Financial regulation: 2002 Q4

1. INTRODUCTION

In 2002 Q4 a considerable number of new financial provisions were enacted, especially with the publication of the Law on reform of the financial system (known as the Financial Law). This law aims to promote market efficiency and boost the competitiveness of the financial industry, while safeguarding customer protection.

A consolidated version of the Law on the Regulation of Pension Schemes and Funds has been published, to give interested parties an up-to-date text to refer to, which includes the regulation of pension schemes and the main aspects of their process of adaptation.

In relation to the securities market, the use by issuers of electronic means to send regular public information to the National Securities Market Commission (CNMV) has been made compulsory, and the special features of the official secondary markets for olive oil futures and options have been regulated.

Notable in the fiscal area is the second partial reform of the personal income tax since 1998, and the amendment of the corporate income tax and the tax on the income of non-residents, given the interrelatedness between them.

Finally, as usual in this period, the main monetary, financial and fiscal measures of the State Budget for 2003 are discussed. As in recent years, a number of fiscal, administrative and social measures have been adopted at the same time as the Budget Law, in order to facilitate the achievement of economic policy objectives. Notable among the administrative measures relating to the financial sector are certain adjustments to the regulation of investor compensation schemes and the requirement for portfolio management companies to belong to the Investment Guarantee Fund.

2. REFORM OF THE FINANCIAL SYSTEM

2.1. Introduction

The financial system has become one of the largest and most international sectors of the Spanish economy and is crucial to the country's economic development. At the same time, the legal system applying to financial intermediaries has become a highly significant competitive factor, with the competitiveness of financial institutions operating in Spain depending on the regulatory framework being effective, but not overrigid.

Law 44/2002 of 22 November 2002 on Reform of the Financial System (BOE (Official State Gazette) 281/2002 of 23 November 2002)

has thus been enacted, in response to the external challenge, to ensure that the competitiveness of the Spanish financial system is not prejudiced and to help improve the channelling of savings towards the real economy, without leaving financial service customers unprotected. It has three basic aims:

a) To ensure that the legal system does not impose any unnecessary burden, putting Spanish financial institutions at a disadvantage relative to their EU counterparts. To this end, measures have been adopted and instruments created to increase the efficiency and competitiveness of the Spanish financial industry.

b) To ensure that the increase in competition and the use of new technologies does not leave financial service customers unprotected. The protection of financial services users has thus been improved.

c) To promote the channelling of savings towards the real economy, the true engine of growth and job creation. In this respect, mindful of their importance in the Spanish corporate fabric, the conditions of financing for small and medium-sized enterprises (SMEs) have been improved.

In addition, the Law transposes various EU directives into Spanish law, including Directive 2000/64/EC of the European Parliament and of the Council of 7 November 2000 amending Council Directives 85/611/EEC, 92/49/EEC, 92/96/EEC and 93/22/EEC as regards exchange of information with third countries; Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions; and Directive 2000/28/EC of the European Parliament and of the Council of 18 September 2000 (1) amending Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions.

Given the extensive provisions of this Law it is summarised in a number of sections below:

2.2. Measures to promote efficiency in the securities market

2.2.1. Integration of the securities clearing and settlement systems

Notable among the measures to improve the efficiency of the system are those that aim to integrate the securities clearing and settlement systems, the main pillar on which the proper functioning of the securities markets rests, given their implications for the cost and legal certainty of transactions.

The Systems Company

In Spain, the main securities clearing and settlement services have up until now been performed by the Spanish Public Debt Book-Entry System (*Central de Anotaciones de Deuda Española*, CADE), in the case of public debt, and by the Securities Clearing and Settlement Service (*Servicio de Compensación y Liquidación de Valores*, SCLV), in the case of securities listed on the Spanish stock exchanges and on the AIAF Mercado de Renta Fija, S.A. (official secondary market for private fixed income). Also, the regional (autonomous) governments with powers in relation to securities have, under the Securities Market Law, set up their own clearing and settlement services for the securities listed on their stock exchanges. This multiplicity of clearing and settlement systems in Spain has not contributed to the competitiveness of the Spanish financial system.

To resolve this situation the Law puts in place a flexible and open legal system to enable the existing clearing and settlement systems to be integrated, providing for the creation of *Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores* (Securities Registration, Clearing and Settlement Systems Management Company, referred to hereafter as "the Systems Company") through a merger of the SCLV and the CADE. This company could incorporate other systems currently existing in Spain, such as the one for financial derivatives and those run by the Barcelona, Bilbao and Valencia Stock Exchanges, and could manage interconnections and alliances with those existing in other countries.

In general, the Systems Company will be responsible for keeping the accounting records for securities listed on stock exchanges or on the Book-Entry Public Debt Market. However, in the case of securities listed on one exchange only, the regional (autonomous) governments with powers in this area may set up services of their own to keep the accounting records, which will have the same powers with respect to such securities as the Law establishes for the Systems Company

The Systems Company will have the following functions:

a) Keeping the accounting records for book-entry securities listed on stock exchanges

(1) See "Financial Regulation 2000 Q4", in the *Economic bulletin,* Banco de España, January 2001, pp. 73-74.

or on the Book-Entry Public Debt Market, as well as the securities listed on other secondary markets, when their governing bodies so request.

b) To manage the settlement and, where applicable, the clearing of securities and cash arising from ordinary transactions carried out on stock exchanges, on the Book-Entry Public Debt Market and, where applicable, on other secondary markets.

c) To provide technical and operating services directly related to the recording, clearing and settlement of securities and any others that may be necessary for the Systems Company to co-ordinate its activities and co-operate with other securities recording, clearing and settlement areas and systems and to be able to participate in the latter.

d) Such others as it may be assigned by the government, on the basis of a report from the CNMV, and where applicable, from the Banco de España.

To facilitate integration, the Clearing and Settlement Systems are to be *demutualised,* like the stock exchange management companies were under Law 14/2000 of 29 December 2000 on fiscal, administrative and social measures (2). This will enable non-market participants to take stakes in the capital of these systems. The government shall establish the criteria for determining the conditions for acquiring and holding capital in the Systems Company, as well as its distribution among the shareholders. Non-resident institutions performing activities abroad similar to those of the Systems Company may be shareholders of the latter, provided that their recording, clearing and settlement activities are subject to supervision arrangements at least equivalent to those applied to the Systems Company. The latter may, in turn, take stakes in the capital of the former. In both cases prior CNMV authorisation shall be necessary.

The Systems Company may enter into agreements with resident and non-resident institutions that perform similar functions and with central counterparty or other entities for the opening and keeping of accounts or for any other activities that it performs.

The rights of the Systems Company over the collateral provided by entities participating in the systems that it manages shall be completely unaffected by a court order declaring such an entity insolvent or the opening of suspension of payments proceedings against such an entity.

At the same time, the Law provides that the government, on the basis of a report from the CNMV and the Banco de España, may authorise other financial institutions to carry out all or any of the functions assigned to the Systems Company. Such institutions shall in all cases comply with the minimum requirements laid down by regulations and shall also be subject to the same supervision and discipline arrangements as the Systems Company, with any special features that may be established in regulations.

Central Counterparty Entities

In relation to securities clearing and settlement systems, the Law also provides for the creation of one or more *Central Counterparties,* the purpose of which is to eliminate counterparty risk from transactions. As this entity is interposed between the buyer and the seller, the latter always benefits from the performance guarantee it provides. The central counterparty or counterparties shall carry on their activities in accordance with the relevant regulations, which shall be approved by the Ministry of Economy on the basis of reports from the CNMV, from the Banco de España and from the regional (autonomous) governments whose Statutes of Autonomy authorise them to regulate securities trading centres. Such regulations shall determine, at least, the requirements for obtaining the status of participant in the system and shall establish the technical, operating and legal conditions for gaining access to the services provided, the collateral security that the member entities are required to provide and the information that they must supply in relation to the transactions that they notify to the central counterparty, as well as the financing arrangements for the latter entity.

The central counterparty may perform, for and on behalf of the contracting parties, their obligations arising under the framework agreements for transactions with transferable securities or financial derivative instruments, subject to the provisions of this or other applicable laws, as well as its implementing provisions. The central counterparty shall be subject to supervision by the CNMV and by the Banco de España, in their respective areas of competence, according to the provisions of this Law.

Subject to the provisions of this and other laws, as well as the implementing provisions of this law, the central counterparty may enter into agreements with other resident and non-resi-

(2) See "Financial Regulation 2000 Q4" in the *Economic bulletin,* Banco de España, January 2001, pp. 79-80.

dent entities that have similar functions or that manage securities clearing and settlement systems, may hold shares in such entities and allow them to take holdings in its own capital. Such agreements shall require the approval of the CNMV.

