Promoting Baltic Economic Growth Through IPOs

Study and Action Proposals

APRIL 2015

Nasdaq

FOREWORD /

Strengthening capital markets and making them easier for companies to access is crucial for sustained economic expansion and job creation in the Baltic countries. Economies only grow when local enterprises increase their ability to create and deliver value. That means developing products, hiring more employees, investing in production capacity and entering new markets – all of which is possible only when companies are able to raise additional capital to finance such growth. While public capital markets in the Baltic region are rather limited at present, much can be done to improve the situation.

In recent years, policymakers and experts around the world have increasingly stressed the economic importance of supporting and promoting Initial Public Offerings (IPOs), through which private companies sell shares for public trading on exchanges and so raise money to finance rapid growth. An IPO Task Force in the United States, formed by market participants in response to the government's desire to improve access to capital, in October 2011 published its groundbreaking report "Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth"[1]. The European Commission addressed conditions for IPOs amid the "equity gap" in European markets in its March 2013 Green Paper on "Long-Term Financing of the European Economy"[2]. That same year, Nasdaq Nordic launched an IPO Task Force project in Sweden[3], followed by similar projects in Finland[4] and Denmark[5] – all with the purpose of improving the climate for IPOs. And in March 2014, the Federation of European Securities Exchanges (FESE) together with other European capital market participants also launched an IPO Task Force project[6].

In the Baltic countries, too, diverse stakeholders and capital market participants have initiated discussions on the needs and possible ways to promote further development of the Baltic capital market and increase the attractiveness of IPOs. As an example, in 2012 the capital market working group of FinanceEstonia, a public-private cluster, compiled and published detailed proposals for development of the local capital markets[7].

Invariably, proposed measures focus on small and medium-sized enterprises (SMEs)[8], as they play a central role in the European economy. More than 99.5% of all European businesses are SMEs; they provide two thirds of all private sector jobs and contribute more than half of the total value added created by businesses in the EU. Interestingly, nine out of ten SMEs in the EU-27 are actually micro enterprises with less than 10 employees[9].

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[1] IPO Task Force: Rebuilding the IPO On-Ramp, October 2011 - **http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf**

[2] Green Paper: Long-Term Financing of the European Economy, March 2013 - **http://eur-lex.europa.eu/resource.html?uri=cellar:9df9914f-6c89-48da-9c53-d9d6be7099fb.0009.03/DOC_1&format=PDF**

[3] An Improved Climate for IPOs for Sweden's Growth, September 2013 - **http://www.nasdaqomx.com/digitalAssets/87/87876_ipo_actionplan_20130925.pdf**

[4] Economic Growth Through IPOs, May 2014 - **http://www.nasdaqomx.com/digitalAssets/93/93832_economic-growth-through-ipos.pdf**

[5] Recommendations for a Stronger IPO Climate for Denmark's Growth, June 2014 - **http://www.nasdaqomx.com/digitalAssets/94/94750_cph-ipo-white-paper.pdf**

[6] FESE release 17 March 2014: "New Industry Task Force to propose solutions for Europe's IPO revival" - **http://www.evca.eu/media/115303/press-release_ipo-task-force.pdf**

[7] Development Proposals for Capital Markets, December 2012 - **http://www.financeestonia.eu/wp-content/uploads/2013/05/FinanceEstonia-development-proposals-for-capital-markets-.pdf**

[8] The category of micro, small and medium-sized enterprises consists of enterprises which employ fewer than 250 persons and which have either an annual turnover not exceeding 50 million euros, or an annual balance sheet total not exceeding 43 million euros - **http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf**

[9] EU SMEs in 2012: At the crossroads. Annual report on small and medium-sized enterprises in the EU, 2011/12, European Commission, 2012 - **http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2012/annual-report_en.pdf**

The Baltic economies are even more tilted toward SMEs, which constitute 99.8% of all enterprises, employ 78% of all job-holders and generate 70% of total value added[10]. Thus, supporting growing companies and securing their access to funding is crucial to employment and overall economic performance here.

The regional capital market's potential to channel financing to Baltic companies needs to be leveraged to a much greater extent. With the aim of producing a wider problem analysis and a list of measures for improving the IPO climate in the Baltic region, Nasdaq's exchanges in Tallinn, Riga and Vilnius ("Nasdaq Baltic" or "the Exchange") engaged representatives of the business and investor community in broad discussions. This report summarizes the key findings.

When reviewing the list of proposed actions, it is important to keep in mind that truly invigorating the regional capital market will require more than just a few isolated and relatively "soft" measures. Getting substantial results demands measures that are powerful and long-term, and that simultaneously support market offer and demand in a coordinated way. We sincerely hope that this report will lead to the type of real actions that can put the Baltic IPO market back on the path to growth – with all the positive effects that would bring for the local economies.

