Financial regulation: 2003 Q4

1. INTRODUCTION

As has become usual in recent years, a substantial number of new provisions of a financial nature were enacted in Q4, basically owing to the need to adapt Spanish law to a large number of Community directives. Some of those provisions, like the Law on fiscal, administrative and social measures (customarily known as the accompanying law), were particularly extensive and detailed.

This article first discusses the new provision that has reduced the contributions that credit co-operatives are required to make to their deposit guarantee fund. Then, in relation to the securities market and other financial institutions, it summarises the main aspects of the new law on portfolio investment institutions, which aims to make more flexible and liberalise certain structural aspects, as well as to adapt Spanish law to various Community directives. Also, it sets out the changes made by the new private insurance law, which transposes certain Community directives into Spanish law.

As usual for this quarter, there is a discussion of the measures, mainly of a monetary, financial and fiscal nature, contained in the 2004 State Budget and in its so-called accompanying Law.

Finally, there is a brief discussion of the new general budgetary Law and the economic reform measures law, which gives parliamentary support to Royal Decree Law 2/2003 of April 2003.

2. DEPOSIT GUARANTEE FUND: REDUCTION FOR CREDIT CO-OPERATIVES

Royal Decree Law 18/1982 of 24 September 1982 and, subsequently, Royal Decree Law 12/1995 of 28 December 1995 on urgent budgetary, tax and financial measures established, first, that credit co-operatives would make annual contributions equal to 0.2% of their deposits to their Deposit Guarantee Fund (the Fund) and, second, that when the net assets of a fund reach a level sufficient for the performance of its objects, the Minister of Economy and Finance (the Ministry), would be able to resolve to reduce such contributions. It was also provided that those contributions would be suspended when the uncommitted net assets of the fund in question were greater than or equal to 1% of the deposits of the member institutions.

Subsequently, Ministerial Order ECO 316/2002 of 14 February 2002 (1) set the contribu-

(1) See "Financial regulation: 2002 Q1, in *Economic bulletin*, Banco de España, April 2002.

tions to the Fund at 0.1% of credit co-operatives' deposits. However, given the level of the net assets of the Fund, and the outlook for the sector, the Ministry has approved *Order ECO/2801/2003 of 3 October 2003*, which reduces the contributions to the Fund (BOE (Official State Gazette) of 14 October 2003).

In particular, this Order has set the amount of the contributions of credit co-operatives to the Fund at 0.08% of a base consisting of the deposits covered by the guarantee. This base shall be calculated in accordance with the provisions of Royal Decree 2606/1996 of 20 December 1996 on Credit Institutions' Deposit Guarantee Funds.

Finally, this Order entered into force upon its publication in the BOE. It is applicable to contributions payable from 1 January 2004.

3. PORTFOLIO INVESTMENT INSTITUTIONS: NEW LAW

Law 46/1984 of 26 December 1984 (2) on Portfolio Investment Institutions (PIIs), now repealed, established a legal system intended to facilitate the full development of collective investment in Spain (which the previous regulation had been incapable of promoting), within the framework of a financial system which was then entering the decisive phase of its reform and modernisation.

However, some twenty years later, successive legislative changes have made necessary a fundamental reform of the legal system for Spanish collective investment, which accounts for net assets that have stabilised at around 30% of GDP, with a composition that is beginning to be very sophisticated. Among the set of provisions justifying this reform, two groups should be highlighted. First, there are those more recent domestic provisions, such as Law 37/1998 of 16 November 1998 reforming Law 24/1988 of 28 July 1988 on the Securities Market, Law 44/2002 of 22 November 2002 on Financial System Reform Measures and Law 46/2002 of 18 December 2002 partially reforming the personal income tax and amending the laws on corporate income tax and the tax on the income of non-residents. Second, there are two directives that have recently modified the Community regulation of Undertakings for Collective Investment in Transferable Securities (UCITS): Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC, which regulates UCITS, with a view to regulating management companies and simplified prospectuses and Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 amending the aforementioned Council Directive 85/611/EEC with regard to investments of UCITS. These directives complete the incorporation of collective investment in transferable securities into the single market for financial services, by extending the Community passport to their management companies and by widening the range of financial assets and instruments in which UCITS can invest.

