Financial regulation: first quarter 1999

1. INTRODUCTION

Unlike the previous quarter, the promulgation of financial regulations was relatively more moderate during the first quarter of 1999.

With regard to credit institutions, their accounting standards have been updated to take into account some of the aspects of the new regulations for the securities market, and to extend the information on activities entered into by these institutions with residents of other countries, by the subsidiaries of institutions abroad and on the country risk they assume. Further, rules on practice and transparency of operations and the protection of credit institutions' customers have been updated to include the provisions laid down by the legislation on the introduction of the euro and the recommendations of the European Commission in this connection.

As regards government debt, several provisions are worth indicating. First, the figure of the government debt market-maker has been re-defined. Financial institutions without a permanent establishment in Spain now have the possibility of belonging to this category. Further, a distinction is drawn between the market-maker and the "dealing entity" in money markets, the latter being regulated for the first time.

Secondly, and as has habitually been the case in the opening months of each year, the terms for euro-denominated government debt issues for 1999 and for January 2000 have been disclosed, with a net-issue ceiling of ESP 2.34 trillion established in the 1999 State Budget Law. Generally, the same instruments, practices and other aspects that shaped debt policy the previous year have been retained, with certain changes in tender-allotment dates and with minimum tender amounts expressed in their new euro denomination.

Thirdly, the conditions have been established for opening securities accounts between the Banco de España Book-Entry System and the securities clearing and settlement systems headquartered in European Union (EU) countries, in accordance with the provisions established in the recent securities-market reform legislation.

In addition, the information to be reported to the Banco de España by appraisal companies and services has also been outlined.

Turning to securities markets, the CNMV has regulated the procedure for registering and updating prospectuses, establishing a format for an abridged prospectus and quarterly report that may be delivered to mutual fund shareholders instead of the full prospectuses and quarterly reports.

In the fiscal area, several important provisions have been promulgated. First, the reporting obligations of the Government Debt Book-Entry System and of the registered dealers intervening in certain government debt operations, along with the obligations of credit institutions to assist the tax authorities. Second, the new personal income tax regulations have been enacted. These include the regulation of personal income tax payments on account, and the rules for the recent income tax on non-residents. Lastly, certain amendments have been made to the regulations covering pension schemes and funds, to corporate income tax and to value added tax, so as to bring them into line with the new personal income tax regulations.

2. CREDIT INSTITUTIONS: AMENDMENT OF ACCOUNTING STANDARDS AND FINANCIAL STATEMENT FORMATS

Law 37/1998 of 16 November 1998 (1) on the reform of the securities market Law, amended the treatment given to goodwill under Spanish corporate law in its fifteenth supplementary provision, raising the limit for its depreciation from ten to twenty years.

Moreover, the recent crisis in certain emerging market economies has highlighted the shortcomings in the information available at the Banco de España on the activity entered into by credit institutions with residents from other countries and the country risk they assume. Accordingly, it is advisable to extend the existing information on such activity. Finally, it is desirable to complement the information on the balance sheet of the subsidiaries of Spanish banks abroad in view of their sizeable presence in Latin America.

As a result, it has been necessary to update, by means of *Banco de España Circular 2/1999 of 26 January* (BOE [Official State Gazette] of 6 February 1999), Banco de España Circular 4/1991 of 14 June 1991 (2) on credit institutions' accounting standards and financial statement formats, so as to include the foregoing premises.

In this way, the goodwill arising on the acquisition of companies or on the acquisition of all or part of the business (even though their capital is not bought) shall be depreciated following a systematic plan, which may not be on an increasing basis and may not exceed the period during which such goodwill contributes to the obtaining of revenue for the company, with the maximum limit of 20 years (previously10 years). If depreciation exceeds five years, the appropriate justification shall be given in the annual report, indicating the amounts of revenue that this asset will foreseeably generate during its depreciation period. It is also indicated that such depreciation shall be accelerated if there are reasonable doubts about the effectiveness of the goodwill. The periods established for the depreciation of the goodwill shall be applicable to the individual or consolidated annual accounts as of 31 December 1998, without modifying the depreciation made in prior years.

Regarding credit institutions' activity with non-residents, form T.12 "classification by country of non-residents' investments and resources» has been amended and is now called «activity classified by country». The latter is much more complete than the previous form and is divided into three parts: total activity with the residents of the country according to principal obligor; international activity with the residents of each country; and information relating to risk for which provision may be made under country risk. Both form T.12 and T.11 (classification by currency and country of investments and resources) shall only be obligatory for institutions with branches abroad or whose risks (direct or ultimate) or liabilities with non-residents in Spain amount to at least EUR 5 million or ESP 832 million (previously ESP 1 billion).

In parallel with form T-12, a new quarterly form called C.10 "consolidated activity classified by country" has been created for credit institutions' consolidable groups. It is divided into the same three parts and will also be obligatory for groups with dependent entities or branches abroad or whose risks (whether direct, ultimate or on the liabilities side of the consolidated financial statements with non-residents in Spain) are equivalent to at least EUR 5 million. That said, the third part of this form will have to be reported by entities which, although they do not reach the aforementioned volume of activity, have risks in countries not classified in group 1 for country-risk purposes.