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[10] The SME Performance Review, European Commission - **http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/**

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THE BALTIC CAPITAL MARKET /

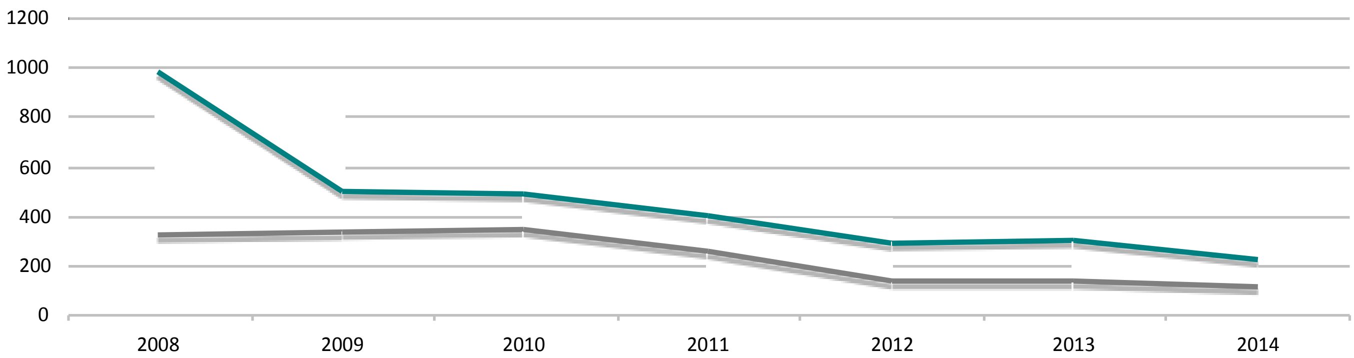
For more than 20 years, Nasdaq Baltic has played an important role in helping companies get both equity and debt financing to fund further growth and create jobs in the process. The Exchange maintains a regulated, open and efficient market infrastructure. It strives to be an efficient channel for companies to raise capital and to facilitate the participation of institutional and private investors in primary offerings and secondary trading.

In the early 1990s, the Baltic countries began rapid mass privatization of state property. The first rounds of privatization ended successfully in 1993-1994 and resulted in broad public ownership of equity instruments. That in turn was the main driver behind the establishment of the three Baltic stock exchanges once the first laws on securities markets were adopted. The Vilnius Stock Exchange opened for trading in September 1993, followed by the Riga Stock Exchange in July 1995 and the Tallinn Stock Exchange in May 1996.

During its first years the Exchange was quite active. It was attractive for both investors and issuers because there were few alternative financing sources or investable products. The banking system was weaker than today and investment funds less developed. So to get access to funding, companies listed their shares. Over time, however, strategic investors began to appear and conduct takeovers. Since they especially looked for transparency and management openness, many of the companies they took over and later delisted were among retail investors' favorites: Hansapank, Eesti Telekom, Mazeikiu Nafta, and others.

The Baltic market again had a very active period in 2005-2008, with more than 10 IPOs attracting some 500 million euros of new capital, including about 70 million euros from retail investors. But this momentum faded after the market decline in 2008. Trading volumes also fell in part due to delistings of flagship stocks. Thus in recent years the Baltic IPO market has dried up and figures for overall trading show a strong downward trend.

Baltic Equity Trading 2008-2014



	2008	2009	2010	2011	2012	2013	2014
TURNOVER, MEUR	978	495	488	401	282	302	224
TRANSACTIONS, TH	321	329	336	252	134	136	115

Statistics reveal the untapped potential of the Baltic capital market. At the end of 2013, equity market capitalization was 10.2% of GDP in Estonia, 4.2% in Latvia and 8.4% in Lithuania. Comparable figures are over 51% for the Euro Area and 75% for the world[11]. Equity turnover of 1% of GDP in Estonia, 0.1% in Latvia and 0.3% in Lithuania compares with more than 40% in the Euro Area and 70% worldwide[12].

[11] The World Bank, 2012 data (5.4 World Development Indicators, Stock Market)

[12] *Ibid*

In order to boost market activity and visibility, Nasdaq Baltic has worked continuously to develop the Baltic market as a regional marketplace. The core idea is to attract more investments to the region by presenting the Baltic market as a joint marketplace and facilitating easy cross-border trading and settlement. This includes implementing the same INET Nordic trading system, interlinking settlement systems and harmonizing rules and market practices. The aim is to reduce the costs of cross-border trading here. It is about helping foreign investors save time and money in getting familiar with the marketplace and ensuring compliance with the rules.

We find it important to continuously increase the visibility of Nasdaq Baltic and local capital markets in the media (including digital media), and continue cooperation with market participants to build public awareness of the benefits of a vibrant capital market and single investment space.

Also, we need to gain support from key stakeholders, particularly governments, policymakers and second-pillar pension fund managers. Wide public support is needed to stimulate important decisions regarding, for example, initial and secondary offerings by state-owned enterprises (SOEs), new listings, better corporate governance, and increased local investments.

In this context, a group of measures is proposed for implementation together with market participants, public authorities and legislators.