This is the background against which *Law 35/2003 of 4 November 2003* on Portfolio Investment Institutions (BOE of 5 November 2003) has been approved. That law aims to adapt to this new reality, following three basic principles:

a) The deregulation of investment policy. Restrictions on PIIs' freedom of investment could become an obstacle preventing Spanish collective investment from fully satisfying the aspirations of an increasingly demanding and diverse investor base. The experience of recent years has shown that it is preferable to abandon the approach based on a large number of legal categories of PII, with restrictions on the assets suitable for investment, and to introduce more flexibility and freedom into the definitions of PIIs' investor profiles.

b) Strengthening investor protection with new instruments. The reinforcement of transparency obligations and rules of conduct to prevent conflicts of interest has proved to be a more effective way of protecting investors than the imposition of restrictions on PIIs' freedom of action.

c) Improving the system of official intervention. The Law makes a considerable effort to speed up the administrative procedure and to improve legal certainty for those subject to intervention. In a sector in which, like in other financial activities, there is a relatively high level of intervention compared to other sectors of economic activity, the quality of regulation largely depends on these two factors.

This Law entails a substantial change in the regulation of this form of investment. A significant part of the regulation is left to the implementing regulations, but the philosophy of this Law takes a more liberalising and flexible approach than the previous one. The changes made by this new Law and its most relevant aspects are described below.

(2) See "Regulación financiera: cuarto trimestre de 1984, in *Boletín económico*, Banco de España, January 1985.

First, as regards the *definition and classification of PIIs*, the Law contains a broad and flexible definition of PIIs and its scope of application extends to PIIs located in Spain, PIIs authorised in other states and marketed in Spain and to PII management companies and custodians. It also regulates the general principles of the two possible legal forms of PII: mutual fund or company. An innovation that should be highlighted is the possibility of PIIs being created with investment compartments; different classes of units or series of shares can exist within a single PII and, within the limits set by regulations, different commissions may be set for the different classes of units in the same fund or compartment. Also, a list of minimum shareholder rights is included, which were dispersed or not explicitly recognised under the previous law. These include the right to contact the customer service department or the ombudsman or, as the case may be, the Commissioner for Investor Protection. As a general rule, the minimum number of shareholders shall be 100.

Two classes of PII are defined: financial and non-financial PIIs. Financial PIIs are those that invest in financial assets and instruments, and can only take the form of a mutual fund, or of an open-end investment company (SICAV). The Law therefore abolishes closed-end investment companies (these must alter their status to that of a SICAV within two years or have their licence revoked), which were established by the previous law and, therefore, eliminates the distinction between a SIMCAV (the acronym used to refer to an open-end investment company under the previous law) and a SIMCF (closed-end investment company under the previous law). SICAVs shall operate on the basis of increases and decreases of their capital within the upper and lower limits set in their articles of association, by means of the sale or redemption by the company of its own shares at their net asset value without the need for a resolution of the shareholders in general meeting. The obligation in the previous law for the shares of a SICAV to be listed has been removed, although listing remains as one possible option for giving liquidity to such shares.

As regards non-financial PIIs, the Law distinguishes between real-estate PIIs (real-estate mutual funds and real estate investment companies) and miscellaneous non-financial PIIs. The main object of real-estate PIIs is investment in urban property for rental and their investment policy must comply with a liquidity ratio and a double risk diversification ratio (referring to both investments and rentals). Owing to the less liquid nature of their assets, real-estate mutual funds (FII) may limit their sales and redemptions of units to once a year. Miscellaneous non-financial PIIs shall be those that may be set up in future with an object other than that of real-estate PIIs and the ordinary regime of the ordinary provisions shall apply to them.