3. CREDIT INSTITUTIONS: AMENDMENTS TO THE REGULATIONS GOVERNING THE TRANSPARENCY OF OPERATIONS AND PROTECTION OF CUSTOMERS. INFORMATION ON THE BALANCES ACTING AS A BASIS FOR THE CALCULATION OF CONTRIBUTIONS TO DEPOSIT GUARANTEE FUNDS

Banco de España Circular 8/1990 of 7 September 1990 (3) on the transparency of op-

(1) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 90-98.

(2) See "Regulación financiera: segundo trimestre de 1991", in *Boletín económico,* Banco de España, July-August 1991, pp. 58-60.

(3) See "Regulación financiera: tercer trimestre de 1990", in *Boletín económico,* Banco de España, October 1990, pp. 76-77.

erations and protection of customers, implemented the Ministerial Order of 12 December 1989 (4), which extended the regulations initially applicable only to deposit money institutions to all credit institutions. Subsequently, these rules have been progressively updated to include the changes which have arisen in our financial system and which have particularly affected credit institutions' operations with their customers.

Law 46/1998 of 17 December 1998 (5) on the introduction of the euro, included the European Commission's recommendations of 23 April 1998 (6) on banking practices relating to *charges for conversion to the euro* and on *dual display of prices and other monetary amounts* during the transitional period (from 1 January 1999 to 31 December 2001).

Recently, Banco de España Circular 8/1990 has been amended, by *Banco de España Circular 3/1999 of 24 March 1999* (BOE of 7 April 1999), with the aim of specifying, during the changeover from the peseta to the euro, various aspects of the regulations on the transparency of operations and the protection of customers. Accordingly, some of the rules in the aforesaid Law 46/1998 and certain issues envisaged in the above-mentioned recommendations are incorporated. Likewise, for greater informative clarity during the transitional period, either it is required that the additional information to be provided to customers be reflected in the prices prospectus, or else the form in which the information already envisaged is to be reflected in the prospectus itself and on the notice board is specified.

During the transitional period for the introduction of the euro, the following provisions shall, among others, be applied:

1. The following bank operations shall be free of charge: the conversion from pesetas into euro or from euro into pesetas of proceeds and payments received/made in national territory; the re-denomination in euro of peseta cash accounts and the means of drawing thereon; and the re-denomination in euro of government debt by registered dealers in the market for book-entry debt, along with the issuance and delivery of the associated new debt vouchers.

2. In banking operations or services involving conversion between national monetary units integrated into the euro, no currency exchange charge shall be applied, without prejudice to the charges which, where appropriate, may be applicable in relation to services linked to the exchange, or other expenses chargeable.

3. In both the general and partial prospectuses, charges shall be expressed in euro and in pesetas, reflecting that the operations indicated in the foregoing points are free. Further, the charges applicable to banking operations or services in euro shall be identical to those applied to the same operations or services when they are conducted in pesetas. In banking operations or services involving the conversion between national monetary units integrated into the euro, the lags envisaged in the valuation date for currency transactions will not be applicable. In addition to the information already indicated in the regulations, the settlement documents relating to these operations shall indicate the conversion rates applied.

Further, the prime rate is specifically defined as the interest rate which credit institutions apply, from time to time, to euro- or peseta-denominated operations conducted in Spain with their most creditworthy customers included in the private sector, whatever the type of operation, in the short term and for a sizeable amount. For these purposes, «a sizeable amount» is considered to be those loans the principal of which exceeds EUR 1 million (formerly, ESP 100 million) or 5 % of the institution's own funds

Regarding the disclosure of the exchange rates of certain operations, credit institutions undertaking transactions with their customers involving foreign currencies or banknotes of countries outside the euro area against euro or pesetas shall disclose the minimum buy rates and maximum sell rates or, where appropriate, the single rates to be applied when the amount does not exceed EUR 3,000 (formerly, ESP 500,000).

Moreover, credit institutions shall disclose the conversion rates of the currencies making up the euro, which shall be those resulting from their respective equivalence with the euro and which shall be applied, as sole rates, to banknote transactions of these currencies between one another, and to whatsoever other transactions between these currencies.

As to the notice board, this shall, in addition to the information previously indicated in Banco de España Circular 8/1990 on exchange rates relating to currency and banknote transactions,

(4) See "Regulación financiera: cuarto trimestre de 1989", in *Boletín económico,* Banco de España, January 1990, p. 35.

(5) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 83-90.

(6) See "Financial regulation: second quarter 1998", in *Economic bulletin,* Banco de España, July 1998, pp. 92-93.

include reference to the existence, if appropriate, of the minimum buy and maximum sell rates and to the applicable charges and expenses. These rates shall be displayed to the public in a suitable place in those bank premises where such operations are habitually undertaken. Likewise, the notice board shall show the conversion rates between the peseta and the currencies making up the euro, accompanied by the charges or expenses, if any, which may be applied to banknote or currency transactions for other than exchange purposes, explaining to what they are attributable.

For the purpose of maintaining the continuity of the related series, the appropriate adaptations are introduced of the definition of the interest and exchange rates – and the way in which they are determined – that are published or communicated to the Banco de España.

Likewise, to improve the transparency of charges, a greater breakdown of the items under particular categories is prescribed.

Lastly, the Circular is used to amend Banco de España Circular 1/1997 of 31 January 1997 (7) on information on the accounting balances making up the basis of calculation for contributions to Deposit Guarantee Funds, so that these balances may be expressed hereafter in thousands of euro.