ISSUER-TARGETED MEASURES /

Public awareness and perceptions of listing

A key challenge in the development of the Baltic market is the limited supply of listed companies. The more listed companies there are on a market, the more attractive it is for investors. Factors that may reduce the attractiveness of listing include potential issuers' fears of facing an increased administrative burden and more public scrutiny.

Many in the Baltics, especially small and medium-sized enterprises, dislike the idea of public attention and being in the spotlight. Entrepreneurs worry about disproportionately negative media coverage. Market participants can help the media to focus more on positive aspects of the securities market. More attention can be drawn to the important roles that capital markets play in allocating capital, promoting growth, creating jobs, and increasing wealth through long-term savings.

Much can be done to improve perceptions of what it means to go public and of listed companies in general. Market participants need to work systematically and in concert to build a positive image of publicly listing securities. Every effort should be made to maximize publicity regarding successful listing candidates, whose positive example can serve as a role model for the entire market.

Necessary actions:

- Build companies' awareness that going public helps companies grow and create jobs, increase visibility and brand value.
- Arrange roundtable meetings with media representatives to strengthen their understanding of the benefits of having a vibrant regional securities market.
- Recognize active promoters of Baltic market during annual Baltic Market Awards ceremony.

Attracting private companies

In the Baltics there are many companies that are suitable for listing. The main task for the Exchange is to boost knowledge and awareness among the owners and managers of potential issuers. This is currently done mostly through private meetings, but also via articles in the media, seminars, financial market conferences and so on. Such efforts are important to address the many remaining myths, fears and misunderstandings, and also because the banking sector's current dominance as a source of financing in the Baltics overshadows alternative solutions, which may not be noticed unless attention is drawn to them.

The owners and managers of potential issuers need to be better informed about the full range of instruments that can be listed. Depending on a company's capital structure and financing needs, the optimal solution can vary and needs to be thoroughly analyzed. The possibility of listing corporate bonds is often overlooked, though that can give companies valuable experience in the listing of fixed-term securities before a potential equity offering.

Private companies' attitudes are also affected by the actions and rhetoric of the Baltic governments. In developing markets, the state is often seen as a role model. The listing of treasury bonds as well as shares and bonds of SOEs has a strong supportive effect in encouraging private companies to go public. In Latvia, for example, a long history of issuing government bonds led to the emergence of an active market for corporate bond issuers. In Estonia, this is unfortunately not the case. Despite a rather active corporate bond market there in the early 2000s, there is no activity at the moment. Efforts need to be made to motivate private companies to issue quality bonds, but these efforts might need to go hand in hand with certain changes in the taxation of interest income in Estonia (addressed further below).

To provide Baltic growth companies with easier access to capital markets, Baltic exchanges have established alternative market First North Baltic, which is a multilateral trading facility (unregulated market) with lighter rulebook and price list. Starting 2015, also corporate bonds can be admitted to trading on First North Baltic market.

Necessary actions:

- Ensure sufficient collaboration between Nasdaq Baltic and other stakeholders (incl. government agencies) to support SME growth using capital markets (incl. co-funding capital raising, covering the initial listing costs, etc.).
- Initiate discussion and closer cooperation with private equity, risk capital and angel investors to encourage them to exit from investments through the Exchange or First North Baltic.
- Raise awareness about the First North Baltic bond market, which offers SMEs a more cost-effective tool for attracting additional financing.

Investor relations and good corporate governance

Various measures are needed to further encourage good corporate governance (CG) and high quality investor relations. Listed companies need help to better understand how active and open investor relations positively influence company value. The Baltic Market Awards competition, which each year recognizes the companies with the best investor relations, is one way Nasdaq Baltic encourages issuers to participate in local and international investor events, arrange webinars and meetings with investors, and take other steps in this area.

The Exchange has prepared information disclosure guidelines for issuers and should continue such efforts. Guidelines and pre-designed templates as well as webinar and annual general meeting services all make it easier for issuers raise the level of their investor relations and openness.

Special efforts need to be made to assist issuers who entered the market as a result of the mass privatization of state property and have not yet recognized the benefits of active investor relations. Being listed mainly for historical reasons, they sometimes feel trapped and have little interest in establishing or further developing investor relations.

Necessary actions:

- Analyze the current corporate governance practice of listed companies. Review corporate governance codes in all Baltic countries, seeking to improve the quality and real value of companies' CG reports.
- Explain the importance of good corporate governance practices during individual meetings with companies and through the media.
- Prepare additional guidelines and templates for issuers and increase efforts to help educate issuers, ensuring a steady flow of information during good times as well as bad times.
- Promote webinars as one of the most convenient and accessible tools for issuers to directly communicate with all interested investors on a regular basis.

Attracting SOEs

There are many high-quality state-owned enterprises (SOEs) in the Baltics that are eligible for listing. For governments it would seem reasonable to exit from non-strategic activities via full or partial sale or a gradual increase of the free float. Some SOEs that are already listed have quite small free floats which will need to be increased via public offerings in the future in order to facilitate more active trading.