Second, as regards the *investment regime*, the Law sets the three main principles governing investment policy: liquidity, risk diversification and transparency. These general principles are supplemented by other provisions applicable to each kind of PII. In this sense, it broadens the range of assets suitable for investment while liberalising investment policies. Thus, financial PIIs may invest in all kinds of financial assets and instruments, including derivative instruments, company shares, the shares and units of other PIIs and unlisted securities. The restrictions on the range of assets suitable for investment contained in the previous text have therefore been lifted. However, certain precautions and quantitative limits have been maintained in order to observe the principle of risk diversification. Moreover, financial PIIs must comply with the liquidity ratio that sufficiently guarantees redemption on such terms as may be established in regulations, and shall clearly define, observing the principle of transparency, their investment objectives. The CNMV shall establish various categories of PII in accordance with such objectives, and PIIs shall supply information thereon to their shareholders and unit-holders, and incorporate in their articles of association or regulations the basic elements of their investment policy. As a general rule, financial PIIs may not invest more than 5% (in certain circumstances 10%) or 15% of their assets in securities issued by the same issuer or by entities belonging to the same group, respectively. In addition to this diversification percentage, a PII may only be permitted to hold a certain percentage of the total securities in circulation of a single issuer. Another change is that, as a result of the greater flexibility of the Law, PIIs that invest in monetary assets are no longer distinguished from those that invest in medium and long-term assets, so that the separate legal category of money market mutual funds (FIAMM, by their Spanish acronym) effectively disappears.

Third, as for *administrative and financial requirements*, this Law establishes that investment companies shall have sound administrative and accounting procedures: their directors or executives shall have recognised commercial and professional standing; a majority of the members of the board of directors shall have adequate knowledge and experience; and they shall have internal rules of conduct. Also, they shall appoint a management company if their capital does not exceed €300,000. In addition, the Law regulates the grounds for the suspension and revocation of licences and the restric-

tion of certain activity to PIIs and the use of their name. The Law regulates, for the first time, the cross-border marketing of shares and units in PIIs, with a special regime for the marketing in Spain of the shares and units of foreign PIIs (distinguishing between those that are harmonised or not harmonised and from non-EU Member States) and, also, the procedure applicable to the marketing of harmonised Spanish PIIs in other European Union countries.

Fourth, with regard to *reporting aspects*, this Law includes the necessary provisions to make the principle of transparency effective. The minimum content, periodicity and manner of distribution of full and simplified prospectuses and of the annual, half-yearly and quarterly reports are determined, as a means of making public all the circumstances that may influence appreciation of the value of the net assets. The information in these informative documents shall be supplemented by the preparation and auditing of accounts and the dissemination of relevant facts and significant holdings in the capital or net assets of PIIs.

Fifth, the *ordinary regime* is supplemented by the regulation of the winding-up, liquidation, alteration of status, merger and demerger of PIIs. Two changes should be highlighted: first, PIIs with a different legal status are permitted to merge provided that they belong to the same class and that the merger is carried out by takeover. Second, the transfer of units or shares in PIIs is regulated and the procedure determined whereby unit-holders or shareholders may transfer their investments from one PII to another taking advantage of the regime for the deferral of personal income tax, introduced by Law 46/2002 of 18 December 2002 partially reforming the personal income tax and amending the laws on corporate income tax and the tax on the income of non-residents.

Sixth, the Law determines the *rules governing the activities of PII management companies*, regulating the conditions for taking up the business and the operating conditions, giving legal support to the effective operation of the Community passport. A significant change is the extension of the sphere of activity of management companies, who may be authorised to perform the discretionary and bespoke management of portfolios, including those belonging to pension funds, to advise on investments in financial instruments, to perform the custody and administration of units or shares in funds or management companies, as well as the administration, management and marketing of venture capital funds, in the latter case in accordance with the provisions of Law 1/1999 of 5 January 1999 regulating venture capital entities and their management companies. The possibility is also provided for of delegation to third party entities of the management of the assets, which shall not entail the delegation of liability. Among the obligations of PII management companies, the Law includes that of informing unit-holders or shareholders of the rules regarding the exercise of the voting rights associated with the securities included in the fund's portfolio, giving reasons for the decision either not to exercise a vote or else for the vote cast.