2.2.2. Promoting the opening-up of Spanish securities markets

The Law modifies the regulation of *cross holdings* between firms that administer secondary markets and their counterparts abroad, making it more flexible so as to facilitate the cross-border integration of markets, while ensuring some control over the suitability of the shareholders of the Spanish markets. Thus, the Minister of Economy, upon a proposal of the CNMV, may oppose the acquisition of a qualifying holding in companies that administer Spanish secondary markets, when he/she deems this necessary to ensure the markets function smoothly or to avoid distortions, and also when Spanish entities are not given an equivalent treatment in the home country of the entity that wishes to acquire the holding.

Also, companies that administer Spanish secondary markets (exchanges) are authorised to take holdings in similar companies in other countries, with the prior authorisation of the CNMV (previously they required government authorisation, on the basis of an opinion from the CNMV).

Notable among the market integration operations that the Law seeks to promote are those affecting the official futures and options markets, in which it is even normal for the various stages of a transaction (negotiation, clearing and settlement) to be performed in different countries.

Further, the Law transposes Directive 2000/64/EC into securities market regulations. This directive amends a number of other directives as regards the exchange of information in the field of insurance, securities and collective investment undertakings, facilitating the exchange of information between EU supervisors and third countries, subject to the appropriate confidentiality guarantees. This measure has already been applied to the credit market by Royal Legislative Decree 1298/1986 of 28 June 1986, on the adaptation of the existing law on credit institutions to that of the European Communities (3). In addition, organised trading systems are extensively regulated as regards, inter alia, authorisation arrangements, the requirement for managing companies to be formed with the status of public limited companies and supervision and sanctioning arrangements.

2.3. Measures to promote efficiency in the credit market

2.3.1. Obligations arising from monetary policy operations

The Law has supplemented and made systematic the specific rules for collateral security provided to the Banco de España, the European Central Bank and the other National Central Banks of the European Union, to ensure that the obligations arising under their monetary policy and overnight lending operations are performed. To this end it incorporates a new additional provision into Law 13/1994 of 1 June 1994 on the Autonomy of the Banco de España (4), reflecting the specific new legal arrangements applicable to such collateral security, which make the constitution and enforcement formalities more flexible. Constitution of collateral security shall no longer require the involvement of a Notary Public or any formality other than the existence of a written record and entry in the relevant register. In addition, in the case of securities represented by certificates, these shall be delivered to the beneficiary or to a mutually agreed third party.

To establish the relevant debt obligation there is no need for a Notary Public either, or for any other formality. In the case of repurchase agreements their specific regulations shall apply.

All that is required to enforce the collateral security is a certificate issued by the Banco de España, the European Central Bank or the relevant EU National Central Bank, evidencing the amounts due and payable that are being enforced, together with a copy of the document by which the security was constituted. When the collateral consists of assets tradable on an organised market, it shall be enforced through the relevant market authorities, In other cases it shall be enforced by means of an auction organised by the Banco de España. Any surplus remaining once the debt has been paid shall be returned to the institution that provided the collateral. In the event of breach by any of the parties to repurchase agreements, the provisions of the Securities Market Law and its implementing provisions shall apply.

(3) See "Regulación financiera: segundo trimestre de 1986", in *Boletín Económico,* Banco de España, July-August 1986, pp. 45 and 46.

(4) See "Regulación financiera: segundo trimestre de 1994", in *Boletín Económico,* Banco de España, July-August 1994, pp. 86-92.

2.3.2. State cash management

The Law seeks to improve and facilitate State cash management by enabling the Treasury to obtain a higher yield on its balance at the Banco de España through the purchase of fixed-income securities under repurchase agreements. The Minister of Economy may authorise the Directorate General of the Treasury and Financial Policy to enter into repurchase or loan agreements, specifying the permitted terms and conditions, in relation to the public debt securities of any EU Member State or other public entity or supranational institution or in relation to other fixed-income securities with a similar credit rating traded on regulated markets.

Where such assets have been provided as security to the Banco de España, their holders may also sell them temporarily to the Directorate General of the Treasury and Financial Policy under its cash management transactions conducted through the Banco de España, upon such terms as may be established by the Minister of Economy, provided that the following conditions are met:

a) That the holder of the assets gives its consent. This may be given in the security agreement or document executed with the Banco de España.

b) That there is sufficient collateral available, having properly secured the obligations to the Banco de España, to the satisfaction of the latter.

The assets in question shall secure the performance of the obligations to the Treasury, such security being fully effective vis-à-vis third parties, without any formality being necessary other than that the Banco de España has properly identified the collateral securing the performance of each such obligation, with the relevant break down. This breakdown shall be kept until the transaction concerned has matured. When such obligations have been fulfilled, the assets shall again be charged to the Banco de España.

2.3.3. Reform of the legal regime for savings banks and the incorporation of flexibility into that for credit co-operatives

The Law reforms the legal regime for savings banks, providing that group interests shall be represented at general meetings through the participation of at least the following groups: the Municipal Corporations within whose districts the bank has a branch open; the bank's depositors; the bank's founders, who may assign part of their representation to Local Authorities that have not founded other savings banks within their territory; the bank's employees. The representation of general government and public law agencies and corporations on the governing bodies of savings banks, even when founders, shall not exceed, in total, 50% of all the voting rights in each such body, all such entities and corporations necessarily being represented. The depositors shall have 25-50% of the voting rights in each governing body, while employees shall have 5-15%.

Another set of provisions aims to increase the professionalism of savings bank management. Members of their decision-making bodies are required to perform their duties for the exclusive benefit of the interests of the savings bank and of fulfilment of its social function, while the fitness requirements for members of the governing bodies are tightened. Members of the board of directors shall be appointed for a term that shall be indicated in the bank's articles of association, without this being shorter than four years or longer than six, although the possibility of re-appointment for another term of the same length may be provided for, provided that the total term never exceeds twelve years. To increase the independence of members of the board of directors, during the term for which they are appointed their appointment shall, leaving aside cases of resignation, death and legal absence, be irrevocable, except in the event of a supervening conflict of interest, when they no longer meet a requirement for holding the post or when there appear to be reasonable grounds for their separation and a resolution to this effect has been adopted in general meeting.

Finally, a number of amendments make it easier for savings banks to enter into strategic agreements with each other, and for mergers to be concluded between the savings banks of different autonomous regions.

The Law makes the investment regime for credit co-operatives more flexible, bringing it more into line with that for banks and savings banks for two reasons: first, to enable these institutions to grow, by promoting an increase in the size of their industrial portfolios; and, second, to facilitate their recourse to subordinated financing, following a resolution of the decision-making body, whatever the precise arrangements, and provided that this possibility is expressly permitted by their articles of association.

2.4. Measures to promote efficiency in the insurance market

Among the measures to promote efficiency in the insurance market, changes have been

made to Law 30/1995 of 8 November 1995 on the Regulation and Supervision of Private Insurance. The object of these changes is to transpose the provisions of Directive 2000/64/EC of the European Parliament and of the Council of 7 November 2000 relating to the exchange of information between supervisors, into insurance market regulations. Co-operation agreements providing for the exchange of information with competent authorities for the regulation and supervision of insurance undertakings and other financial institutions, or with other authorities or bodies of third countries, shall require that the information disclosed be subject to guarantees of professional secrecy, and that the purpose of the exchange of information shall be the performance of the tasks of regulation and supervision of such authorities. Where the information originates in another member state of the European Economic Area, it may not be disclosed without the express agreement of the competent authorities which have disclosed it and, where appropriate, solely for the purposes for which those authorities gave their agreement.

The autonomous agency *Comisión Liquidadora de Entidades Aseguradoras* shall cease to exist from the entry into force of the Law, its functions, assets and personnel being taken over by the public-sector corporate entity *Consorcio de Compensación de Seguros*. This merger will enable management costs to be reduced, owing to the synergies existing between the two bodies.

The Fourth EU Motor Insurance Directive, which regulates the rights of persons injured in motor accidents outside their country of residence, but inside the European Union, has been transposed into Spanish law. Insurance companies authorised in Spain may now freely choose their representatives for handling and settling claims, who must reside or be established in the Member State for which they are appointed. They shall notify the information agencies of each Member State of the name and address of their representative in that State. Spanish persons injured in accidents occurring in another Member Sate may claim compensation from the insurance company in that State or from its representative in Spain.

2.5. Measures to boost the competitiveness of the financial industry

2.5.1. Territorial certificates

This new security, which resembles a mortgage certificate, enables credit institutions to refinance their loans to general government using a method similar to one available in other EU countries, namely by issuing fixed-income securities whose capital and interest are specially secured by the loans and credit granted by the institution to the State, regional (autonomous) governments, local authorities, as well as the autonomous bodies and public-sector corporate entities reporting thereto, or other entities of a similar kind in the European Economic Area. These securities shall be subject to the same tax and financial regime as mortgage certificates.