Without doubt, the listing of SOEs must be preceded by thorough analysis and the development of proper investment cases. Some SOEs might require restructuring or reorganization to segregate assets and diverse operations. And some SOEs may need changes in their corporate governance or the adoption of new policies to ensure protection of the interests of minority investors.

The listing of shares of larger SOEs would greatly help to enliven the Baltic stock market because such shares, if floated to a sufficient extent, tend to attract not only local but also foreign institutional and retail investors. There is strong existing demand, including from regional and local pension funds, that needs to be matched with offers of attractive investment targets.

In order to reinvigorate the regional bond market, governments can also encourage SOEs to refinance some existing debt through public bond issues. A recent good example is the fully state-owned Latvian company Latvenergo, which issued and listed bonds on the Nasdaq Baltic bond market. There is demand for such bonds and repeated issues would transform the bond market into a true alternative financing source for both SOEs and private companies.

Necessary actions:

- Include listing of state-owned companies' shares and the gradual increase of the free floats of already listed SOEs as goals in the State ownership policy.
- Encourage SOEs to be more active on the bond market. Review the current financing options of SOEs and promote public issues of corporate bonds to reduce pressure on the state budget and to provide local investors with more diversified investment opportunities into domestic economies.
- Use public bond issues to finance large strategic infrastructure projects (roads, railways, ports, etc.) and to accomplish these projects sooner.

Issuing and listing government bonds in Estonia

Bond markets in Latvia and Lithuania benefit from the presence of listed government bonds. Issuing Estonian government bonds, especially via public offering, would be a very powerful step toward reviving the bond market in that country, as well.

Government bonds define a "risk-free" rate of return that is used for the evaluation of other financial assets in a country. If the risk-free rate of return cannot be determined based on market instruments, as in the case of Estonia at present, then parties are forced to use estimates, which often result in undervaluing of financial assets.

Government bonds would also increase the currently very limited offering of suitable domestic long-term investment instruments in Estonia. They would make it possible to put long-term local savings, including second-pillar pension funds and the savings of private persons, in the highest quality domestic asset class.

Necessary actions:

- Reassess the alternatives for financing state investments and facilitating further economic growth, considering possibilities offered by the regional capital market.
- Undertake a study of the potential benefits of issuing government debt in Estonia, including the impact of replacing existing bank loans with listed government bonds, of using such bonds to attract retail savings and institutional money, etc.

Attracting foreign issuers, dual listing

The presence of more and diverse companies makes it more attractive to trade on an exchange. Nasdaq Baltic's attractiveness could be enhanced by listing foreign companies.

The Exchange can screen potential listing candidates and actively offer secondary listings to foreign companies that have shareholders or operations in the Baltics countries. Secondary listings in the Baltics also need to be proposed to local companies that have stated their intention to list outside of the region.

Additionally, there are potential issuers from non-EU regions that see the Baltics as a point of entry to the EU financial markets (for tax-related, language skills or other reasons). Certain European issuers may also view Nasdaq Baltic as a suitable venue for a euro-based listing, since trading and settlement in euros would reduce the currency risk for certain investor groups. Here, the ease of technical and regulatory access is the key.

Necessary actions:

- Promote secondary (EUR) listing of foreign listed companies on the Baltic market.
- Find solutions to the clearing and settlement issues that may arise if securities are kept outside of the Baltic CSDs.

Reducing listing barriers

The amount and complexity of regulations with which listed companies must comply are constantly increasing. It can be challenging for an individual listed company to keep track of all the norms that currently apply to its operations. Regulations need to be more transparent and simple to understand.

Each additional requirement can be seen as a serious burden in the Baltic market, given its limited size. Yet, there have been certain cases in the Baltics, where local legislation is even more demanding than EU regulations.

The difficulties and costs of adopting International Financial Reporting Standards (IFRS) are among the biggest challenges potential issuers perceive. Implementing IFRS requires a lot of work and increases listing costs because private companies usually do not yet have the type of institutional infrastructure that IFRS demands. The European Commission, in its current review of the impact of IFRS in the EU, will also consider limitations for IFRS application and the introduction of "IFRS Light" – simpler standards for small and medium-sized businesses. In practice, "IFRS Light" would reduce the obligations for smaller companies to disclose reference data.

A listing handbook and checklist that clearly outline the requirements for each phase of the listing process could benefit companies considering going public and advisers. The handbook could also clarify and give examples of some Prospectus Directive interpretations and risk description requirements. That would make drafting a prospectus quicker and more efficient for all involved parties by resolving issues of interpretation, since the content and scope of a prospectus are affected both by regulations and established market practices. Note that smaller companies looking to go public have difficulty finding cost-efficient consulting services. And smaller IPOs are relatively more expensive. Clarifying and standardizing the listing process would reduce the costs of going public, and so make IPOs more financially reasonable for smaller companies.

Another important listing barrier is the decreasing number or even lack of active advisers and investment bankers in the region. Knowledge and experience deteriorate when IPOs are few and far between, making it more difficult and costly to carry out a successful IPO.