4. GOVERNMENT DEBT: REGULATING THE "MARKET-MAKER" AND THE "DEALING ENTITY"

A Resolution of the Banco de España Executive Council dated 19 January 1988 established the figure of market-makers and regulated the criteria governing access to and maintenance of this status, along with relations between these entities and the Banco de España. These criteria have been revised on quite a regular basis. The last time was pursuant to the Ministerial Order of 29 March 1994 (8), which amended the Ministerial Order of 24 July 1991 (9) and which defined market-maker's functions and the obligations and rights inherent to their status.

The Ministerial Order of 19 June 1997 (10) regulating the stripping and reconstituting of government bonds allowed the Treasury to execute special loans *(préstamos singulares)* with financial institutions and empowered it to authorise specific market-makers to undertake stripping and reconstituting operations, provided that they undertook to meet the requirements laid down by the Treasury.

The implications of Economic and Monetary Union (EMU) for the current structure of the government debt markets advise redefining the status of the government debt market-maker, allowing for the possibility of financial institutions without a permanent establishment in Spain belonging to this category. At the same time, the setting in place of the single monetary policy and the requirement that the national central banks forming part of the European System of Central Banks (ESCB) should select their counterparties in accordance solely with monetary policy criteria, means a distinction should be drawn between government debt market-makers and money market market-makers (dealer entities).

Bearing this in mind, the *Ministerial Order of 10 February 1999* (BOE of 13 February 1999), implemented by the *Resolution of 11 February 1999* (BOE of 15 February 1999), and the *Resolution of 4 March* 1999 (BOE of 10 March 1999), both passed by the Directorate General of the Treasury and Financial Policy (hereafter, the Treasury), have laid down the basic principles regulating Spanish government debt «market-makers» and «dealer entities».

With regard to market-makers, their fundamental function continues to be that of enhancing liquidity in the Spanish government debt market and co-operating with the Treasury in the dissemination of these instruments on the domestic and foreign fronts. The main difference with the previous regulations is that now, to gain access to market-maker status, it is not necessary to have registered dealer status; it suffices to be a market member of the Book Entry System and to meet the requirements laid down in these new regulations. Financial institutions without a permanent establishment in Spain may also have access to this category further to the provisions laid down in Law 37/1998 of 16 November 1998 on the reform of the securities market Law (11), as the scope for becoming a market member of the Book-Entry System has been extended to the following groups of institutions:

(7) See "Regulación financiera: primer trimestre de 1997", in *Boletín económico,* Banco de España, April 1997, p. 112.

(8) See "Regulación financiera: primer trimestre de 1994", in *Boletín económico,* Banco de España, April 1994, pp. 92-93.

(9) See "Regulación financiera: tercer trimestre de 1991", in *Boletín económico,* Banco de España, October 1991, pp. 52-53.

(10) See "Regulación financiera: segundo trimestre de 1997", in *Boletín económico,* Banco de España, July-August 1997, pp. 108-109.

(11) In this respect, the Ministerial Order of 10 February 1999 amends the Ministerial Order of 19 May 1987. The latter implements Royal Decree 505/1987 of 3 April 1987, which created the government debt book-entry system.

a) Investment services companies (ISC) and credit institutions authorised in another EU member state, provided that, in addition to meeting the legal requirements established for operating in Spain, they are authorised by their home country to provide government debt Book-Entry System market-member services.

b) Spanish ISC and credit institutions authorised in a non-EU member state, provided that, in addition to meeting the legal requirements established for operating in Spain, they are authorised by their home country to provide government debt Book-Entry System market-member services.

Market-maker status shall be officially conferred by the Treasury, following a favourable report by the Banco de España (12), in which connection account will be taken of the activity engaged in by the institution on the primary and secondary markets for government debt over a period deemed sufficient by the Treasury. Retaining this status will require compliance with the commitments undertaken and the periodic approval by evaluators of the activity the institution engages in on the primary and secondary government debt markets. Specifically, the Treasury will evaluate market-makers' activity monthly in the following areas:

a) Subscription of tendered securities.

b) Share in total monthly turnover in the RMNDPA (Network of Book-Entry Government Debt Inter-Dealer Brokers) (13).

c) RMNDPA stock prices.

d) Share in monthly government debt turnover among market members in the official secondary markets for debt.

e) Share in market-makers' trading with institutions that are not Book-Entry System market members.

f) Stripping-reconstitution of strippable securities.

The Treasury shall establish the criteria for evaluating market-makers' operations, setting greater store by activity in the «blind market» (trading where the counterparty is not known) (14) and by the greater residual majority of the securities being traded.

The Resolution of 11 February details market-makers' rights and obligations. Concerning their rights, market-makers may:

a) Participate in Treasury tenders whereby, once the general deadline for submitting bids to each tender of government bonds has elapsed, market-makers will have thirty minutes to submit their bids.

b) Have access to second rounds, i.e. once the bid-submission phase has finalised for each bond tender, market-makers may have exclusive access to a second round that will take place between the allotment of the tender and midday on the second business day following the day the tender was held. During the second round, each market maker may submit bids which will be allotted at the rounded, weighted, average price resulting from the tender stage.

c) Participate on an exclusive basis in stripping and reconstitution operations, i.e. market-makers alone shall be authorised to strip and reconstitute securities representative of strippable government debt.

d) Receive information about the Treasury's financing policy, participate in the setting of medium-and long-term debt instrument issuance targets, and have a representative on the Advisory Commission of the book-entry government debt market.