The total amount of the certificates issued by a credit institution may not exceed 70% of the amount of the outstanding loans or credit granted to the general government bodies referred to above. That said, this limit may be exceeded for a period of up to three months, provided that the difference is covered by a deposit of cash or government securities at the Banco de España.

2.5.2. Savings bank equity units

The Law updates and supplements the legal regime for equity units (*cuotas participativas*) (5), initially contained in Law 26/1988 of 29 July 1988 (6), and developed by RD 664/1990 of 25 May 1990 (7), promoting and enhancing this financial instrument. The aim is to enable savings banks to raise sufficient own funds using this instrument, thereby ensuring that the financing conditions they face are similar to those for other deposit institutions.

As was already envisaged, equity units may not be issued for less than their nominal value. When necessary they should be issued at a premium to avoid the dilution of the existing rights over the assets and future surpluses. Equity units shall be in registered form and shall be fully paid for in cash at the time of issue.

One of the changes made is that the volume of outstanding equity units shall not exceed 50% of the total assets of the savings bank, although for two years following the entry into force of this Law it shall not exceed 25% of its assets. Also, equity units shall be listed on or-

(5) The equity units of savings banks are transferable securities representing monetary contributions of indefinite duration. They may be applied in the same proportion and to the same purposes as the institution's initial funds and reserves.

(6) See "Regulación financiera: tercer trimestre de 1988", in *Boletín económico,* Banco de España, October 1988, pp. 56-58.

(7) See "Regulación financiera: segundo trimestre de 1990", in *Boletín Económico,* Banco de España, July-August 1990, p. 79.

ganised secondary markets. However, no natural or legal person or economic group shall directly or indirectly hold more than 5% of all outstanding equity units. If this percentage is exceeded all the economic rights pertaining to the units acquired by the person or economic group concerned shall by suspended.

In exceptional situations that jeopardise the effectiveness of a savings bank's own funds, as well as its stability, liquidity and solvency, the Deposit Guarantee Fund and other institutions in the savings bank sector may, with prior Banco de España authorisation, hold more than 5% of the equity units issued by such savings bank.

The direct acquisition of equity units by the savings bank itself or its economic group is not permitted. Indirect acquisitions are permitted, provided that the nominal value of the units held by the institution or its consolidated group does not exceed 5% of the outstanding units.

Meanwhile, the following funds that must be established when the units are issued continue to be regulated: the Equity Fund (*Fondo de Participación*), which shall be equal to the total nominal value of the equity units issued; the Unit-Holder Reserve Fund (*Fondo de Reservas de los Cuotapartícipes*), which shall be made up of the freely disposable surplus corresponding to the equity units that has not been assigned to the Stabilisation Fund or paid out to the unit holders, and the Stabilisation fund (*Fondo de Estabilización*), the purpose of which is to avoid excessive fluctuations in the remuneration of the equity units. The Equity Fund, the Unit-Holder Reserve Fund and, if there is one, the Stabilisation Fund shall be set against losses in the same proportion and order as the initial funds and the reserves. Also, the Equity Fund and the Unit-Holder Reserve Fund shall be considered to be own funds.

2.5.3. Securities lending by collective investment undertakings

Collective investment undertakings are to be allowed to undertake *securities lending,* through both market and over the counter (OTC) transactions. The purpose is to enable them to offer higher yields to investors, without any reduction in the safety of their investments. The Minister of Economy shall be responsible for establishing the limits and security for these transactions.

2.5.4. Contractual compensation agreements

The Law gives legal certainty to so-called *contractual compensation agreements* which provide for the possibility of bankruptcy of the parties. In fact, it is common practice for financial institutions to operate with one another on the basis of framework agreements that contain guarantees to cover, day to day, the net position resulting from all financing, securities lending, financial derivative, etc. transactions carried out by the parties. The Law extends to these agreements the rules of additional provision ten of Law 37/1998 of 16 November 1998 amending Securities Market Law 24/1988 of 28 July 1988 (8), which shall therefore also apply to OTC transactions. However, certain limitations are maintained with regard to the parties involved (at least one of the parties must be a credit institution or investment services firm) and to the content of the agreement (it shall include the mechanism for calculating the net amount payable) so that the effects of this guarantee regime go no further than strictly necessary.

2.5.5. Improved financing conditions for SMEs

The Law also attempts to improve the financing conditions for SMEs. To this end, it makes it easier for them to raise financing through *factoring,* by permitting their portfolios of general government debt to be assigned en masse.

Notable among the measures to improve the financing of innovative small and medium enterprises is the amendment of the law on the legal and tax regime for *venture capital companies,* regulated by Law 1/1999 of 5 January 1999 (9). As a result of the experience gained since this law was enacted the following changes have been introduced: first, it is made easier for these companies to continue to hold the shares of firms that were not listed at the time of their acquisition and that have subsequently been listed on an exchange; second, it is made easier for them to invest in securities issued by firms which have more than 50 per cent of their assets in property, provided that they are directly involved in a business undertaking or activity that is not strictly property-centred; third, the operations of these companies are given greater flexibility, with in-kind capital contributions permitted after their formation; and, finally, it is ensured that the company operations of a venture capital company or which give rise to one are duly controlled.

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

(9) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 100-101.

Also, venture-capital companies are permitted to invest up to 25 per cent of their assets in companies belonging to their group or to that of their management company, provided that the following requirements are fulfilled:

a) That their articles of association or internal rules envisage such investments.

b) That the company or, where applicable, its management company has an internal procedure, specified in its internal rules of conduct, to enable conflicts of interest to be avoided and to ascertain that transactions are in the exclusive interest of the company. A committee of the board of directors or an internal body of the management company shall be responsible for verifying fulfilment of these requirements.

c) That the company's prospectuses and regularly published information give details of any investments in entities belonging to the same group.

2.5.6. Promotion of the use of electronic techniques

Another chapter of the Law regulates the legal effects of *electronic trading* and transposes the Directives on electronic money into Spanish law. Electronic money is defined as monetary value as represented by a claim on the issuer which is stored on an electronic device, issued on receipt of funds of an amount not less in value than the monetary value issued and accepted as means of payment by undertakings other than the issuer.

Electronic Money Institutions (EMIs) are credit institutions whose main activity is the issuance of means of payment in the form of electronic money. Institutions seeking to carry on this activity may not receive funds of an amount exceeding the monetary value issued. The receipt of funds shall not constitute the receipt of funds repayable to the public if they are immediately exchanged for electronic money. However, they shall be subject to the same treatment as deposits, for the purposes of their coverage by deposit guarantee funds, if the device into which they are incorporated is in registered form or they are linked to an account representing a deposit made by its holder.

To carry on the business of issuing electronic money within Spanish territory authorisation to act as a credit institution shall be obtained and the entity shall be entered in the relevant registers. The Minister of Economy, further to a report of the Banco de España, shall be responsible for authorising EMIs, and the Banco de España shall be responsible for their supervision and inspection, as well as for entering them in the register set up for the purpose. EMIs shall be subject to the sanctioning regime applicable to credit institutions, with such adaptations as may be determined by regulations.

The Law enables the government to develop the rules applicable to the setting up of Electronic Money Institutions and the conditions for pursuit of their business. Also, the Minister of Economy is authorised to regulate the special features of the general rules governing electronic trading, ensuring that the legitimate interests of customers are protected, without prejudice to the freedom to trade that, in its substantive aspects and subject to the limitations that may arise from other legal provisions, must govern the relations between investment services firms and their customers.

2.6. Measures to protect financial services customers

2.6.1. Bodies to defend customers

First, the law regulates some administrative bodies newly set up to defend financial service customers. These are: *the Commissioner for the Defence of Bank Customers; the Commissioner for the Defence of Investors and the Commissioner for the Defence of Insurance Policyholders and Pension Scheme Participants,* attached to the Banco de España, the CNMV and the Directorate General for Insurance and Pension Funds, respectively, whose express aim is to protect the rights of financial service users in their relevant area. Also, the government has been empowered to develop regulations to implement the provisions of the law relating to these Commissioners and, in particular, dealing with their appointment, their hierarchical ranking, the procedure for resolving complaints and claims and the content of their annual reports

Second, the law establishes an obligation on all credit institutions, investment services firms and insurance companies to attend to and resolve the complaints and claims presented by their customers in relation to their legally recognised interests and rights. For these purposes, the financial institutions shall have a customer care department or service. Also, they may appoint an *ombudsman,* who shall be responsible for dealing with and resolving the types of claims determined, in each case, by their rules of operation, and that shall be an independent entity or expert. Decisions of the ombudsman in favour of claims shall be binding on the institu-

tion. The Law authorises the Minister of Economy to lay down certain minimum requirements that shall be met by the customer care department or service and by the ombudsman.