Necessary actions:

- Ensure that local listing and disclosure requirements are in line with EU standards and use the opportunity to remove extra requirements from local legislation where appropriate from the legal and investor perspective.
- Ensure close cooperation between the Exchange and local supervisory bodies in order to facilitate common interpretation of the rules and develop detailed guidelines for issuers.
- Streamline listing process by standardization of services and documentation to make the listing process smoother and less resource-intensive for smaller companies.

Reporting and disclosure

Exchange rules currently require issuers to publish quarterly financial reports even when local laws require only semiannual interim reporting. Considering the European initiatives to lighten reporting requirements and review the Transparency Directive, thought should be given to reducing the costs and workload necessary to prepare quarterly reports. The format for presenting the reports could be made shorter and lighter. For smaller companies, the requirement for quarterly reports might even be eliminated, replacing them with an interim management statement. Companies that trade on the First North market are already allowed to report on a semiannual basis only.

Changing the established practice would require some management of investor expectations to ensure that neither the market nor specific companies become less attractive. Investors generally prefer more frequent (quarterly) reporting by listed companies, seeing this also as related to liquidity and insider trading. In any case, issuers need to provide clear and accurate information to the market. If this can be done in a more time- and cost-efficient manner than at present, the Exchange would welcome the development.

A new equilibrium between the interests of issuers and investors also might need to be found regarding the language in which information is disclosed. In companies that operate internationally, English is often the primary working and internal reporting language. Giving such companies the option to choose English as their single disclosure language would reduce their administrative burden without causing inconveniences for regional investors. At present, foreign issuers can be exempted from the bilingual disclosure requirement on certain grounds, but this does not apply to local issuers. The possibility of allowing English as a single disclosure language should be analyzed.

Necessary actions:

- Consider amending regulations regarding reporting frequency and disclosure language (English as a single disclosure language), paying careful attention to market practices and finding the balance between the interests of issuers and investors.
- Arrange regular issuer trainings and discussions related to disclosure requirements and practices.

INVESTOR-TARGETED MEASURES /

More developed marketplaces have a broad-based investor culture that serves as a strong foundation for attracting companies, including SMEs, to list. Active involvement of local investors is also something that increases interest in a market among foreign players. Thus measures that target investors are an important part of what is needed to further develop the Baltic market. The focus of many of the proposed measures is to increase liquidity (e.g., through a liquidity provider program and by attracting institutional investors) and to boost visibility (e.g., by getting Baltic shares included in widely recognized indices).

The local retail investor base

Domestic share ownership in the Baltics is concentrated among a few large strategic investors, with a small base of medium-sized investors and a wide range of micro-investors. Most investments by Baltic private investors in domestic shares are rather small and undiversified. Tallink Grupp, for example, has about 11,200 shareholders, but more than 10,500 of them have holdings of less than 1000 euros each, which combined amount to only 3% of all shares. Similarly, Ventspils Nafta has about 18,100 shareholders, but the value of holdings is below 1000 euros for more than 17,900 of them, who together own only 0.8% of the company.

The retail investment culture is very weak in the Baltics for a number of reasons, including historical experience, lack of knowledge and levels of income. People do not have the habit of investing in shares or other financial instruments. They tend to prefer bank deposits as the main tool for saving – partly due to the safety mechanisms that protect deposit owners.

Negative experiences during economic and financial crises, bankruptcies of listed issuers and credit institutions, and even the violations of the rights of minority shareholders years ago during mass privatization have all contributed to discouraging retail investors and creating a certain distrust of capital markets.

The Exchange thus needs to focus on education and changing habits. Frequent investment fairs should be organized, and seminars and lectures held, to form the next generations of potential investors. Also, tax incentives and additional investor protection measures (e.g. improved Corporate Governance Code) are needed to increase motivation with regard to long-term investment.

Finally, retail investors have very limited access to the statistical data and investment research products they need to support informed investment decisions. Together with market participants, the Exchange can improve public access to such information.

Necessary actions:

- Build public awareness of the benefits of long-term investment and support the development of an investment culture at the regional level; organize investment fairs, student lectures and seminars.
- Facilitate easier public access to research products and statistical data regarding the financial performance of issuers.
- Expand the range of financial instruments available to retail investors in order to broaden investment opportunities. Saving notes in Latvia and Lithuania are a very good example.
- Explore the possibility to improve liquidity by facilitating lending/borrowing and short selling of listed securities.
- Encourage issuers to launch stock programs for their employees as a way to promote investing and create a culture of share ownership.
- Encourage companies to adopt and announce dividend policies in order to improve the predictability of returns and thus attract more investors.

The international retail investor base

The international retail investor base depends heavily on international brokerages and their access to the Baltic market. Currently, remote members' total market share on the Baltic market is about 5% which, combined with the limited activity on the market, does not justify putting additional resources into promotion of the Baltic market among their retail clients.

Nasdaq Nordic has made Baltic issuer and trading data available through existing Nordic data distribution channels, including the Nordic market website and data-vendor network. Disclosures published by Baltic issuers are disseminated through the same channels, making it very easy for Nordic investors to get information about the Baltic market. Additional efforts can be made to provide international investors with higher value-added data.