Finally, market-maker status shall be evaluated in the selection of counterparties for other financial transactions that the Treasury may perform, such as swaps or currency issues.

As to their obligations, market-makers shall:

i) Participate in tenders, submitting bids for a minimum value of 3 % of the amount allotted by the Treasury in bond tenders at prices no less than the marginal allotment price minus 5 and 10 cents for three- and five-year bonds, respectively; and 15 and 30 cents for bonds at 10 years and over, respectively.

ii) Ensure liquidity in the secondary market, whereby they shall quote certain bonds in accordance with the specific conditions detailed in the above-mentioned provision.

iii) Provide the information the Treasury may request on the debt market in general and the market-maker's activity in particular. Specifically, market-makers shall report monthly on their proprietary trading and trading on behalf of third parties, geographical base and the type of institutions that make up their customers.

(12) Previously it was conferred by the Banco de España, following a favourable report by the Treasury.
(13) Formerly known as the MEDAS network.
(14) The blind market is the core of the market to which only leading institutions have access. It is characterised by the fact that the contracting parties do not know the identity of their counterparties.

The loss of market-maker status may come about for the following reasons: communication of the relinquishment of such status by the market-maker itself to the Treasury; a decision to this effect by the Treasury when it considers the market-maker is not maintaining its commitments in accordance with the evaluation criteria established; failure to comply with obligations for six consecutive months; and by Treasury decision when an institution, in its operations with non-residents, fails to observe the criteria laid down under the regulations in force regarding the system of withholdings on account.

Regarding government debt dealing entities (hereafter, dealers), regulated for in the Resolution of 4 March 1999, they shall have exclusive access to the RMNDPA and the possibility of access to market-maker status in the form and under the conditions established previously for the latter.

Dealer status shall be officially conferred on book-entry government debt market members by the Treasury subject to a favourable report by the Banco de España and the CNMV. The following requirements must be met:

a) Market member acting as a principal in the Banco de España Book-Entry System.

b) Meet the technical requirements laid down by RMNDPA and, in particular, satisfy at least one of the following conditions:

—Have a credit rating as a high level issuer according to one of the international credit rating agencies.

—Possess own funds equal to or higher than EUR 100 million (equivalent to ESP 16,638.6 million).

—Place with the Banco de España a deposit for EUR 10 million (equivalent to ESP 1,663.9 million) as cover for activities in the RMNDPA in the form stipulated by the Banco de España

To retain the status it will be necessary, first, for the institution's participation in monthly RMNDPA turnover to exceed 1 % of the total, this being defined as the sum of spot purchases and sales of bonds over the course of one month. And further, to quote on the RMNDPA screen for at least 60 % of the trading session the five benchmark bonds selected at the monthly meeting between the Treasury and the market makers under specific conditions.

The loss of dealer status shall be for the following reasons: communication of the relinquishment of such status by the dealer itself to the Treasury; failure to comply with obligations for two consecutive months or three alternate months over a period of no longer than six months; or because the Treasury considers that the dealer's commitment to the Spanish government debt market is insufficient.

5. GOVERNMENT DEBT: ISSUANCE CONDITIONS DURING 1999 AND JANUARY 2000

Law 49/1998 of 30 December 1998 (15) on the State Budget for 1999, authorises the government so that, on the proposal of the Ministry of Economy and Finance (MEH), it may increase the outstanding balance of government debt during 1999 to ESP 2,338 trillion (EUR 14,051 million). This amount will be effective at the end of 1999, although it may be exceeded during the course of the year. Likewise, Royal Decree-Law 1091/1988 of 23 September 1988, through which the redrafted text of the General Budgetary Law was approved, empowers MEH to issue, place and manage government debt, subject to the Government's criteria and within the quantitative limits set by the Budget Law.

Law 46/1998 of 17 December 1998 (16) on the introduction of the euro, established that Treasury issues of government debt (hitherto denominated in pesetas) should, as from 1 January 1999, be denominated in euro. In turn, the government, via Royal Decree 2813/1998 of 23 December 1998 (17) established the procedure for the redenomination in euro of government debt registered with the Book-Entry System, stipulating that all peseta-denominated government debt in circulation registered with the System as at 31 December 1998 would be redenominated in euro as from 1 January 1999.

In this respect, and as background information, mention may be made of the Ministerial Order of 14 October 1998 (BOE of 23 December 1998). This eliminated the unit nominal values of book-entry government debt so that individual holdings, made up of securities of the same code, could be converted into individual nominal balances, thus facilitating their subsequent redenomination in euro.

Pursuant to Law 46/1998, the following regulations were promulgated: Ministerial Order of

(15) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 109.

(16) See note 5.

(17) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 83-90.

23 December 1998 (BOE of 30 December 1998), providing for the issuance of government debt in euro in January 1999; and two Treasury Resolutions of 23 December 1998 (BOE of 30 December 1998), providing for certain issues of government bonds and Treasury bills in euro to be made that month.