The Law also regulates *the rules governing the activities of custodians*. It establishes the conditions that credit institutions, securities agencies and securities-dealer companies must satisfy to be able to act as custodians, entrusting them generally with the custody of the PII's assets and with oversight of the management performed by the management company.

Finally, the Law regulates the *rules of conduct, supervision, intervention and replacement, as well as the sanctioning regime* applicable to the different institutions. It subjects management companies, custodians, those investment companies that do not fully entrust their management to a management company, as well as those persons who hold directorships and management posts in them, to the rules of conduct established in the Securities Market Law. This regime is supplemented by the regulation of two specific types of rules of conduct to prevent conflicts of interest that may prejudice unit-holders or shareholders: a) in relation to related transactions, carried out between the management company, the investment company, the custodian and their directors and managers, the management company is required to establish an internal control procedure for such transactions and to report on their performance in the relevant informative documents; b) the separation of the custodian, which requires that, in cases in which the custodian of a PII belongs to the same group as the management company or as the investment company, the management company or, where applicable, the investment company has a specific internal procedure to prevent conflicts of interest. The fulfilment of the requirements necessary to guarantee independence shall be entrusted to an independent committee within the management company or investment company, that shall report thereon. Finally, the powers of supervision and inspection are assigned to the CNMV (which shall exercise over the entities subject to the provisions of the law and over whoever may be carrying out transactions specific to such entities, in particular to check whether the restriction on the pursuit of activities to PIIs and to their management companies and on the use of their names have been infringed) and the sanctioning regime is established.

Finally, the Law determines the tax regime for PIIs. The Law shall enter into force on 5 February 2004.

4. PRIVATE INSURANCE: ADAPTATION TO COMMUNITY LAW

Private insurance activity in Spain has been undergoing major transformation as reflected in the many regulations enacted in recent years to modernise the industry and converge with insurance activities in the other Member States of the European Economic Area and, ultimately, foster the development and expansion of the private insurance market.

It is necessary to continue with the process of legislative change and adapt Spanish legislation to Community law. In particular, Law 30/1995 (3) of 8 November 1995 on the Regulation and Supervision of Private Insurance has to be adapted to the new Community directives approved in the field of insurance: Directive 2001/17/EC on the reorganisation and winding-up of insurance undertakings; Directive 2002/13/EC amending the solvency margin requirements for non-life insurance undertakings; and finally, Directive 2002/83/EC concerning life assurance.

To this end *Law 34/2003 of 4 November 2003* amending private insurance legislation and adapting it to Community law was enacted (BOE of 5 November 2003). The subject matter of this law and the new features introduced by it can be summarised as follows. First, it includes changes relating to reorganisation and winding-up of insurance undertakings, solvency, duty to inform policyholders and requirements for the establishment of branches by insurance undertakings from third countries outside the European Economic Area.

Second, amendments have been made to establish information requirements and obligations for the conclusion of distance contracts in insurance. Third, various amendments are made to the consolidated Law on motor vehicle third-party liability and insurance, including most notably a new scale for assessing injuries to people in road accidents. Fourth, certain aspects of the memorandum and articles of association of the Consorcio de Compensación de Seguros (Insurance Compensation Consortium, a public-sector corporate entity which, among other activities, underwrites extraordinary risks) have been amended to allow the indemnification of personal injuries as a result of extraordinary events abroad.

Finally, provisions have been set in place to regulate the fee for issuing diplomas to graduate insurance intermediaries and the interest rates applicable should an insurance undertaking choose to pay in instalments the surcharge imposed to finance the Consortium's insurance entity winding-up functions together with the premia.

5. STATE BUDGET FOR 2004

In December 2003 the State budget for 2004 was approved by means of *Law 61/2003 of 30 December 2003* (BOE 313/2003 of 31 December 2003).