2.6.2. Other protection provisions

Strengthening of supervisory powers

The law updates and modifies the sanctioning regime for credit institutions, investment services firms and insurance companies, introducing as grounds for sanctions deficiencies in the administrative or accounting organisation or in the internal control procedures, including those relating to risk management, when such deficiencies jeopardise the institution's solvency or stability. It also modifies the law regulating currency-exchange bureaux, tightening the requirements for taking up the business by introducing a requirement for administrative authorisation, when such business is carried on by natural or legal persons other than credit institutions, and requirements of commercial and professional repute for the owners of such bureaux. In addition, the Law establishes greater control over institutions selling foreign banknotes or travellers' cheques or arranging international transfers, making the Banco de España responsible for their supervision and oversight. Finally, the Law widens the sanctioning regime applicable to these institutions.

Transparency in capital markets

The protection of capital market investors is promoted, by strengthening the transparency rules and improving information.

First, transparency rules are applied to *related transactions,* to avoid abuses by executives and directors contrary to the interests of the shareholders. Specifically, companies issuing securities listed on an official secondary market shall necessarily include in their half-yearly information quantified information on all the transactions carried out by the company with related parties (executives and significant shareholders) in such form as may be determined by the Ministry of Economy or, with its express authorisation, by the CNMV, indicating the type and nature of the transactions and the related parties involved. However, the Ministry of Economy shall determine on which transactions individual information shall be supplied, where these are significant on account of their amount or are relevant to an adequate understanding of the company's financial statements.

Second, the regulation of *inside information* and *relevant information* is tightened, to avoid the loss of market integrity and, in the final analysis, a rise in the cost of corporate financing on account of lack of investor confidence. The concept of *inside information* is extended to cover instruments other than transferable securities, and it is considered to be any information of a specific nature that has not been published and that if it were or had been published, might influence or might have influenced their price on a market or organised trading system appreciably.

All entities or groups of entities that provide investment services and those other entities that perform or provide securities-market investment advisory services are under an obligation to establish such measures as may be necessary to prevent the flow of inside information between the various areas of their business, so as to ensure that each of them takes its decisions in relation to the securities market autonomously and that conflicts of interest are avoided. Also, all the entities and groups of entities that make, publish or disseminate reports or recommendations on companies that issue listed securities or financial instruments shall act fairly and impartially, stating in a prominent place in their reports, publications or recommendations any relevant links they may have, including commercial relationships, and any permanent holding that the entity or its group may have or be going to have in the company analysed, and also that the document does not constitute an offer to sell or subscribe for securities. The Minister of Economy and, with its specific authorisation, the CNMV may establish measures of a compulsory nature to develop this article and, in particular, an obligation on entities to have specific internal rules of conduct for their investment advisory services.

The Law also specifies in great detail the information that should be considered *relevant,* namely that whose knowledge may reasonably affect an investor thinking of acquiring or transferring securities or financial instruments and therefore may significantly influence their price on a secondary market. Issuers of securities are obliged to disclose it to the market immediately, by means of prior notification to the CNMV, before it is published by any other means, and as soon as the fact, decision or agreement in question is known, has been taken or has been signed. Also, issuers of securities shall also disclose this information on their websites.

Preventive organisational measures are also specified for institutions that provide services in the securities markets, in order to prevent the leaking of information between the different areas of an entity or between entities of the same

group (so-called "Chinese walls"). The previous obligations to act transparently are extended to executives, directors and employees. All of them are prohibited from indulging in practices aiming to distort the free formation of prices in the securities market, i.e. price manipulation.

The Minister of Economy and, with its express authorisation, the CNMV, may establish compulsory measures that, inter alia, determine the method and time periods for the directors and executives, and those persons that have a close link with them, to notify the CNMV and the general public of acquisitions of securities and financial instruments issued by the entity in which they hold such office or indexed thereto.

The law also assigns powers to the CNMV to make the necessary requirements of and, where applicable, to impose sanctions on the persons or entities that fail to comply with the above-mentioned rules.

Changes to the rules governing the authorisation of collective investment undertakings

The Law amends the rules on the authorisation of collective investment undertakings, to follow the principle that it should be the regulatory body (the Minister of Economy) which authorises the management company and the supervisory body (the CNMV) the collective investment undertaking (CIU), instead of the Minister of Economy as until now. Except for CIUs with the status of companies, the registration of funds in the Mercantile Registry is now optional, registration with the CNMV being sufficient.

The Minister of Economy, instead of the CNMV, is now responsible for authorising CIU management companies, upon a proposal from the CNMV, while the CNMV remains responsible for authorising CIU depository institutions. In both cases subsequent entry in the relevant CNMV administrative register is required and this shall be granted on the terms that may be established in regulations. Also, the Law expressly requires CIU depositories to be members of the clearing, settlement and registration systems in the various Spanish markets.

As regards the merger of funds, the procedure laid down in Law 46/1984 of 26 December 1984 regulating Collective Investment Undertakings (10) is specified and widened. Thus, mutual funds may merge either through takeover by an existing fund, or through the dissolution of both and the transfer en bloc of their assets and liabilities to a new fund. The commencement of the procedure shall require a prior resolution of the management company and of the depository of the funds that are going to merge, which shall be presented, along with the merger project, to the CNMV for its authorisation. The minimum content of a fund merger project shall be specified in regulations.

In the event of insolvency or the admission for consideration of a petition for suspension of payments of a securities depository of any CIU, the Law authorises the CNMV to transfer immediately, without charge to the institution, the foreign securities, including those deposited with third parties, held in the name of the depository on behalf of the collective investment undertakings that it manages, to another institution authorised to carry on the same business.

Also, Law 24/1988 of 28 July 1988 on the Securities Market (11) has been amended to extend the applicability of the rules on the fitness and properness of directors, general managers and similar officers of investment services firms to cover agents with general powers of representation.

Strengthening of the rules of conduct in the securities market

With a view to effective compliance with the abovementioned transparency obligations, the Law strengthens the rules of conduct of the institutions that operate in the securities market (in particular, investment services firms and credit institutions) with the ultimate aim of protecting investors. Thus, among the new rules of conduct added by the Law, institutions must abide by the following principles: *a)* ensuring that customers are treated equally, avoiding giving priority to some over others when distributing recommendations and reports; *b)* refraining from taking positions for own account on securities or financial instruments in respect of which it is conducting a specific analysis, from when the conclusions are known until the related recommendation or report is released and *c)* to state to customers any possible conflict of interest in relation to the advice or to the investment service provided.

Insofar as they are compatible with their business, these principles shall be applicable to

(10) See "Regulación financiera: cuarto trimestre de 1984", in *Boletín económico,* Banco de España, January 1985, pp. 41-44.

(11) See "Regulación financiera: tercer trimestre de 1988", in *Boletín económico,* Banco de España, October 1988, pp. 61 and 62.

those persons or institutions who carry out analysis of securities and financial instruments.

Finally, the law requires them to send internal rules of conduct to the CNMV within nine months. In addition, they shall send a written undertaking to ensure that these internal rules of conduct are kept updated and that their content is known, understood and accepted by all the persons belonging to the organisation to whom it is applicable.

THE AUDIT COMMITTEE IN COMPANIES THAT ISSUE SECURITIES

The Law introduces the institution known as the *Audit Committee,* which companies that issue shares or bonds listed on official secondary securities markets are required to have. The number of members, the powers and rules of operation of the Committee shall be established in the company's articles of association. Its duties shall include at least the following:

1. Reporting to the shareholders in General Meeting on matters they have raised that come within its competence.

2. Proposing the appointment of the auditors to the Board of Directors for submission to the shareholders in General Meeting.

3. Supervising the internal audit services, as well as knowing the financial information process and the company's internal audit systems.

4. Contacting the external auditors to request information on matters that may compromise their independence and any others relating to the auditing of the accounts, as well as those other communications provided for in the law on the auditing of accounts and in the technical audit rules.

CHANGES TO THE CONDITIONS FOR PERFORMING AUDITING ACTIVITIES AND TO THE RELATED SANCTIONING REGIME

As regards becoming an auditor, a new *single examination system* is established. Examinations shall be held upon the joint proposal of the corporations representing auditors, and secondarily of the Institute of Accounting and Auditing, following approval by the latter of the proposal, which shall be published by means of an Order of the Ministry of Economy. Persons passing these examinations shall be qualified to join the corporations representing auditors, in relation to performance of the audit function, without prejudice to the specific membership requirements of each corporation. Also, compulsory continuous education is established for auditors, in such form and upon such conditions as may be laid down in regulations.