As is habitual around these dates, Royal Decree 80/1999, of 22 January 1999 (BOE of 23 January 1999) and Ministerial Order of 27 January 1999 (BOE of 29 January 1999) were promulgated, providing for the creation and issuance conditions of government debt for 1999 and January 2000, with the limit for this latter month at 15 % of the volume authorised for 1999. There were also two Treasury Resolutions of 28 January 1999 (BOE of 29 January 1999), specifying certain debt issues and disclosing the timetable for regular tenders of the Treasury bills and government bonds, all in euro, that will be offered during this period.

Broadly, the same instruments, techniques, practices and other aspects that made up debt policy for 1998 are retained. And, specifically, MEH remains authorised to conduct the following operations, among others, and may:

a) Continue to conduct borrowing operations under the vehicles envisaged, changing the commercial name or grouping more than one vehicle under a single denomination.

b) Create, within the framework of current fiscal legislation, new government debt vehicles, whether or not tradable or non-tradable.

c) Regulate issuance or coupon-interest-determining practices allowing issues to be grouped or successive tranches of a single issue to be placed.

d) For the purposes of debt dealing, authorise government debt strips (the stripping of the principal and interest of certain issues and their subsequent reconstitution).

In the case of government debt issues which are initially offered or placed abroad, the usual clauses and conditions envisaged under the General Budget Law for these operations may be agreed in respect of the returns obtained by non-residents.

As to the formalisation of government debt, this will, as in previous years, be in the form exclusively of book-entry Treasury bills (at six, twelve and eighteen months), short- and medium-term government bonds (at three and five years) and long-term government bonds (at ten, fifteen and thirty years).

The traditional issuance procedures are retained, namely: competitive tenders, public offerings and competitive methods among a restricted number of authorised entities, preferably market-makers (system used in second rounds).

The periodicity with which regular tenders are held is retained, with minor changes in allotment dates:

— For Treasury bills: twelve- and eighteen-month Treasury bill tenders coincide and take place every two weeks, while six-month bill tenders (formerly fortnightly) are held every four weeks in a week without tenders of twelve- and eighteen-month bills.

— For medium- and long-term government bonds: monthly, except for thirty-year bonds, which will be once every two months. The redistribution of allotment dates for bond tenders will be as follows: in the case of three- and ten-year bonds, on the first Wednesday each month (previously Tuesday); and on the following Thursday (formerly Wednesday), five-, fifteen- and thirty-year bonds (the latter in the corresponding month). In both cases this is provided working days are involved.

As to competitive bids, the minimum nominal amount will be EUR 1,000 for twelve- and eighteen-month Treasury bill tenders, EUR 500,000 for six-month bills and EUR 5,000 for bond tenders. In all cases, applications for higher amounts must be integer multiples of EUR 1,000, except for six-month Treasury bills, where they must be multiples of EUR 100,000.

In the case of non-competitive bids, the minimum nominal amount shall be EUR 1,000 for both twelve- and eighteen-month bills and for bonds, with a maximum nominal amount per bidder of EUR 200,000. Non-competitive bids will not be accepted for six-month bills.

Finally, the holding of second rounds following tenders remains unchanged exclusively among market-makers, under the terms laid down in the Order dated 24 July 1991 (18), amended partially by the Order of 29 March 1994 (19), both of which have been repealed.

In second rounds the price to be paid for the allotted debt is always that offered in each bid accepted, unlike in the first round when it is al-

(18) See note 8.
(19) See note 9.

lotted at the weighted average price to those who have bid prices higher than this average.

6. APPROVED APPRAISAL COMPANIES AND SERVICES: CHANGES IN THE INFORMATION TO BE REPORTED TO THE BANCO DE ESPAÑA

Royal Decree 775/1997 of 30 May 1997 (20) on the rules governing the approval of appraisal services and companies specifically made the Banco de España responsible for overseeing compliance by these entities with the requirements for obtaining and retaining the necessary approval, as well as with all such other obligations to which they may be subject. Subsequently, Banco de España Circular 3/1998 of 27 January 1998 (21) laid down the information these entities must submit to the Banco de España to enable it to perform its duties properly.

The period for appraisal companies to adapt to the new legislation having expired, Banco de España Circular 3/1998 has been slightly amended by *Banco de España Circular 4/1999 of 24 March 1999* (BOE of 7 April 1999). The amendments relate to the rules governing liability insurance policies and the information the companies must submit to the Banco de España, which must now be expressed in euro.

7. OPENING OF SECURITIES ACCOUNTS BY THE BANCO DE ESPAÑA BOOK-ENTRY SYSTEM AND SECURITIES CLEARING AND SETTLEMENT SYSTEMS BASED IN THE EUROPEAN UNION WITH EACH OTHER

Law 37/1998 of 16 November 1998 reforming the Securities Market Law and Royal Decree 2590/1998 of 7 December 1998 amending the legal regime for securities markets envisaged the possibility of securities clearing and settlement systems based in European Union (EU) countries keeping securities accounts with the Banco de España Book-Entry System and vice versa.

A *Ministerial Order, of 18 March 1999* (BOE of 25 March 1999), has now been published establishing the conditions for the opening of such accounts.