The activity of international retail investors depends heavily on the ease and cost-efficiency of access to our marketplace, as well as on its liquidity and the number and quality of new listings.

Necessary actions:

- Promote the Baltic market and issuers more actively at Nordic investor events and elsewhere.
- Provide remote members and international retail investors with easier access to online market information and research products.
- Promote developing better access to trading through technical solutions provided by market participants (e.g., via internet banks or similar environments).

The local institutional investor base

Pension funds are the largest single investor group in the Baltics and continue growing, with second-pillar pension funds now managing more than 6 billion euros[13]. Yet their investments in domestic assets are significantly smaller than those made by pension funds and foundations in neighboring countries. Calculations and estimates show that the average share of the home market in pension funds' asset allocation was 6% in Estonia and less than 1% in Latvia and Lithuania in mid-2014. Reasons for this vary, including the small size of our capital market, easy access to global markets and the outsourcing of fund management decision-making. But the result is an increased vulnerability of the regional market due to an almost total absence of local institutional investors.

Experience shows that fund managers, seeking cost-efficiency, often centralize decision-making outside the Baltics. That in turn results in significantly lower allocations to the home market than for funds that are managed locally. In this respect, an effort should be made to bring pension funds' decision-making back to the Baltics as a way to help increase investments into the Baltic capital market. In addition, pension fund managers should be discouraged from using passive investment strategies, practicing indirect investment or acting as a fund of funds.

Historically, many countries have placed restrictions on foreign investments by their pension funds, one of the aims being to support the local economy. In the past 10 years, these restrictions have been reduced in European Union countries in order to guarantee the free movement of capital, but despite liberalization, pension funds still have a strong home bias. This is not the case in the Baltics, as the vast majority of our pension investments are made outside the Baltics.

Necessary actions:

- List and/or increase the free floats of large, well-performing SOEs to provide institutional investors with quality assets that match their risk profile.
- Encourage making pension fund management decisions locally, providing regulatory support and positive examples. Promote implementation of active investment strategies and stock picking by fund managers; encourage wider analyst coverage of Baltic issuers.

[13] **http://www.pensionikeskus.ee/**, **http://www.manapensija.lv/**, **http://www.lb.lt/**

The international institutional investor base

The percentage of Baltic shares owned by foreign shareholders is very high by international standards, partly due to the small size of our economies. About 40% of the shares issued by Estonian listed companies are under foreign ownership[14]. The largest portion - about 11% - belongs to residents of Luxembourg (mostly institutional investors). According to unofficial calculations, about 50% of Latvian and 25% of Lithuanian listed shares belong to foreign residents[15]. The vast majority of capital attracted during Baltic IPOs over the past decade came from international institutional investors.

International institutional investors set high requirements for the liquidity of a marketplace. There have to be enough solid and sizeable companies on the market as well as sufficient market depth and velocity to facilitate entry and exit. Easy and cost-efficient access to the market and reasonable custody services are also important factors.

Necessary actions:

- List and/or increase the free floats of large, well-performing SOEs to provide institutional investors with quality assets that match their risk profile.
- Create additional links with foreign CSDs (including Clearstream and Euroclear) in order to facilitate easier access to the Baltic capital market and seamless cross-border transactions.
- Cooperate with Baltic members and issuers to actively organize and participate in road-shows and investor events, organize Baltic road-shows for foreign investors to visit companies and meet management on-site.

Taxation

Countries with well-developed capital markets (e.g. Sweden, Great Britain and the United States) use a wide variety of tax incentives to encourage the participation of different types of investors in the public market. If targeted tax incentives are valuable in these places, they are even more necessary to help the Baltic capital market develop beyond its current limited level. The existing foreign models offer a good starting point for local policymakers to prepare and implement suitable legal amendments. Well-designed and precisely targeted tax incentives would help to reduce market barriers and significantly boost market activity.

A priority should be to encourage long-term retail investments by private persons. Therefore, tax incentives should be limited to long-term minor holdings (stakes of no more than 5-10% that are held for at least 1-3 years). The set of incentives could include a non-taxable minimum and/or a lower tax rate on investment-related income – capital gains, interest income and dividends.

Taxation of retail investors currently varies among the Baltic countries:

- The capital gains tax is 20% in Estonia and 15% in both Latvia and Lithuania, but:
  - In Estonia, incurred capital losses can be carried forward indefinitely to be deducted from future capital gains. In addition, Estonia allows those holding investment accounts to defer paying taxes on accumulated gains until the gains are taken out of the investment account.
  - In Latvia, losses realized in one tax year cannot be set off against capital gains in subsequent tax years.
  - In Lithuania, a non-taxable minimum of 3000 euros is applicable to gains from sales of financial instruments starting January 1, 2014. At the same time, two tax exemptions were eliminated – tax exemption of sales of shares and securities obtained before 1999 and tax exemption of sales of shares, securities and derivatives obtained after 1999, held in ownership for more than 1 year and constituting less than 10% of a company's share capital for 3 years prior to sale.
- Interest income is taxed at 20% in Estonia, 10% in Latvia and 15% in Lithuania, but:
  - In Estonia, interest income is tax-exempt if received from a credit institution resident in any country of the European Economic Area (EEA).
  - In Lithuania, a non-taxable minimum of 3000 euros is applicable to interest income starting January 1, 2014.