2004 is the second year in which Law 18/2001 of 12 December 2001 on General Budgetary Stability will be effective. 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:

As regards the financial system, the legal interest rate and the interest rate charged on overdue tax were reduced to 3.75% (previously 4.25%) and 4.75% (previously 5.5%), respectively. An increase in State debt of not more than €12,838 million over its level as at 1 January 2003 has been authorised for 31 December 2004. 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 2004 is determined. Also, the overall limits are determined for government guarantees and other guarantees given by the State and public bodies. A notable new development intended to improve the financing of firms' productive activities is that €1,803 million of guarantees have been authorised to back fixed-income securities issued by asset securitisation

(3) See "Regulación financiera: cuarto trimestre de 1995, in *Boletín económico*, Banco de España, January 1996.

vehicles, unlike in 2003 when such guarantees were only provided for "FTPymes".

In the fiscal area, and specifically as regards personal income tax, 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 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 2004.

There are 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 for personal income tax, 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 two years ago, 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.

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.

6. FISCAL, ADMINISTRATIVE AND SOCIAL MEASURES

As in recent years, to help achieve the economic policy objectives set in the State budget for 2004, a number of fiscal, administrative and social measures have been adopted, this time in *Law 62/2003 of 30 December 2003* (BOE of 31 December 2003).

This Law contains various measures relating to direct and indirect taxation, to social security and the social area, to general government personnel, to government administration and organisation and to financial institutions and operations. Given the nature of this article, we highlight below the main changes relating to the monetary and financial system, those of a fiscal nature and, finally, other changes of interest.

6.1. Financial system

As regards new financial transactions, Law 62/2003 regulates for the first time the synthetic securitisation of loans and other creditors' rights. These transactions enable the credit risk arising from an asset portfolio to be transferred to the capital market via a securitisation vehicle without need to sell the assets to the vehicle as in traditional securitisation. In particular, asset securitisation vehicles may synthetically securitise loans and other creditors' rights, and assume all or part of the related credit risk by means of one or more credit derivatives. The counterparty in the credit derivative contract must be a credit institution, an investment services firm or a non-resident institution authorised to conduct the activities which Spanish law reserves exclusively for the above-mentioned entities.

There are five amendments relating to savings banks: three concerning their governing bodies (amendments to Law 31/1985 of 2 August 1985) and two addressing the securities market (reform of Law 24/1988 of 28 July 1988). First, when savings banks have branches in more than one region, the voting power of municipal corporations and depositors in the general assembly shall, in application of the principle of equality, be in proportion to the share of deposits accounted for by each region in which there are branches, provided that it is within the percentage assigned to each of them.

Second, the regulatory provisions applicable to the remuneration and investments commit-

tees established by Law 26/2003 of 17 July 2003 have been amended. As a result, the Board of Directors ("the Board") of savings banks has to set up a remuneration committee with the remit of reporting on the general remuneration and incentives policy for directors and management. This committee will consist of a maximum of three people appointed by the Board from among its members. The terms of reference of the remuneration committee will be established by the articles of association and rules of procedure of each savings bank.

In addition, it has been clarified that each savings bank Board has to set up an investments committee (IC) consisting of a maximum of three people, the remit of which will be to report to the Board on the investments and divestments of a strategic and stable nature made by the savings bank, whether directly or through entities in its group, and on the financial viability of such investments and how consistent they are with the savings bank's budgets and strategic plans. The members of the IC will be appointed by the Board from among its members on the basis of their technical ability and professional experience. The annual report drafted by the IC will be included in the savings bank's corporate governance report. The terms of reference of the IC will be established by the articles of association and rules of procedure of each savings bank.

Fourth, Law 62/2003 expressly lays down the functions of the audit committee that can now be taken on by the control committee of those savings banks that issue securities listed on official secondary stock markets. Fifth, regarding the annual corporate governance report, savings banks have to list the credit, guarantee or collateral transactions (previously the provisions only referred to "transactions", which could be taken to be ordinary ones) conducted by Board members, control committee members and relatives in the first degree with firms or entities in the financial group. Also, transactions with public institutions are expressly deemed to include those with territorial (local and regional) entities, provided that such institutions and entities have appointed general councillors (*consejeros generales*).