Auditors shall be and shall be seen to be independent of the firms or entities they audit, and shall refrain from acting when the objectivity required to check the relevant accounting documentation might be seen to be compromised. Also, the new Law widens the cases of non-compatibility envisaged in the Auditing Law 19/1988 of 12 July 1988 and retains the three-year period following termination of contract, during which auditors shall not work for or belong to the administrative or management bodies of the audited firm or entity, or have any direct or, if it is significant for either of the parties, indirect financial interest in the audited entity.

The supervisory arrangements for audit activities are widened to allow, inter alia, the Banco de España, the CNMV and the Directorate General of Insurance and Pension Funds to have access to audit documentation. This access shall only be available when these agencies and bodies cannot obtain the specific documentation to which they require access from the entities themselves and shall be solely for the purpose of performing their duties in relation to entities subject to their supervision and control, when the matter is particularly serious. The aforesaid agencies and bodies may also request from auditors any information they may have on a specific matter relating to the auditing of the accounts of the entity in question with clarification, where applicable, of the content of working papers.

Finally, the range of infringements that can be committed by auditors is widened and a new category of infringement is introduced, namely very serious ones. Inter alia, these include: the issuance of audit reports with an opinion inconsistent with the evidence obtained by the auditor, when there has been especially serious and inexcusable wrongdoing or negligence; breach of the auditor's duty of independence; stopping or resisting performance of the Institute of Accounting and Auditing's duties of supervision or discipline; and the use of information obtained in the performance of their duties for own or third-party benefit.

MEASURES TO IMPROVE THE EFFICIENCY, EFFICACY AND QUALITY OF SUPERVISION PROCEDURES

To this end, the Law provides that the National Energy Commission (*Comisión Nacional de la Energía*) the Telecommunications Market

Commission (*Comisión del Mercado de las Telecomunicaciones*), the CNMV (*Comisión Nacional del Mercado de Valores*) and the Banco de España shall have internal control bodies whose hierarchical relationships and reporting powers shall be governed by the principles of impartiality, objectivity and the avoidance of conflicts of interest. These bodies shall issue an annual report on their supervisory function, describing their supervisory activities and procedures, with information indicating the efficacy and efficiency thereof. This annual report shall also include a report by the internal control body concerned on the appropriateness of the decisions taken by its governing body in the light of the procedural law applicable.

The Banco de España, the CNMV and the Ministry of Economy shall, within the sphere of their respective legal powers to supervise and inspect financial institutions, co-operate closely in order to harmonise where desirable and to improve, on the basis of their experience, the criteria and programmes involved in the supervision techniques and practices they use to perform their functions. For this purpose, they shall regularly exchange relevant information, in particular, that relevant to the quality of the techniques used, and they may enter into an agreement or agreements to standardise such exchanges, to homogenise specific procedures or practices and, where applicable, to specify the instruments that enable the aforementioned objectives to be monitored.

2.7. Other changes

2.7.1. Reform of the Central Credit Register

A further measure to boost the efficiency of the financial system is the reform of the law governing the Central Credit Register of the Banco de España (CCR), which aims to unify the legal arrangements and to strengthen its role within the financial system. The CCR is of fundamental importance both to the control of risk by credit institutions and to the supervision carried out by the Banco de España, so that the Law gives it the legal nature of a *public service* and entrusts its management and administration to the Banco de España. The latter is responsible for treatment of the collected data, those persons affected having no right to challenge the treatment of their personal data when these have been obtained in accordance with the law. The objectives of the CCR are: to collect from the reporting institutions information and data on credit risks; to enable the authorities responsible for the prudential supervision of such institutions to exercise their powers of supervision and inspection appropriately; to help the Banco de España perform the other functions it has been legally assigned correctly; and to contribute to the stability of the Spanish credit system.

The Law regulates other important aspects of the functioning of the CCR, such as the entities and risks that must be declared, the information that shall be supplied to CCR users, the use and transfer of data by the reporting institutions and the Banco de España, the rights of access, rectification and cancellation of the information on borrowers and the length of time the information shall be maintained, which is ten years, although it can be maintained indefinitely for statistical, historical or scientific purposes, as long as the borrowers cannot be identified. The Law also refers to the sanctions that may be applicable in the event of breach of provisions regarding the use of data or inaccuracies in its reporting.

2.7.2. Externalisation of pension commitments

First, the period for adapting companies' pension commitments to staff to additional provision one of Law 8/1987 of 8 June 1987 on the Regulation of Pension Schemes and Funds (12), already extended to 16 November 2002 by additional provision twenty-five of Law 14/2000 of 29 December 2000 on Fiscal, Administrative and Social Measures, has been further extended to *31 December 2004* for the purpose of integration into jointly promoted employment pension schemes of those commitments arising under supra-firm collective agreements, which are linked to a worker's length of service in the firm or sector up until retirement and consist of a single benefit payable upon retirement.

For such purposes, the representatives of the firms and of the workers at the supra-firm level may promote one or more jointly promoted pension schemes, which those firms subject to the collective agreement may belong to, notwithstanding the necessary adaptations that must be agreed upon in order to adjust the form of the aforementioned commitments to the basic principles of pension schemes established in the law relating thereto.

Finally, the financial limits for the externalistion of pension commitments through pension schemes have been abolished. For this pur-

(12) See "Regulación financiera: segundo trimestre de 1987", in *Boletín Económico,* Banco de España, July-August 1987, pp. 49-51.

pose, section 4 of transitional provision fifteen of Law 30/1995 of 8 November 1995 on the Regulation and Supervision of Private Insurance (13) has been amended so that the maximum amount of recognised past services corresponding to the years beginning on 1 January 1988 until the institution of the Pension Scheme cannot exceed, for each of these years, the amount of the annual financial limit in force in each of these years. However, when the pension commitments of firms to their employees or workers arise under a collective agreement all past services shall be included. For such purposes, where appropriate, the related rebalancing plans shall be modified for their approval or inspection by the Directorate General of Insurance and Pension Funds.

2.7.3. Restrictions on the temporary financial investments of non-profit entities

The CNMV, the Banco de España and the Ministry of Economy shall, each within their area of supervision, approve codes of conduct containing the specific rules for the temporary financial investments of foundations, establishments, non-profit institutions and associations, professional associations, employment promotion funds, mutual associations, mutual social welfare societies, mutual insurance companies for workplace accidents and occupational diseases within the Social Security System and, as the case may be, other institutions subject to low corporate income tax rates, but not subject to a specific system for the diversification of investments to optimise the return on the cash they have available to be used to earn a return in accordance with their operating rules.

The governing, administrative or management bodies of such institutions must present an annual report on the degree of compliance with such codes for the information of the person covered or their associates or members.

2.7.4. Other measures

The law revises in depth the organisation and functions of the CNMV and provides for the approval of by-laws for this body.

It also introduces certain changes to the Public Limited Companies Law and the Private Limited Companies Law. Particularly notable are those relating to the valuation of the shares and other equity of a company in certain specific cases, such that the valuation shall generally refer to "fair value" instead of "real value", a value that shall be determined by an auditor other than the company's auditor.

The Law also regulates the system of rounding for certain credit transactions (mainly mortgage loans) that has been applied in accordance with the customs of banking practice. From the entry into force of the law, the variable interest rate that may be agreed in credits and loans secured by mortgage, bond, pledge or some other equivalent guarantee shall be rounded to the end of the nearest agreed interval, without this exceeding one eighth of a percentage point.

3. CONSOLIDATED TEXT OF THE LAW ON THE REGULATION OF PENSION SCHEMES AND FUNDS

Law 30/1995 of 8 November 1995 on the Arrangements for the Supervision of Private Insurance amended Law 8/1987 of 8 June 1987 on the Regulation of Pension Schemes and Funds. The amendments included most notably the incorporation of arrangements for the safeguarding of companies' pension commitments with their employees, established in compliance with Council Directive 80/987/EEC of 20 October 1980 on the approximation of the laws of the Member States relating to the protection of employees in the event of the insolvency of their employer. Subsequently, Law 66/1997 of 30 December 1997 (14), amended by Law 50/1998 of 30 December 1998 (15), both consisting of fiscal, administrative and social measures, complemented the transitory financial and fiscal regime for the adaptation of pension commitments provided for in Law 30/1995.

Likewise, Law 30/1995 updated and finalised the administrative sanctioning regime of Law 8/1987, in line with the regulation and supervision of insurance corporations. It introduced a system of special control measures to ensure the end-purpose for which pension funds were regulated. It further identified the grounds for winding up management companies and pension funds, along with the grounds for terminating pension funds and those for an administrative resolution to intervene in the liquidation and revocation of authorisation of management companies and pension funds, all this

(13) See "Regulación financiera: cuarto trimestre de 1995", in *Boletín económico,* Banco de España, January 1996, pp. 86-91.

