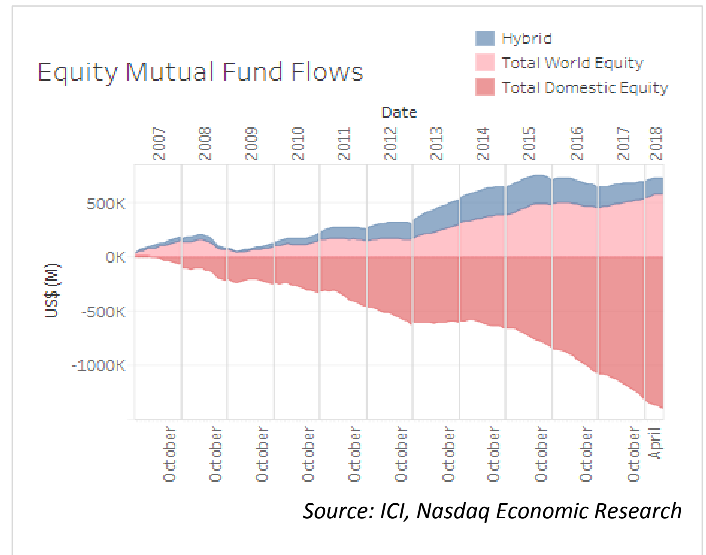
Source: Nasdaq Economic Research, 2016

For American workers to benefit from this wealth effect it's vital that US public markets are able to compete – not only with alternative forms of capital but also with other countries – to attract the best new companies from all over the world, as early in their lifecycles as possible.

[2] *Do Stocks Outperform Treasury bills?, Bessembinder, Arizona State University, May 2018*

Don't underestimate the mobility of capital

One final point I want to make about investors is that their capital is highly mobile. We are not just competing within the US for forms of investment capital – but we are also competing internationally for where companies choose to base and list themselves.



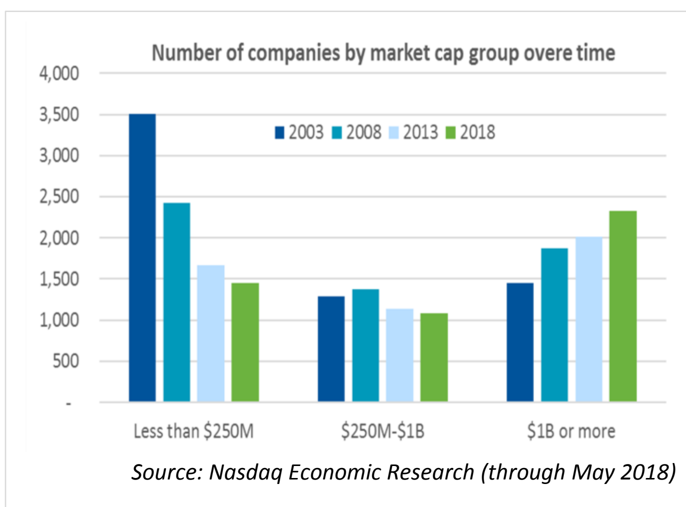
Source: ICI, Nasdaq Economic Research

What we've seen is that investors can, and in fact already are, shifting their investments offshore. We've seen US equity Mutual Fund outflows, totaling almost $1.5tr over the past 10 years. Around 1/3rd of that has been invested into international equity markets.

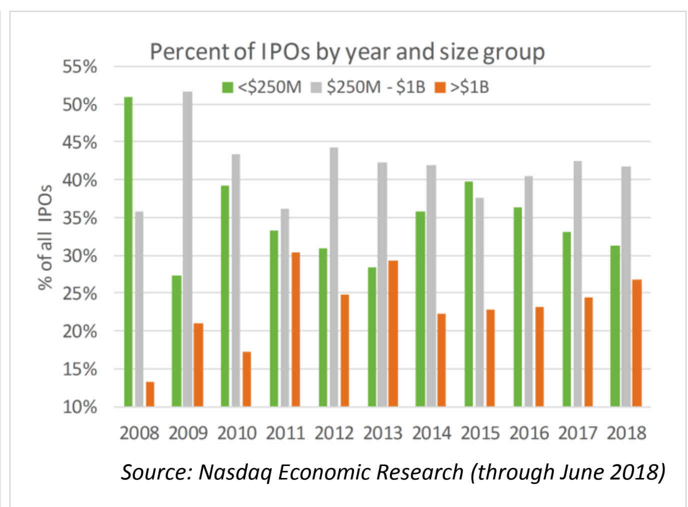
Which begins to answer the important question of "do we actually have a problem?" with attracting IPO's to list in the United States.