Concerning investment ratios, own funds and reporting requirements of financial intermediaries, Law 13/1985 of 25 May 1985 has been amended in various respects.

In order to comply with the requirement to compile consolidated accounts pursuant to the Commercial Code, when the accounting rules approved by European Commission regulations are not applied, the rules used shall be those specified by the procedure and criteria provided for in the first paragraph of section 1 of Article 9 in the corporate groups: a) whose controlling company is a credit institution, b) whose controlling company's main activity is the ownership of stakes in credit institutions and c) which include one or more credit institutions the activity of which is the major activity of the group.

The obligation to compile consolidated accounts for prudential purposes falls on the Board of Directors or equivalent body of the controlling entity of a consolidatable group of credit institutions, unless the Banco de España, in certain circumstances, designates another entity in the group as being subject to this obligation.

Also, the Banco de España may require the year-end consolidatable accounts referred to in this section to be subject, in certain circumstances, to the control of the auditors of the entity obliged to compile them.

Furthermore, groups —including groups of credit institutions— in which one or more entities are listed must compile their annual accounts and directors' report according to the international accounting standards approved by the European Commission regulations. Annual accounts can also be compiled under international accounting standards by groups that, although not containing a listed entity, have opted to do so as an alternative to the rules set forth in the Commercial Code.

Finally, the issuance of debt instruments is liberalised under certain circumstances for subsidiaries of credit institutions and listed entities other than credit institutions, provided in both cases that they are resident in a EU country and they engage exclusively in the issuance of preference shares.

As regards *securities market regulation*, two facets of Law 24/1988 of 28 July 1988 have been amended. First, the CNMV has been expressly empowered to supervise and, where appropriate, authorise the advertising of activities relating to the securities market. Second, the ceiling on issuance of debentures established in the public limited companies law for listed public limited companies has been abolished.

Regarding the *regulation of coins*, it shall be an offence to alter or change in any way the physical characteristics of legal tender coins for use in advertising or for any other purpose not envisaged in issuance law, unless authorised by the Directorate General of the Treasury and Financial Policy.

6.2. Tax measures

There are four salient elements as regards taxation affecting transactions and financial institutions. First, it has been established that the tax regime for *savings banks' non-voting equity units* ("cuotas participativas») shall be the same as that applied – in all instances, for all taxes and for all purposes – to the shares and other equities of institutions' capital stock or equity capital.

Second, there is the tax regime for *specific securities lending,* in particular securities traded on stock exchanges and organised trading markets and systems based in OECD member states. Broadly, it has been stipulated that there will be no change for the lender in the composition of its assets and, therefore, neither the delivery of the securities on loan nor the return of other such homogenous securities upon the loan maturing will constitute taxable income for personal or corporate income tax purposes. Conversely, the remuneration on the loan and the amount of compensation relating to the dividend rights arising on the securities lent during the term of the loan shall, for the lender, be considered as income obtained on the transfer of own capital to third parties.

As far as borrowers are concerned, dividends, participations in profit and other returns arising on the securities borrowed shall be included in their income. Also, the full amount received by the borrower further to a distribution of the share premium or to a capital reduction involving a reimbursement of contributions to shareholders affecting the securities borrowed (or their market value if this were in kind), shall be considered as income from capital.

Third, as regards *venture capital funds and companies,* specific improvements have been made in the attendant arrangements under corporate income tax. Firstly, the term of the 99% exemption has been extended, from the second to the fifteenth year (hitherto the twelfth); next, the term over which this tax benefit may exceptionally be extended has also been increased (to a maximum of 20 years, as opposed to 17 years to date); and finally, the period that may elapse from the time of the investee listing on the stock exchange without forgoing this partial exemption has been extended from two to three years. The beneficial treatment for dividends and positive income arising on the transfer or reimbursement of shares hitherto envisaged for resident shareholders is extended to non-resident shareholders. Hence, non-residents with a permanent establishment shall be subject to the same regime as corporate income tax taxpayers, while for those who do not have a permanent establishment it is stipulated that income shall be understood as not obtained in Spain.