(14) See "Financial regulation: fourth quarter of 1997" in *Economic Bulletin,* Banco de España, January 1998, pp. 90-91.

(15) See "Financial regulation: fourth quarter 1998" in *Economic Bulletin,* Banco de España, January 1999, p. 110.

in parallel with the arrangements for insurance undertakings.

Law 14/2000 of 29 December 2000 on fiscal, administrative and social measures amended Law 8/1987 on the own-funds requirements applicable to the managing entities of pension funds. For its part, Law 24/2001 of 27 December 2001 on fiscal, administrative and social measures (16) introduced a series of amendments. These included most notably those affecting the regulation of employment pension schemes, providing for their co-ordination with representation and bargaining processes in the labour environment; those relating to the maximum annual contribution limit for pension schemes; and those detailing the freedom of the provision of pension fund investment management services further to Community Directives, and the reporting obligations on pension scheme participants and beneficiaries.

The above-mentioned Law 24/2001 authorised the Government to draft, in the twelve months following the entry into force of this legislation, a consolidated text for the Law on the Regulation of Pension Funds and Schemes, integrating therein, once duly regularised, clarified and systematised, Law 8/1987 of 8 June 1987 on the Regulation of Pension Funds and Schemes and other similarly related provisions.

In compliance with this authorisation, *Royal Legislative Decree 1/2002 of 29 November 2002* has recently been enacted. This legislation approves the consolidated text of the Law on the Regulation of Pension Funds and Schemes (BOE 298/2002 of 13 December 2002). The consolidated text includes, as ordered by the legislator, the financial regime applicable to the handicapped and established under Law 40/1998 of 9 December 1998 on Personal Income Tax and other tax rules (17), updated by Law 6/2000 of 13 December 2000 on urgent fiscal measures to encourage household saving and small and medium-sized enterprises, and by Law 24/2001 of 27 December 2001.

The consolidated text also incorporates the process of externalisation of pension commitments, so as to endow the social agents involved with a regulatory text encompassing the regulation of pension schemes and aspects of the duly updated process of adaptation. The consolidated text likewise retains the treatment accorded to the voluntary transformation of companies' internal funds and other staff welfare systems into pension schemes, since the associated effects may still have a bearing on processes initiated in this connection.

4. AMENDMENT OF PERIODIC REPORTING FORMATS FOR INSTITUTIONS ISSUING STOCK-MARKET-LISTED SECURITIES

In its capacity as supervisory body of the markets, the CNMV is empowered to resolve various procedures contained in Securities Market Law 24/1988 of 24 July 1988 and, consequently, it is the authorised agency responsible for approving the electronic, IT and teleprocessing procedures to be used in its relations with those under its supervision. Pursuant to the foregoing, the CNMV, by means of the Resolution dated 11 March 1998 (BOE of 27 March), set in place an electronic application called CIFRADOC/CNMV (the "CNMV On-line Information Exchange System"). The system was structured as a means of information exchange to be progressively used by the CNMV itself, the institutions supervised by it (issuers, agency brokers and securities-dealer companies, management entities, etc.) and the public in general. Its scope covered both the handling of specific procedures (under the responsibility of the CNMV) and the reception of information submitted to the Commission. It also covered the complaints and enquiries which correspond to the public information department of the CNMV, and left open the possibility of incorporating any other exchange of information which, in accordance with current law, it considered fit to incorporate into the CIFRADOC/CNMV. The outcome was greater flexibility in such procedures, without detracting from their legal security in any way.

The Ministerial Order of 18 January 1991 on the periodic public reporting by institutions issuing securities listed on Stock Exchanges (18) authorised the CNMV to amend the formats included in the annexes to this regulation. Accordingly, CNMV Circular 3/1994 of 8 June 1994 (19), amending the periodic public reporting formats for institutions issuing stock-market-listed securities, already accommodated the possibility of information being reported by computerised means, in accordance with the technical requirements specified by the CNMV.

(16) See "Financial regulation: 2001 Q4" in *Economic Bulletin,* Banco de España, January 2002, pp. 97-99.

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

(18) See "Regulación financiera: primer trimestre de 1991", in *Boletín económico,* Banco de España, April 1991, p. 52.

(19) See "Regulación financiera: segundo trimestre de 1994", in *Boletín Económico,* Banco de España, July-August 1994, pp. 99-100.

On the basis of the above-mentioned authorisation, *CNMV Circular 2/2002 of 27 November* (BOE 301/2002 of 17 December 2002) was published. This amends Circular 3/1994 of 8 June 1994. It is intended to institute use of the coding and electronic signature system CIFRADOC/CNMV for the transmission of the periodic public information regulated by the aforementioned Order, as it is considered that the benefits entailed by the widespread use of the system by corporations issuing stock-market-tradable securities will be appreciable for investors, for the issuing institutions themselves and for the supervisory tasks of the CNMV.

A prior requisite for the on-line reporting of documents is registration as a system user and the exchange of codes for coding and decoding the documents, with the CNMV providing the necessary software. That ensures confidentiality, security and non-repudiation in the transmission of information. This simplicity of procedure and the need for technical equipment that is fully accessible to corporations with securities traded on a stock market has led the CNMV to institute the CIFRADOC/CNMV system as the sole periodic public information reporting system.

Nonetheless, when exceptional circumstances arise making the transmission of the aforementioned information through the CIFRADOC/CNMV system impossible, the CNMV may, exceptionally and upon the request of the issuing corporation, authorise the periodic public information to be submitted on the forms prepared by the CNMV, in accordance with the stipulations of the formats currently in force.

5. OFFICIAL SECONDARY MARKETS FOR OLIVE OIL FUTURES AND OPTIONS

Royal Decree 1814/1991 of 20 December 1991 (20) regulated in broad terms the official secondary futures and options markets. Subsequently, this regulation was amended by Royal Decree 695/1995 of 28 April 1995 (21), which established special rules applicable to the official secondary markets for citrus fruit futures and options and empowered the Ministry of Economy to determine the specialities to which the official secondary markets for futures and options based on non-financial instruments other than citrus fruits should be subject.

Law 37/1998 of 16 November 1998, amending Securities Market Law 24/1988 of 24 July 1988, empowers the Government to authorise the creation of the various official secondary futures and options markets.

By virtue thereof, the *MINISTERIAL ORDER ECO/3235/2002 of 5 December 2002* has been enacted. This implements the particular features applicable to the official secondary markets for olive oil futures and options (BOE 303/2002 of 19 December 2002).

The salient particularity of the regulation contained in this Order is the provision whereunder other non-financial entities that habitually engage in the production, marketing, mediation and/or distribution of olive oil may have access to market-member status. This involves the need to regulate the requirements to be met by these entities, with the aim of ensuring they comply with minimum standards of solvency, professionalism and specialisation, and, moreover, that their participation does not introduce exceptional risks into the markets. The admission of industrial members will prove useful for this sector, since it will have a bearing on increasing market activity.

Further particularities of this regulation compared with the general provisions governing the official secondary markets for financial futures and options lie in the reports that must be requested of certain public agencies regarding the viability of the markets and of the contracts that can be traded on them; the content of the general conditions of negotiable contracts, which should feature as an annex to the corresponding market Regulation; the special circumstances in which trading can be suspended, given the characteristics of the underlying asset; and the questions applicable to the management bodies of these markets.

Authorisation of the official secondary markets for olive oil futures and options shall be the competence of the Government, upon a proposal of the CNMV (CNMV). Without prejudice to the administrative responsibilities that may arise, the CNMV shall propose to the Government the withdrawal of the authorisation granted to the Management Company should there be supervening non-compliance with any of the requirements motivating the conferral of said authorisation.

The legal regime and functions of Management Companies are also regulated and, finally, their regulatory implementation is provided for. Inter alia, this shall, given the particularities of this market, include the presence of market information dissemination systems, the setting of

(20) See "Regulación financiera: cuarto trimestre de 1991", in *Boletín económico,* Banco de España, January 1992, pp. 63-64.

(21) See "Regulación financiera: segundo trimestre de 1995", in *Boletín Económico,* Banco de España, July-August 1995, pp. 104-105.

limits on open positions and other specific control measures.

6. PARTIAL REFORM OF PERSONAL INCOME TAX, CORPORATE INCOME TAX AND THE TAX ON THE INCOME OF NON-RESIDENTS

6.1. Introduction

Following the consolidation of the structure and content of personal income tax set in place by Law 40/1998 of 9 December 1998, further reforms have become necessary to adapt the tax to the changing circumstances of Spanish society and thus to promote saving, investment and employment, in compliance with the commitments envisaged in the budgetary stability programme.