Data seems to show that we do:

Firstly, there is evidence that companies are choosing to stay private longer. In fact, US markets have seen growth of around 50% in the number of listed companies with market cap over $1bn. But the count of listings with a market cap ***under $250m** has **fallen*** by over 2000 (left chart below). Similarly, when we look at IPO's we see companies with less than $250m in market cap contributing a declining proportion of all IPO's, offset up an increase in larger $1bn+ IPOs (right chart below)



Source: Nasdaq Economic Research (through May 2018)

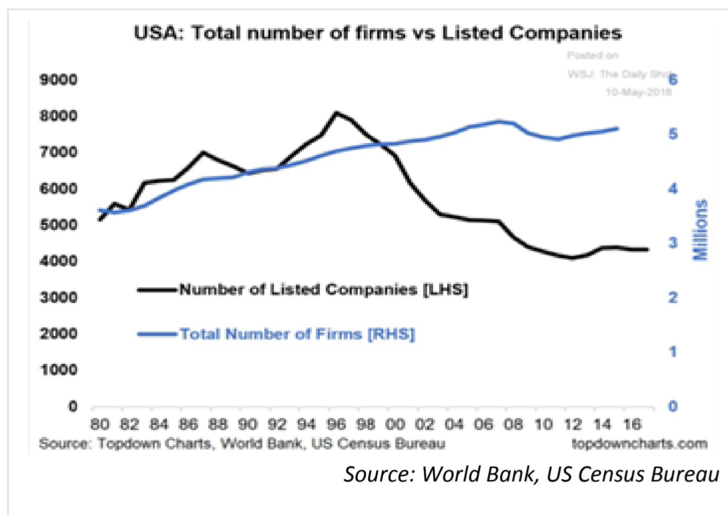


Source: Nasdaq Economic Research (through June 2018)

That's supported by a report from Vanguard which noted that microcap companies account for most of the decline in listings.

The reason this is important, is because those micro-cap companies are likely to be the ones experiencing rapid growth – which in turn means rapid gains in valuation. If we want all Americans to share in the growth of these companies, it's important that listed markets are attractive, so these stocks make their way into mutual funds at an earlier point in their life-cycle.

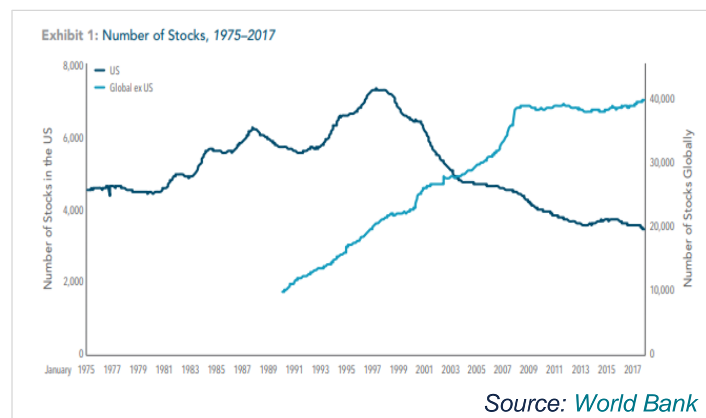
Second, this is not due to a lack of entrepreneurs. You may have also heard that 1999 was a "blip" in listed companies, caused by the tech bubble, and should not be considered normal. However data shows that the number of private companies has grown, albeit more slowly, since 1998. Over the same timeframe, listed US companies have roughly halved.