[14] **http://statistics.e-register.ee/et/investments/**

[15] Calculations by Nasdaq Baltic (as of Oct 31, 2014 in Latvia and June 30, 2014 in Lithuania)

- The dividend income from resident company is taxed at 0% in Estonia, 10% in Latvia and 15% in Lithuania, but:
  - In Estonia, a dividend from an Estonian resident company is tax exempt only if the company has paid the profit distribution tax (20/80 of the total net dividend amount).

As an additional measure to improve the tax climate, procedures for retail investors to declare investment-related income need to be reviewed and simplified. Pre-filled declarations should be provided and reporting timelines loosened. As an example of current complexity, in Latvia the frequency with which tax declarations must be submitted depends on the amount of capital gains[16]:

- monthly, if capital gains exceed EUR 711.44 per month;
- quarterly, if capital gains are between EUR 142.30 and EUR 711.44 per month;
- annually, if capital gains are less than EUR 142.29 per month

The declaration deadline is the 15th calendar day of the next period (month/quarter/year) and the tax amount must be paid within 15 days after submitting the declaration. Easing such strict and complex requirements would encourage investors to be more active and, as a result, over time would increase state revenues.

The application of any additional taxes (e.g. financial transaction tax) on investment activities needs to be avoided. Additional taxes raise the cost level for investors and decrease market attractiveness, thus having destructive effect on developing capital market and financing opportunities of SMEs. Tax environment needs to be kept as homogeneous as possible in the Baltic region and local tax anomalies must be avoided.

Necessary actions:

- Fully reform the taxation principles for investment-related income in order to encourage long-term investment by retail investors. Tax incentives should be limited to long-term minor holdings (stakes of no more than 5-10% that are held for at least 1-3 years) and consist of a non-taxable minimum and/or a lower tax rate.
- Amend dividend taxation legislation to encourage the payment of dividends to minority holders of listed companies, at least during a period of 3-5 years after a company goes public.
- Introduce an “investment-account” tax regime also in Latvia and Lithuania or, alternatively, allow capital losses to be carried forward indefinitely for deduction from future capital gains.
- In Estonia, tax interest income on listed corporate bonds on the same terms as interest income from EEA credit institutions; otherwise corporate bonds are not able to compete with deposits and debt instruments provided by banks.
- In Latvia, replace the current complex requirement for monthly/quarterly/annual tax declarations with only annual declarations in order to decrease the administrative burden on local retail investors. To the extent possible, declarations should be pre-filled using transaction data from the Baltic market.
- Promote the idea that at least part of income invested for the long term in publicly traded instruments in the country/region should be deductible from taxable income (as per the taxation principles of Estonia’s third pension pillar).
- Participate actively in all activities aimed to oppose the implementation of a financial transactions tax (FTT).

[16] http://www.ablv.com/en/legal/income-tax

SUMMARY OF NECESSARY ACTIONS /

The table below indicates whether proposed measures can be implemented through the Exchange or require broader action at the regional level.

ACTION POINTS	REGIONAL LEVEL	EXCHANGE LEVEL
ISSUER-TARGETED MEASURES		
Public awareness and perceptions of listing		
Build companies' awareness that going public helps companies grow and create jobs, increase visibility and brand value.	X	
Arrange roundtable meetings with media representatives to strengthen their understanding of the benefits of having a vibrant regional securities market.		X
Recognize active promoters of Baltic market during annual Baltic Market Awards ceremony.		X
Attracting private companies		
Ensure sufficient collaboration between Nasdaq Baltic and other stakeholders (incl. government agencies) to support SME growth using capital markets (incl. co-funding capital raising, covering the initial listing costs, etc.).	X	
Initiate discussion and closer cooperation with private equity, risk capital and angel investors to encourage them to exit from investments through the Exchange or First North Baltic.	X	
Raise awareness about the First North Baltic bond market, which offers SMEs a more cost-effective tool for attracting additional financing.		X
Investor relations and good corporate governance		
Analyze the current corporate governance practice of listed companies. Review corporate governance codes in all Baltic countries, seeking to improve the quality and real value of companies' CG reports.	X	
Explain the importance of good corporate governance practices during individual meetings with companies and through the media.		X
Prepare additional guidelines and templates for issuers and increase efforts to help educate issuers, ensuring a steady flow of information during good times as well as bad times.		X
Promote webinars as one of the most convenient and accessible tools for issuers to directly communicate with all interested investors on a regular basis.		X
Attracting SOEs		
Include listing of state-owned companies' shares and the gradual increase of the free floats of already listed SOEs as goals in the State ownership policy.	X	
Encourage SOEs to be more active on the bond market. Review the current financing options of SOEs	X	