Lastly, in the case of corporations whose sole activity and purpose is the *issuance of preference shares* and/or other financial instruments, tax has been reduced in the case of the actual management headquarters or the registered office being moved to Spain. In particular, such moves have been declared exempt from tax under capital transfer tax and stamp duty.

6.3. Personnel in the service of general government

With regard to personnel in the service of general government, the law accompanying the Budget has regulated certain aspects of the regime governing Banco de España members of staff. Specifically, this legislation states that employment law shall govern the relations between the Banco de España and its members of staff.

Further, Banco de España members of staff who may have access to confidential information shall report, in accordance with the applicable internal rule approved by the Executive Commission, the securities market operations they carry out, whether directly or through an intermediary. This internal rule shall determine the restrictions applying to these members of staff concerning the purchase, sale or availability of these securities, in addition to the reporting obligations and restrictions applying to financial operations carried out by members of staff with entities subject to the Banco de España's supervision, whether by themselves or by an intermediary. Infringement of the provisions of this paragraph shall be subject to the sanctions laid down in the Banco de España's internal rules. Data provided under these reporting obligations shall be kept for a maximum of five years.

7. GENERAL BUDGETARY LAW

General Budgetary *Law 47/2003 of 26 November 2003* has been enacted. Given the nature of this article, the following comments shall cover exclusively aspects relating to the definition and conduct of the Treasury's financial operations.

First, the Law, in the same terms employed by the consolidated text, defines the Treasury as the financial resources of State Finances. The main functions attributed to the Treasury are, among others, the collection of State creditors' rights and the payment of State obligations, and observance of the principle of a single cen-

tralised centre in this connection. Government debt, comprising the overall capital borrowed by the State, may be in the form of various vehicles, such as the issuance of government debt, the arranging of loans, etc., the specific means thereof not being exhaustively stipulated. Lastly, a section of the Law is set aside for establishing the information which, as regards financial operations, the Government and the Ministry of Finance shall submit to Parliament.

Second, the legislation implements the regulations affecting government debt, establishing the legal authorisation for the creation of such debt and determining the manner in which the authorised limits on changes to its outstanding balance should be calculated. It further determines which section of the budget shall be assigned for the appropriations intended to cover expenses relating to government debt, and the form in which both revenue and expenses arising from these operations shall be allocated to the appropriations in question.

It also regulates government debt operations, covering both the trading thereof and the undertaking of financial operations aimed at restricting, reducing or diversifying the risk or the cost of debt incurred both in domestic and foreign currency.

Third, it stipulates the powers of the various State agencies involved in the execution of these operations and, finally, it implements the regulations governing securities issuance, credit operations, hedging operations and other operations relating to government debt, from a standpoint more in keeping with the current financial climate.

Fourth, the legal regime is established for government debt in respect of the securities representing such debt. The transfer thereof is regulated as is the statute of limitations for the Administration's obligations.

Finally, concerning the management of State treasury services, the Law has introduced the annual approval of a Monetary Budget. This instrument is intended to provide for a proper distribution over time of payments and to avoid inefficiency in the distribution and management of the broadly defined money supply. As regards relations with the Banco de España and other credit institutions, the current regulation does not substantially modify what is laid down in the consolidated text.

8. ECONOMIC REFORM MEASURES

Law 36/2003 of 11 November 2003 on economic reform measures (BOE of 12 November 2003) has been enacted, giving parliamentary backing to Royal Decree Law 2/2003 of 25 April 2003, which was previously discussed in the Economic Bulletin (4). Particular mention may be made of the measures to improve the workings of the mortgage market, the regulation aimed at fostering the activity and creation of small and medium-sized enterprises, the regulations to promote the house-rental market and the investment-boosting tax measures.

9.1.2004

(4) See "Financial regulation: 2003 Q2", in *Economic bulletin*, Banco de España, July 2003