Source: World Bank, US Census Bureau

Thirdly, this is not a global phenomenon. Quite the opposite in fact.

Global data shows that over the same time that US listings have halved, offshore listings of companies have roughly doubled. This reconfirms that we are in global competition for listings.



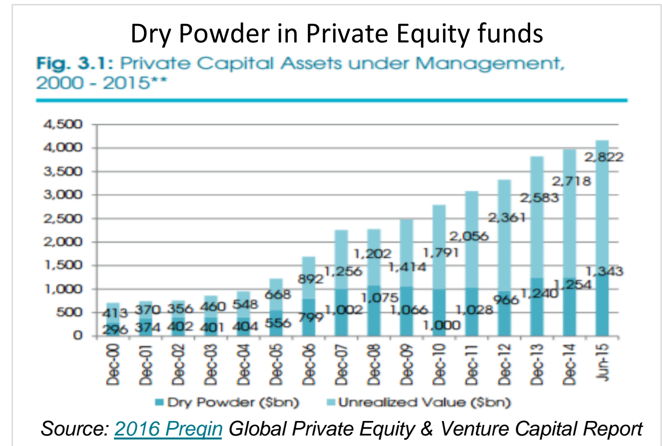
Source: World Bank

Some of you may have seen reports last week that 2018 is shaping up to be a strong year for IPO's in US markets. But that same story highlighted that many of the largest listings this year will actually be in China. It made specific mention of some companies listing in Hong Kong after the HK stock exchange loosened its listing rules around dual-class shares.

What are the reasons?

Academics and economists have suggested many reasons for the decline in US listings. Including:

- Acquisitions of small companies by larger companies
- A more highly organized and competitive Private Equity market
- Excessive regulatory burdens, often focused on Sarbanes Oxley, but also applicable to other regulations



Source: 2016 Preqin Global Private Equity & Venture Capital Report

In putting together our revitalize initiative, we talked to many of our issuers about their experiences. There were a number of common themes that deter them from, or make it more difficult to, be public.

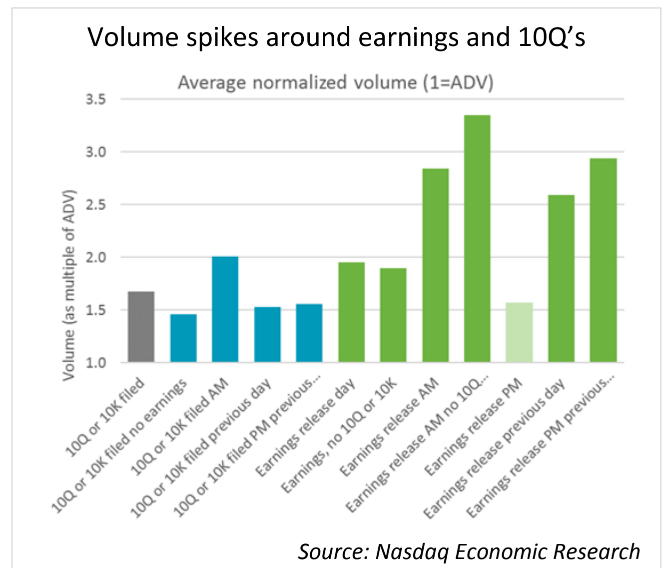
Many of them talk about the **regulatory and reporting burdens** in the United States. And in fact, you may have seen the recent letter by Jamie Dimon and Warren Buffett criticizing the short-termism of US investors[3].

Companies also highlighted the costs of shareholder proxy fights and litigation, which also distract management from growing their businesses.

In our own studies we also see that investors react more to earnings releases than the more detailed 10Q that follows, measured by the uptick in trading activity.

Not surprisingly, changes to these are among the key recommendations in our revitalize paper.

We also list a number of tax reform proposals to improve competitiveness of public listings on an after tax basis for investors.