ACTION POINTS	REGIONAL LEVEL	EXCHANGE LEVEL
and promote public issues of corporate bonds to reduce pressure on the state budget and to provide local investors with more diversified investment opportunities into domestic economies.		
Use public bond issues to finance large strategic infrastructure projects (roads, railways, ports, etc.) and to accomplish these projects sooner.	X	
Issuing and listing government bonds in Estonia		
Reassess the alternatives for financing state investments and facilitating further economic growth, considering possibilities offered by the regional capital market.	X	
Undertake a study of the potential benefits of issuing government debt in Estonia, including the impact of replacing existing bank loans with listed government bonds, of using such bonds to attract retail savings and institutional money, etc.	X	
Attracting foreign issuers, dual listing		
Promote secondary (EUR) listing of foreign listed companies on the Baltic market.		X
Find solutions to the clearing and settlement issues that may arise if securities are kept outside of the Baltic CSDs.		X
Reducing listing barriers		
Ensure that local listing and disclosure requirements are in line with EU standards and use the opportunity to remove extra requirements from local legislation where appropriate from the legal and investor perspective.	X	
Ensure close cooperation between the Exchange and local supervisory bodies in order to facilitate common interpretation of the rules and develop detailed guidelines for issuers.	X	
Streamline listing process by standardization of services and documentation to make the listing process smoother and less resource-intensive for smaller companies.		X
Reporting and disclosure		
Consider amending regulations regarding reporting frequency and disclosure language (English as single disclosure language), paying careful attention to market practices and finding the balance between the interests of issuers and investors.	X	
Arrange regular issuer trainings and discussions related to disclosure requirements and practices.		X
INVESTOR-TARGETED MEASURES		
The local retail investor base		
Build public awareness of the benefits of long-term investment and support the development of an investment culture at the regional level; organize investment fairs, student lectures and seminars.	X	
Facilitate easier public access to research products and statistical data regarding the financial		X

ACTION POINTS	REGIONAL LEVEL	EXCHANGE LEVEL
performance of issuers.		
Expand the range of financial instruments available to retail investors in order to broaden investment opportunities. Saving notes in Latvia and Lithuania are a very good example.	X	
Explore the possibility to improve liquidity by facilitating lending/borrowing and short selling of listed securities.	X	
Encourage issuers to launch stock programs for their employees as a way to promote investing and create a culture of share ownership.		X
Encourage companies to adopt and announce dividend policies in order to improve the predictability of returns and thus attract more investors.		X
The international retail investor base		
Promote the Baltic market and issuers more actively at Nordic investor events and elsewhere.	X	
Provide remote members and international retail investors with easier access to online market information and research products.	X	
Promote developing better access to trading through technical solutions provided by market participants (e.g., via internet banks or similar environments).	X	
The local institutional investor base		
List and/or increase the free floats of large, well-performing SOEs to provide institutional investors with quality assets that match their risk profile.	X	
Encourage making pension fund management decisions locally, providing regulatory support and positive examples. Promote implementation of active investment strategies and stock picking by fund managers; encourage wider analyst coverage of Baltic issuers.	X	
The international institutional investor base		
List and/or increase the free floats of large, well-performing SOEs to provide institutional investors with quality assets that match their risk profile.	X	
Create additional links with foreign CSDs (including Clearstream and Euroclear) in order to facilitate easier access to the Baltic capital market and seamless cross-border transactions.		X
Cooperate with Baltic members and issuers to actively organize and participate in road-shows and investor events, organize Baltic road-shows for foreign investors to visit companies and meet management on-site.	X	
Taxation		
Fully reform the taxation principles for investment-related income in order to encourage long-term investment by retail investors. Tax incentives should be limited to long-term minor holdings (stakes of no more than 5-10% that are held for at least 1-3 years) and consist of a non-taxable minimum and/or a	X	

ACTION POINTS	REGIONAL LEVEL	EXCHANGE LEVEL
lower tax rate.		
Amend dividend taxation legislation to encourage the payment of dividends to minority holders of listed companies, at least during a period of 3-5 years after a company goes public.	X	
Introduce an “investment-account” tax regime also in Latvia and Lithuania or, alternatively, allow capital losses to be carried forward indefinitely for deduction from future capital gains.	X	
In Estonia, tax interest income on listed corporate bonds on the same terms as interest income from EEA credit institutions; otherwise corporate bonds are not able to compete with deposits and debt instruments provided by banks.	X	
In Latvia, replace the current complex requirement for monthly/quarterly/annual tax declarations with only annual declarations in order to decrease the administrative burden on local retail investors. To the extent possible, declarations should be pre-filled using transaction data from the Baltic market.	X	
Promote the idea that at least part of income invested for the long term in publicly traded instruments in the country/region should be deductible from taxable income (as per the taxation principles of Estonia’s third pension pillar).	X	
Participate actively in all activities aimed to oppose the implementation of a financial transactions tax (FTT).	X	

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