Securities clearing and settlement systems based in the EU may keep a securities account with the Book-Entry System provided that they have entered into an agreement with the Banco de España setting out the terms and conditions for operating such account. This agreement, which must be approved prior to its execution by the Ministry of Economy and Finance, shall lay down the link-up and reconciliation procedures to ensure that the book-entries of such systems properly correspond to the respective global accounts of the Book-Entry System. The securities account of each securities clearing and settlement system shall reflect the overall balance of securities listed on the government debt market which correspond to members of the former and shall constitute, at all times, the permanent and exact counterpart of the Securities registered at the central depository.

Likewise, the Book-Entry System may keep securities accounts in its name with securities clearing and settlement systems based in the EU, provided that it has entered into an agreement, previously approved by the Ministry of Economy and Finance, with each of them, setting out the terms and conditions for operating the same. This agreement shall also lay down the link-up and reconciliation procedures to ensure that the records of the Book-Entry System match those of the securities clearing and settlement system. Each of these accounts shall exclusively reflect the balances of fixed-income securities issued by public-sector issuers of EU Member States registered in the respective securities clearing and settlement system, which correspond to members of the book-entry government debt market.

8. MUTUAL FUNDS: PROSPECTUSES AND QUARTERLY REPORTS

An Order of 12 July 1993 implemented Royal Decree 291/1992 of 27 March 1992 on securities issues and public offerings, and completed the process of transposition of Council Directive 89/298/EEC of 17 April 1989, relating to prospectuses for the issuance and public offering of securities. Formats were established for the prospectuses which collective investment undertakings must submit for prior approval and registration at the CNMV, in the event of operations for the issuance and public offering of securities, admission to listing and marketing of these institutions. Likewise, the Order obliges CIUs to update their prospectuses each year, when the auditor's report on the previous year's accounts becomes available. The Order authorised the CNMV to establish the term and the conditions for presenting and using the prospectus, which it has done by means of CNMV Circular 1/1994 of 14th March 1994.

(20) See "Regulación financiera: segundo trimestre de 1997", in *Boletín económico,* Banco de España, July-August 1997, pp. 113-114.

(21) See "Financial regulation: first quarter of 1998», in *Economic bulletin,* Banco de España, April 1998, p. 107.

Subsequently, a Ministerial Order of 1 October 1998 updated the prospectuses and permitted FIMs (capital market funds) and FIAMMs (money-market funds) to use abridged prospectuses and quarterly reports (22) in order to transmit a clear and precise commercial message to the investor, and to provide standard information with the minimum content necessary for knowledge of the product (23). This Order also empowers the CNMV to issue regulations implementing the rules, which it has done by means of CNMV Circular 1/1999 of 14 January 1999 (BOE of 3 February 1999). The Circular also takes the opportunity to incorporate in a single text all the regulations relating to the prospectuses of all CIUs of a financial nature.

The aforementioned Circular regulates the procedure for registering and updating prospectuses and establishes the format for the abridged prospectuses and quarterly reports which may be delivered to mutual fund shareholders instead of complete prospectuses and quarterly reports. Nonetheless, it does not alter the rules applicable to closed- and open-end investment companies (SIMs and SIMCAVs), since the obligation to deliver and send complete prospectuses and quarterly reports only relates to the shareholders of mutual funds. Foreign commercial CIUs in Spain do not come within its scope of application either, remaining subject to the information rules laid down in CNMV Circular 3/1997 of 29 July 1997.

Having obtained authorisation of the proposal to form a mutual fund and its rules of management, the management company, when applying for registration of the new fund, may present, together with the application for registration of the complete prospectus, an abridged prospectus in the form contained in this Circular. Both prospectuses shall be subject to simultaneous checking and registration when the fund is registered by the CNMV.

The Circular also reproduces the circumstances in which it is necessary to update the complete prospectuses. The sections concerned must be checked and registered by the CNMV. The same rules apply to abridged prospectuses, provided that the modification of the complete prospectus affects the content of the abridged one. Partial alteration of any section of the abridged prospectus shall require it to be fully updated.

In the event that the prospectus must be updated owing to an alteration in its essential elements which gives shareholders the right to withdraw, the procedure established in the Circular shall be followed. Namely, the shareholders shall be notified of the fact within the established term, and informed of their right to opt for redemption of their shares without the deduction of commissions or any other amounts. Upon expiry of the term, the management company shall update the prospectus, the CNMV having verified performance of the aforementioned information obligation.

As regards the quarterly reports, the management company may opt to use an abridged quarterly report which must be submitted to the CNMV, along with the complete quarterly report, for simultaneous registration.

Both the prospectus and the quarterly report, which must be delivered to each shareholder at his address, free of charge, prior to subscription for the shares, may be in the abridged form, although they must refer to the existence of a complete prospectus and quarterly report, stating where these may be obtained, and the right to request that they be delivered or sent periodically free of charge.

Finally, the terms of waiver of the right to receive the complete quarterly report by the shareholders are likewise applicable to abridged reports. If the shareholder has waived the right to be sent these reports, the management company may not send any other information in their place.

9. OBLIGATIONS TO PROVIDE INFORMATION TO THE TAX AUTHORITIES ON CERTAIN GOVERNMENT DEBT TRANSACTIONS. OBLIGATIONS ON CREDIT INSTITUTIONS TO ASSIST THE TAX AUTHORITIES

As a consequence of the promulgation of the Regulation for the new personal income tax, approved by Royal Decree 214/1999 of 5 February 1999 (to be discussed in the following section), certain tax provisions have been reformed by Royal Decree 215/1999 of 5 February 1999 (BOE of 9 February 1999) to ensure that tax law as a whole is adapted to the new personal income tax legislation (discussed below).