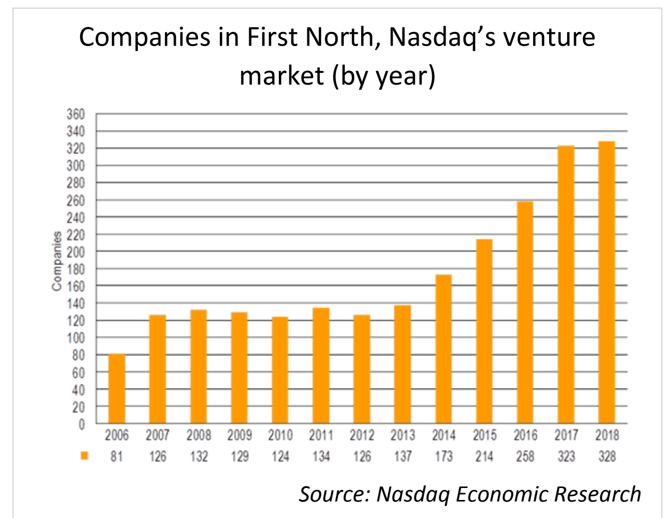


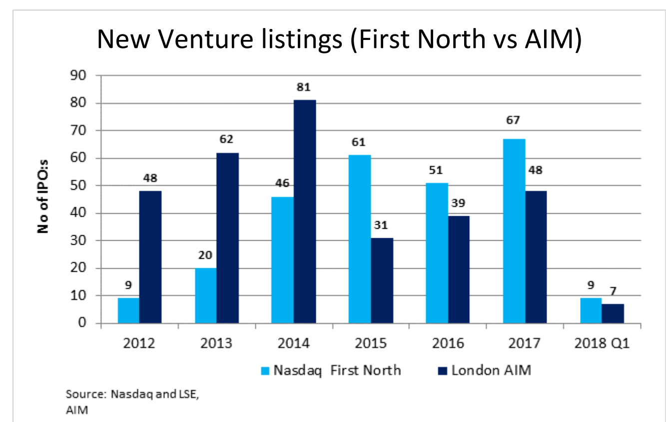
Source: Nasdaq Economic Research

But total deregulation is also not the answer

[3] Short termism is harming the Economy: https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801

Clearly, excessive regulation and costs, place the US public markets at a competitive disadvantage.





But the value that investors get from listing standards, and corporate accountability cannot be under-estimated.

The costs of those standards need to be weighed against the benefits.

An interesting example that we can draw using international experience is to compare Nasdaq's First North venture market to AIM, the UK's venture market.

Since 2006, First North listings have increased 300%. More recently First North has been listing more companies than the more established AIM market in the UK.

Why?

Regulatory uncertainty from Brexit is likely a factor. But so too, we understand, is some poor investor returns and experiences from AIM listed companies.

What do we propose for the US?

As indicated earlier, Nasdaq studied this issue over a year ago, reached out to public and private CEOs and entrepreneurs running emerging growth and high growth companies, industry experts and others to understand the roots of these problems. There is no single variable that can be changed and solve the problems. Like the well-intentioned laws and regulations that layered themselves into barriers, several policies aimed at several fronts to reduce those barriers to listing will help improve capital flows into the public markets. That includes:

- Strengthening the market trading experience for smaller companies;
- Deploy intelligent minimum price movements, or tick sizes, for small and medium growth companies;
- Cultivate innovative solutions that improve the trading of small and medium growth companies.
- Increasing the flexibility of reporting obligations;

- Enhancing transparency around activist investing;
- Equalizing short interest transparency and;
- Supporting the dual class structure that is critical to attracting the most innovative and growing companies to participate in public markets.

Conclusion

We should not ignore the fact that the US has the deepest, most liquid, and most efficient capital markets in the world. But we need to make sure that we keep it that way as competition from less regulated investment pools and other regions increases.

We appreciate the opportunity to present Nasdaq's views on a such an important topic for American investors and the economy.

Thank you Mr. Chairman and all members of the Joint Economic Committee.