Furthermore, the approval of Law 21/2001 of 27 December 2001 regulating the fiscal and administrative measures of the new financing arrangements for the ordinary-regime regional (autonomous) governments and the city-enclaves (Ceuta and Melilla) with autonomous region status, has shaped the new framework of fiscal co-responsibility and powers of the regional governments in respect of personal income tax.

So as to see these points through, Law 46/2002 of 18 December 2002 was enacted. This legislation partially reforms personal income tax and amends the Laws on corporate income tax and the tax on the income of non-residents (BOE 303/2002 of 19 December 2002), given their interrelatedness.

The Law comprises three chapters, each dedicated specifically to the tax being amended. The key details are outlined hereafter.

6.2. Partial reform of personal income tax

The family occupies a central role in the present reform, continuing along the initial lines established in 1998. Particular regard is had to needs arising from circumstances such as the decline in the birth rate, population ageing and disabilities, while the incorporation of women into the labour force is encouraged, in keeping with the spirit and the objectives of the government's *Integrated Plan for Family Support*.

As part of the new reform of the tax, then, the minimum amount of the personal and family tax-free allowance has been raised, i.e. that portion of their income that taxpayers generally set aside to meet their needs and those of their children, with particular attention given to large families. Likewise, new deductions are included in the taxable base for children under three years old, for the age of taxpayers themselves or of their parents, for expenses relating to care for the elderly and for the disabled, in an attempt to adapt the tax burden to situations of dependency. Specifically, the treatment for tax purposes of the family and of situations of disability is improved, with a general increase in the amounts involved and a new deduction for care, so as better to attend to the needs of both the disabled and the people on whom they depend. In order to compensate for the social and labour costs arising from maternity, a new deduction from net tax payable is added for mothers, with children under three, who work outside the home.

The taxation of income from work is improved by the increase in the amount deductible for this type of income, and by the creation of two specific deductions for these earnings. The first is the deduction for extending one's working life, and the second is to facilitate labour mobility.

As one of the aims of the reform is to continue to promote long-term saving, the new so-called *insured provision-for-retirement schemes* have been created, the tax regime for which is on a par with that of individual pension schemes provided they meet a series of requirements. These essentially match those demanded of pension schemes which, in turn, will mean that the premiums paid on these new insurance contracts may be deducted from the tax base.

For income from property arising on rented housing, the calculation of net income has been refined and simplified, and additional incentives for increasing the supply of rented housing and reducing rental prices have been introduced.

Regarding movable capital (savings and investments) income, changes have been made which involve progress in the promotion of long-term saving, an aim pursued via greater neutrality and an improved taxation regime. This has taken the form of an increase in the reducing percentages applicable, a reduction in the period that must transpire before their application, and simplification by means of the reduction in the number of percentages scheduled.

For the determination of net income from business activities, the personal income tax self-assessment arrangements are altered, with new restrictions being added. These include that relating to the volume of purchases, to adapt the tax regime better to the size of the

firm, and the restriction on business activities pursued in the region where the tax is applied. To increase neutrality in respect of business activities, the tax transparency regime has been eliminated and the regime for companies subject to income attribution has been amended so as to obtain greater information on the activities they engage in.

With regard to capital gains and losses, the most significant changes are the reduction in the tax rate applicable to the special-regime final tax base and the absence of any taxation of redemptions of shares in mutual funds which the taxpayer holds, provided that the resulting balance is reinvested in shares in other funds.

The tax schedule has been simplified and the tax burden lessened, whereby rates and the number of brackets have been reduced.

To provide for greater international mobility of workers and for the related changes in residence from Spain to abroad or vice-versa, the payment-on-account arrangement applicable to income earned in these circumstances has been simplified by means of a mechanism involving communication of the immediate change of residence to the tax authorities. This new arrangement, which has been added in parallel to the legislation on the taxation of non-residents' income, represents a significant improvement for employees and employers alike.

Finally, the possibility of draft returns being sent to taxpayers by the tax authorities has been regulated, the aim being to smooth the processing of the tax and to promote voluntary compliance, which is a priority basic to the tax authorities' activity.

6.3. Amendment of corporate income tax

The partial amendment of Law 43/1995 of 27 December 1995 on Corporate Income Tax (22) focuses on the elimination of the special tax transparency regime. The disappearance of this regime, warranted for reasons of neutrality, entails the elimination of all degrees of the special regime for entities whose income arises from professional, artistic or sporting activities, while the new special regime covering investment companies will be applicable to the so-called portfolio or asset-holding institutions.

These investment companies will be taxed under personal income tax regulations as regards the determination and integration of the tax base, in such a way that the tax will be divided into two parts: the general portion and the special portion. The former will be taxed at a rate of 40% and the latter at 15%, with no attribution to shareholders.

The elimination of the tax transparency regime means the references to it throughout the articles of the legislation governing the tax have to be revised, if not indeed repealed. The biggest adaptation involves Spanish and European economic interest groupings and joint ventures. The previous special regimes for these three types of vehicles, based on the reference to tax transparency, are now unified under a new regime in which the same material regulation hitherto applicable to them is reproduced.

As far as taxpayers that are shareholders of entities subject to the income attribution regime are concerned, a reference is made to the general regulation covering this regime in personal income tax Law 40/1998.

Finally, and under the fiscal consolidation regime, the specific requirements to be met by the permanent establishments of non-resident entities on Spanish territory that acquire the status of controlling entity of a Spanish fiscal group are regulated.

6.4. Amendment of the tax on the income of non-residents

The reform is in accordance with the broad thrust of Law 41/1998 of 9 December 1998 (23) on the Tax on the Income of Non-residents and Other Tax Provisions. Thus, it attempts to make technical improvements to the previous text, in the light of the experience gained from its application, at the same time as certain new elements not expressly regulated before are incorporated. All this has three basic objectives: to assist the internationalisation of Spanish firms, both from the viewpoint of investment and of the geographical mobility of labour, to attract more foreign investment to Spanish financial markets and to improve control mechanisms to avoid tax fraud.

As regards liability, the representatives of taxpayers who operate in Spain through a permanent establishment are made jointly and severally liable for the tax debts of the latter. A

(22) See "Regulación financiera: cuarto trimestre de 1995", in *Boletín económico,* Banco de España, January 1996, pp. 91 and 92.

(23) See "Financial regulation: fourth quarter 1998", in *Economic bulletin,* Banco de España, January 1999, pp. 107-108.

number of changes have been made to the factors that determine the income obtained within Spanish territory subject to the tax, which are intended to facilitate their application. Notable for their importance are charges, the remuneration of members of entities' boards of directors and pensions.

At the same time, the regulation of the so-called payment criterion has been amended, its application being restricted to the circumstances intended by means of better specification of factual cases, with broad definitions being avoided. Thus, the payer criterion is no longer generally applicable with exceptions for certain income, but shall only be applicable to expressly specified income.

As regards income obtained without a permanent establishment, as mentioned above, the possibility is introduced for taxpayers of the tax on the income of non-residents who change residence and, in consequence, become personal income tax taxpayers, or vice versa, to anticipate the effects of that change in the withholdings made on their income from paid employment.

Also, a number of provisions are established relating to entities subject to income attribution, which previously had no specific treatment for the purposes of this tax. The general rules for these entities are regulated in the personal income tax so that this Law only introduces the special rules on the taxation of entities subject to income attribution that have been set up abroad, which are made taxpayers of the tax in certain cases, and of non-resident shareholders of both Spanish and foreign entities subject to income attribution.

Finally, the tax regime for certain income obtained in Spain by non-residents who are resident in some other EU Member State is regulated in greater detail than in the previous law.

7. STATE BUDGET FOR 2003

As usual in the month of December, the State budget for 2003 was approved by means of *Law 52/2002 of 30 December 2002* (BOE 313/2002 of 31 December 2002).

2003 is the first year in which Law 18/2001 of 12 December 2001 on General Budgetary Stability is applicable. This law aims to ensure that the target for the deficit is achieved and it affects the State budget at three different stages: prior to its preparation, as it stipulates that a spending ceiling must be fixed, which shall apply to the allocations in the budget expenditure statements; during its preparation, as it affects the structure of expenditure statements by requiring a new budgetary section called "Contingency Fund"; and during its execution, since, when modifications to the budget cannot be financed by a reduction in another appropriation, they must be financed out of the Contingency Fund so as to leave the deficit target set by the government unaffected.

From the viewpoint of financial regulation, the following aspects should be highlighted owing to their importance or novelty:

In relation to the financial system, the legal interest rate and the interest rate charged on overdue tax were held at 4.25% and 5.5%, respectively. An increase in State debt of € 13,745 million over its level as at 1 January 2003 has been authorised for 31 December 2003. This limit may be exceeded during the year, following authorisation from the Ministry of Economy, and the cases in which it will be automatically reviewed are established. In the case of public bodies, the level of debt authorised for each in 2003 is determined. Also, the overall limits are determined for government guarantees and other guarantees given by the State and public bodies.