The text of the Royal Decree also incorporates the information obligations of the Central

(22) This possibility is supplementary to and does not extinguish the obligation to prepare the complete prospectuses and quarterly reports in force, which must always be available to the shareholders.

(23) The abridged prospectus shall, like the complete prospectus and its updated versions, be subject to approval and registration by the CNMV. In the same way, both the abridged and the complete versions of the quarterly report shall be registered at the same time in the same register by the CNMV.

Book-Entry System and the management entities involved in certain government debt transactions, as well as the obligations on credit institutions to assist the tax authorities. These obligations were previously regulated by article 11 of Royal Decree 505/1987 of 3 April 1987 (24) on book-entry government debt, which has been repealed, and by Royal Decree 2027/1985 of October 23 1985, which has been completely repealed.

In this respect, the Book-Entry System and management entities involved in the subscription for and transfer of government debt represented by book entries shall be obliged to supply information on such operations to the tax authorities. Also, the Book-Entry System shall inform the tax authorities of the withholdings made on interest paid to management entities in respect of the balances on their securities accounts both for their own account and for the account of their principals. In turn, the management entities must submit, within the term established for the annual summary of withholdings, a list with the names of their principals who receive interest, in the form established by the Ministry of Economy and Finance. They shall also be obliged to supply information to the tax authorities on the book-entry government debt subscription, transfer and redemption operations of their principals. This obligation shall be deemed fulfilled, as regards operations subject to withholdings, with the submission of the annual summary of withholdings.

As regards credit institutions, they shall be obliged to supply to the tax authorities all kinds of data, reports and background information arising from their economic or financial relationships with other persons. In particular, they must supply at the request of the tax authorities, and in accordance with the assistance procedure outlined in the Royal Decree, movements in current accounts, savings and time deposits, loan and credit accounts and any other lending and borrowing transactions with any taxpayer. With regard to joint accounts in the name of several persons or entities or groups of joint owners, whether or not voluntary, jointly held deposits and the like, a request for information on one of the co-holders requires all the data and movements of the account, deposit or operation to be made available. However, the tax authorities may not use the information obtained with respect to another holder without first taking the necessary steps in the relevant assistance procedure.

(24) See "Regulación financiera: segundo trimestre de 1987", in *Boletín Económico,* Banco de España, July-August 1987, pp. 46-48.

10. PERSONAL INCOME TAX REGULATION

Law 40/1998 of 9 December 1998 (25) on personal income tax (IRPF) undertook a far-reaching reform of the tax, in line with the model existing in other industrial countries. Thus, a personal and family tax-free allowance was established, greater equity was introduced into the distribution of taxes, and the treatment of earned income and persons with greater family responsibilities was improved. Subsequently, Royal Decree 2717/1998 of 18 December 1998 (26), which regulated, inter alia, payments on account of IRPF, brought all the legislation on payments on account into force before the approval of the regulation.

Law 40/1998 has recently been implemented by means of *Royal Decree 214/1999 of 5 February 1999* (BOE of 9 February 1999), which approved the IRPF regulation, incorporating into its provisions the regulation of payments on account of IRPF that was included in the said Royal Decree 2717/1998.

The structure of the regulation follows that of the Law. Thus, as regards *earned income,* subsistence and travel expense allowances and normal maintenance and living expenses are regulated; an annual limit is placed on the amount of fees paid to professional associations which can be claimed as deductible expenses; a comprehensive list is included of the circumstances and cases in which earnings are deemed to be received irregularly and certain rules applicable to earnings received in instalments with a generation period of more than two years are set out; and, finally, the reductions applicable to earnings arising from social welfare systems are regulated. As regards income in kind, the conditions which must be met in certain cases which do not amount to compensation in kind are specified, along with the valuation rules.

With regard to *income from property,* the regulation specifies deductible expenses and the depreciation expenses for income of this kind, and income from property obtained in a clearly irregular manner over time including income received in instalments.

As for *income from savings and investments,* the regulation details the taxation of both group and individual insurance contracts, specifying the reductions applicable to income

(25) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 105-107.

(26) See previous note.

arising thereunder; income and capital benefits are defined, in terms similar to those in the legislation regulating pension schemes and funds; and, in the same way as for income from property, the regulation defines income from savings and investments obtained in a clearly irregular manner over time and income received in instalments.

As regards *income arising from business activities,* the assets and liabilities assigned to the same are determined; the values of such assets and liabilities when assigned and when not assigned to the business are determined; and income from business activity considered to be obtained in a clearly irregular manner over time is specified, as well as that received in instalments. Likewise, in accordance with the provisions of Law 40/1998, the rules for determining this type of income are developed: direct estimation, which will have two forms, normal and simplified, and objective estimation. It should be pointed out that, under the tax regime for small and medium-sized businesses, a ceiling of ESP 75 million has been introduced for the total activity on which income may be determined by the objective estimation system. This includes operations for which they are obliged to issue invoices and those which must be recorded in ledgers.

As for *capital gains and losses,* the incidence of redemptions in the determination of the acquisition value and the conditions for entitlement to the exemption for reinvestment in a habitual residence are regulated. With respect to the deduction for investment in an habitual residence, construction and extension are treated in the same way as acquisition, and the conditions and requirements determining the application of the percentages of deduction increased in the case of borrowing, the requirements which must be met by housing accounts and, finally, the work to make a habitual residence suitable for disabled persons entitled to a deduction, are set out.