In the fiscal area, and specifically as regards the personal income tax (IRPF), for the purpose of calculating capital gains on property, the coefficients to adjust the acquisition value have been increased by 2%, this being the percentage rate of inflation forecast for the coming year. Also, provisions have been established to compensate for the loss of tax benefits suffered by certain taxpayers, including lessees and purchasers of habitual dwellings, under the current personal income tax law when comparing with the situation under the previous one.

With regard to the corporate income tax, the measures included are, as in the case of the personal income tax, those effective for a year specifically referred to in the Law on Corporate Income Tax. They therefore include the updating of the coefficients applicable to property assets, which enable monetary depreciation to be corrected for in cases of transfer, and the way instalments are to be determined during 2003.

There were no major changes to the financing arrangements established for the regional (autonomous) governments (RGs) last year. The ordinary-regime RGs are financed through the following mechanisms: receipts from assigned taxes and charges; the regional tax rate schedule of the IRPF, which corresponds to 33% of the total schedule for the

tax; the assignment of 35% of the net VAT receipts corresponding to the consumption of each region, and the assignment of 40% or, in certain cases, 100% of the net receipts from specific excise duties. For its part, the sufficiency fund, set up last year, is the main mechanism for levelling and closing the system, and covers the difference between the spending needs of each RG and its revenue-raising capacity in the base year of the system (1999). The sufficiency fund is made up of State funds, which are transferred to the RGs. The financing arrangements for the Ordinary Regime RGs provide for the incorporation of the cities with autonomous region status, through their participation in the sufficiency fund in the base year of 1999 at an amount comprising the valuation of the services transferred and incorporating the subsidisation of the self-government bodies.

The Basque Country and Navarre regional governments are financed through the specific-status arrangements. The financial relations between the Basque Country and the State are regulated by an Economic Accord (*Concierto Económico*), the current one having been approved by Law 12/2002 of 23 May 2002. The financial relations between Navarre and the State are regulated by an Economic Agreement (*Convenio Económico*), with an indefinite term. A period of five years is established for the method of determining the contribution, but this method can be applied to subsequent years too, this having been the case in 2000, 2001 and 2002.

Finally, the Inter-territorial Compensation Fund is regulated, distinguishing between the Compensation Fund and the Supplementary Fund. The Compensation Fund is equivalent to the former Inter-territorial Compensation Fund. The Supplementary Fund is initially used to finance investment expenditure by the regional (autonomous) governments, but it is possible for the regional (autonomous) governments to use it to finance current spending associated with investment financed out of the Compensation Fund or the Supplementary Fund itself.

8. FISCAL, ADMINISTRATIVE AND SOCIAL MEASURES

As usual in recent years, to facilitate attainment of the economic policy objectives set in the State budget for 2003, a number of fiscal, administrative and social measures have been adopted, in *Law 53/2002 of 30 December 2002* (BOE 313/2002 of 31 December 2002).

As in previous years, the Law contains various measures relating to tax, social areas, general government personnel, government administration and organisation and government action in various spheres.

Given the nature of this article, the key measures are highlighted below, first those of a monetary and financial nature and second those of a fiscal nature.

8.1. Government action in the monetary and financial sphere

With regard to *investor-compensation schemes,* certain amendments relating to the Investment Guarantee Fund (IGF) have been introduced into Securities Market Law 24/1988 of 28 July 1988, as previously amended by Law 37/1998 of 16 November 1998. First, certain clarifications are made in the text and the government is given additional powers in relation to the functioning of these funds. In particular, the rules to determine the amount of the contributions that the member institutions are required to make, which must be sufficient to cover the guarantee provided, the frequency of such contributions and the rules that apply when contributions are overdue are specified. Second, portfolio management companies are now required to join the IGF (by 1 February 2003), in accordance with the rules laid down in the relevant regulatory provisions, although they remain exempt from the obligation to take out liability insurance.

Royal Decree 948/2001 of 3 August 2001 on investor-compensation schemes has been amended, to specify and, where applicable, supplement the content of certain provisions, as well as to include the changes mentioned above relating to portfolio management companies.

Also, the financial arrangements for the IGF have been amended. The member institutions shall make annual contributions equal to the sum of the following amounts:

A) A fixed amount, according to the following scale: € 20,000 for investment services firms whose gross fee revenue is less than € 5 million; € 30,000, when such revenue is between € 5 and € 20 million, and € 40,000 when it exceeds € 20 million.

B) 0.2% of the money, plus 0.005% of the effective value of the securities and financial instruments deposited with them or man-

aged by them that belong to customers covered by the guarantee.

C) The product of multiplying the number of customers covered by the guarantee by 0.015% of the minimum amount referred to in article 6.1 (€ 20,000).

The Minister of Economy may, upon a proposal from the CNMV, resolve to reduce the above amounts and percentages when the net assets of the IGF reach a sufficient level for its purposes to be fulfilled. Contributions shall be suspended, in any case, when the net assets not committed to operations for the specific purposes of the IGF, exceed the product of multiplying the maximum cover provided for in article 6.1 by 5% of the number of customers covered by the guarantee of all the institutions belonging to the IGF in the previous year.

When the IGF's management company foresees that the net assets and financing available to the IGF in any year for the performance of its functions and obligations are insufficient, the Board of Directors of the management company shall take such measures as may be necessary to make up the financial shortfall, and may require member institutions to make extraordinary contributions. These contributions shall be payable by the member institutions in proportion to their contributions to the IGF during the preceding three years, or since the institution joined the IGF, when this period has not been completed, 2003 being taken as the first year for these purposes. They shall be payable on such date as the management company may establish, following notification to the CNMV, and their amount shall not exceed the sum required to eliminate the shortfall. The uncommitted net assets of the IGF shall be held in the form of public debt, or other highly liquid low risk assets.

Law 26/1988 of 29 July 1988 on the *Discipline and Intervention of Credit Institutions* has been amended to prohibit auditing firms from working for bodies of regional (autonomous) governments, or for agencies or entities reporting to them, in relation to the exercise of the powers that these authorities have in relation to savings banks and at the same time, or during the previous or subsequent five years, performing any audit work at the savings bank at which they have worked at the behest of the aforementioned institutions.

Law 44/2002 of 22 November 2002 on *Reform of the Financial System* (24) has also been amended to allow data that identify legal persons to be maintained indefinitely by the CCR, so as to enable the relevant authorities to exercise their supervisory and inspection powers, as well as to contribute to the appropriate performance of the other functions that the Banco de España has been legally assigned.

Finally, Law 10/1975 of 12 May 1975 on *coins* has been amended in relation to the infringements and administrative sanctions applicable to the alteration of coins, their modification in the production of articles of metal craftsmanship and jewellery and their industrial use.

8.2. Fiscal sphere

It is in 2003 that the Government's second reform of direct taxation will come into force, with the changes to personal income tax mentioned above. Also, the reform of local taxation will enable the financing of local authorities to be adapted to the principle of financial sufficiency, so that, when the new system of financing of the regional (autonomous) governments and the city-enclaves with autonomous region status comes into force, territorial financial reform will be closed.

Certain technical changes have been made to the tax on inheritance and gifts making it more efficient. These relate to the taxation of bare ownership and to the calculation of the net tax base in the event of accumulation of donations and, finally, the cases of vicarious liability of certain intermediaries are clarified.

Most of the changes to VAT arise from the adaptation of domestic law to the Community Directives on electronic commerce and radio and television broadcasting services and on invoicing. In addition to these measures, various technical improvements have been made to the tax. Notable among them is that which places the special rules for determining the place in which a service is provided on a systematic footing. Also, the special factors affecting the right to deduction under the simplified special regime are specified, as well as the special regime for agriculture, farming and fishing.

Certain modifications, also of a technical nature, have been made to stamp duty (*Impuesto sobre Transmisiones Patrimoniales y Actos Jurídicos Documentados*). The rules relating to the tax base in the case of loans secured by mortgage or other collateral and in cases of extension and improvement of mortgages, as regards the "gradual" fee for

(24) See section two above.

notarial documents, are clarified. Also, the enforceability of the gradual fee in respect of documented legal acts for notarial documents that may be registered in the Property Register is clarified. The taxable event relating to documented legal acts has been abolished in the case of copies of deeds that document the change in value of shares or the change in their registered or bearer status and, finally, the obligation to appoint a representative is established for non-resident taxpayers. When they fail to do so, their tax domicile shall be deemed to be the transferred property.

20.1.2003.