With respect to *net tax payable,* the average effective rate is defined for the purposes of application of the limit for deducting payments on account and payments of corporate income tax corresponding to certain look-through companies which it is appropriate to include in the shareholder's IRPF assessment.

Also, the formal, accounting and registration obligations of taxpayers and certain institutions are defined. The latter include mortgage loan entities, entities which receive donations and the management entities of collective investment undertakings.

Finally, a transitional regime is established for certain cases contemplated in the above legislation, such as: the presentation of returns and communications; the amounts paid into housing accounts opened before 1 January 1999, which will have a maximum term of five years; transfers of assets and liabilities assigned to business activities carried out before 1 January 1998 (reinvestment of extraordinary profits and reinvestment exemption); the determination of assets and liabilities not assigned to business activities to which the reduction percentages provided for in the Law shall be applicable; and the application of the new method for calculating withholdings on earned income in accordance with the data which recipients must provide in the relevant communication.

11. REGULATION OF THE TAX ON THE INCOME OF NON-RESIDENTS

Law 41/1998 of 9 December 1998 (27) on the tax on the income of non-residents and other tax provisions, has incorporated into the Spanish tax system independent regulation of the direct taxation of the income of taxpayers not resident in Spanish territory. It includes the tax obligations of non-resident taxpayers, which were previously included in the IRPF and corporate income tax.

This law has recently been implemented by *Royal Decree 326/1999 of 26 February 1999* (BOE of 27 February 1999), which approved the regulation of the tax on the income of non-residents.

The regulation is divided up into five chapters and a final provision which implement the most important aspects of the law. Chapter one refers to income obtained in Spain by non-resident taxpayers through a permanent establishment in which the diversity of permanent establishments is taken into account, along with the assessment of the management and general administration costs attributable to the permanent establishment. Chapter two regulates the taxation of income obtained without a permanent establishment. It includes the rules for determining the tax base for business activity and operations carried out without a permanent establishment and the regulation of the formal obligations and declaration of this income.

Chapter three regulates the special tax on the property of non-resident entities which shall

(27) See «Financial regulation: fourth quarter 1998», in *Economic Bulletin,* Banco de España, January 1999, pp. 107-108.

fall due on 31st December of each year and which shall be declared and paid in the following month of January. Also the circumstances are set out in which there is deemed to exist a business operation distinguishable from the simple holding or letting of property.

Chapter four regulates the optional regime for taxpayers resident in other EU Member States, which allows them in certain circumstances to be assessed for tax under the rules of the IRPF contained in Law 40/1998 of 9 December 1998 and its implementing provisions. Private individuals resident in an EU Member State may apply for this treatment. They need to evidence that at least 75 % of their income in the tax period is made up of earned income and income from business activities obtained during this period in Spain, and that they have paid the tax on the income of non-residents in this period. Nonetheless, private individuals to whom the optional regime is applicable shall in no event lose their status as taxpayers of this tax. Accordingly, they shall be subject to the obligations applicable to them by virtue of the law regulating the tax on the income of non-residents.

Finally, Chapter five includes the rules regulating the regime for payments on account of this tax, distinguishing between income obtained with and without a permanent establishment.

12. AMENDMENTS TO THE REGULATIONS OF PENSION SCHEMES AND FUNDS, CORPORATE INCOME TAX AND OTHER TAX LEGISLATION

As mentioned above, *Royal Decree 215/1999 of 5 February 1999* (BOE of 9 February 1999), amends the regulation of pension schemes and funds, as well as certain tax provisions relating to corporate income tax and value added tax (VAT), in order to adjust them to the recently approved IRPF legislation.

With respect to the regulation of pension schemes and funds, approved by Royal Decree 1307/1988 of 30 September 1988, certain provisions have been implemented relating to cases of serious illness and long-term unemployment. Likewise, the regime applicable to pension schemes and social welfare mutual societies constituted in favour of the disabled, regulated in Law 40/1998 of 9 December 1998 on the IRPF and other tax provisions, is completed.

As to the regulation of corporate income tax, the obligation on the transferor to make a payment on account in certain cases of transfers of shares or equity representing the capital or assets and liabilities of collective investment undertakings is modified, and the depreciation coefficients of the “farm” group are incorporated.

As for VAT, the rule is specified for determining the place of provision of services provided by the organisers of trade fairs. It is consistent with the criteria commonly accepted in the EU, so as to avoid cases in which such services are taxed twice or not at all. Likewise, certain amendments have been introduced to the scope of application of the simplified and agriculture, livestock and fisheries special regimes in relation to the application of an overall ceiling of ESP 75 million for the application of the aforesaid regimes, in line with the objective estimation regime of the IRPF.

Finally, Royal Decree 2717/1998 of 18 December 1998, which regulates the payments on account of IRPF and the tax on the income of non-residents, is amended to exclude the following cases from withholding: transfers made before 1 January 2000 of coupon-paying financial assets issued prior to 1 January 1999 which have not been transformed into book entries; and transfers made in the so-called “blind market” for government debt, which will enable non-resident operators to be admitted to that market.

19.4.1999.