Financial Regulation: 2005 Q1

Introduction

In 2005 Q1 the new legislation of a financial nature was fairly plentiful compared with the same period of the previous year.

A major legislative development in this period was the measures adopted to spur productivity in the economic system which, from the financial standpoint, have given rise to a number of reforms in the securities market designed to improve the competitiveness of the Spanish financial system.

Regarding national payments systems, the European Central Bank has modified the TARGET regulations so that the real-time gross settlement (RTGS) systems of the new Member States, which have not adopted the euro, can be connected to the TARGET system by the usual interlinking mechanism or by a bilateral connection.

Regarding the area of public debt, as usual in this period the terms of issue of State debt were set for 2005 and for January 2006, subject to the limitation established in the 2005 State Budget Law.

In the Community arena, two directives were published: the first updating the common fiscal policy applicable to mergers, divisions, asset contributions and share exchanges, and the second establishing a new organisational structure for financial services committees. Also, the anti-money laundering regulation was amended to incorporate the latest national and Community legislative developments.

Finally, the procedure for exchange of tax information between the competent authorities of EU Member States was updated.

Urgent reforms to spur productivity and improve public-sector procurement.

In the current setting of growing openness and integration of the Spanish economy in the European and international markets, and in the face of the risk and uncertainty derived from the high energy prices and from a possible tightening of monetary conditions, it is necessary to adopt urgent reforms to resolutely promote the efficiency and competitiveness of the financial and energy markets, as a means of helping to boost the productivity of the economic system as a whole.

To this end, *Royal Decree-Law 5/2005 of 11 March 2005* (BOE of 14 March 2005) on urgent reforms to spur productivity and improve public-sector procurement was published. The reforms addressed in this Royal Decree-Law (which forms part of a broader set of measures to boost productivity), apart from having an impact on the financial and energy markets, are supplemented by other measures dealing with the trading of greenhouse gas emission rights and by amendments to general government contract legislation extending it to cover certain aspects of public-sector foundations.

In addition, the *Resolution of 1 April 2005* of the Undersecretariat of the Prime Minister's Office (BOE of 2 April 2005) providing for publication of the Agreement of the Council of Ministers of 25 February 2005 adopting certain mandates to launch measures to boost productivity was published.

Following are succinct comments on the major aspects of the provisions, with particular reference to the financial markets.

FINANCIAL MARKET REFORMS

In the financial sphere, the Royal Decree-Law brings about the required transposition of two Community directives crucial for the competitiveness and development of these markets, in addition to introducing other measures to prevent the possible risk of delocalisation, particularly in securities issuance and listing and in the provision of financial guarantees.

Amendments relating to the regime for offers to the public and for admission to trading on official secondary securities markets in Spain (transposition of Directive 2003/71/EC)

First, Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, was transposed to Spanish law.

The basic aim of Directive 2003/71/EC, which must be incorporated into national legislation by 1 July 2005, is to harmonise the requirements relating to the whole prospectus approval process required for admitting securities to trading on regulated markets in the Community and for offering securities to the public. Also, as an essential new development, it allows the securities issuer to choose freely, in certain cases and for certain categories of securities, the competent authority and thus the regulatory system that it wishes to be applied in the authorisation of the prospectus.

For this purpose, and to enable the market's competitive position to be maintained after the Directive has been transposed, it is necessary to eliminate any requirements, obstacles or costs not needed to protect investors or to ensure the proper functioning of the market.

Specifically, in the *primary securities market*, the need for prior administrative approval of securities issues is dispensed with, the power of the Ministry of Economy to prohibit certain issues or subject them to prior authorisation is abolished and the principle that prior administrative approval is not required for securities issues is maintained, thereby strengthening the principle of freedom of issuance.

The content of the prospectus to be published when securities are offered to the public or admitted to trading is expanded to include all the information which, in view of the particular nature of the issuer and of the securities, is necessary to enable investors to make an informed assessment, based on sufficient information, of the assets and liabilities, financial position, profit and losses, and to properly evaluate the prospects of the issuer and of any guarantor, and of the rights attaching to such securities. This information shall be presented in an easily analysable and comprehensible form. Further, as a new development absent in the previous regulatory system, the prospectus shall contain a *brief summary* in non-technical language reflecting, among other things, the essential characteristics of, and risks associated with, the issuer, any guarantor and the securities.

Further, the Royal Decree-Law makes reference to the cross-border validity of the prospectus, in order to bring into effect the *Community passport* for this document, which means that once it has been approved by the CNMV, it will be valid for admission to trading in any host Member State, provided that the CNMV notifies the competent authority of each host Member State. Similarly, the prospectus approved by the competent authority of the home Member State will be valid for admission to trading in Spain, provided that said competent authority notifies it to the CNMV.

The characteristics of a public offer to sell or subscribe securities remain similar to those under the previous regulations, although the cases in which it will not be compulsory to publish a prospectus for the purposes of the previous regulations are listed. They are as follows:

a) An offer of securities addressed solely to qualified investors.

b) An offer of securities addressed to fewer than 100 natural or legal persons per Member State, other than qualified investors.

c) An offer of securities addressed to investors who acquire securities for a total consideration of at least €50,000 per investor for each separate offer.

d) An offer of securities whose denomination per unit amounts to at least €50,000.

e) An offer of securities with a total consideration of less than €2,500,000, which limit shall be calculated over a period of 12 months.

Regarding *book-entry securities*, the public deed evidencing the representation of securities by book entries is replaced by a document that is to be prepared by the issuer and must contain all the information needed to identify the securities included in the issue. The issuer must file this document with the entity in charge of the accounting register and with the CNMV, and, in the case of securities admitted to trading on an official secondary market, with its governing body.

As to the *secondary securities market*, the system of prior administrative approval by the CNMV for admitting securities to trading on an official secondary market remains in place, although the information requirements for admission to trading on this market are significantly reduced, now consisting of the following: submission to and registration with the National Securities Market Commission (CNMV) of the documents accrediting that the issuer and the securities are subject to the particular legal system applicable to them and of the audited financial statements of the issuer; and the submission to, approval by and registration with the CNMV of a prospectus and the publication thereof. These requirements are designed to significantly reduce certain CNMV charges (registration of prospectuses, supervision of the process of admission to trading and supervision of the activity of the entities belonging to the Clearing and Settlement Service) and improve the competitiveness of securities markets. Another new development is that these requirements will not apply to non-participating securities issued by State, regional (autonomous) and local government agencies. However, these issuers may prepare a brochure, which will enjoy cross-border validity.

Contractual netting and financial collateral arrangements (transposition of Directive 2002/47/EC)

Second, the Royal Decree-Law transposes to Spanish law Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. This Directive aims to achieve a broad Community harmonisation for all financial collateral arranged by parties and to put on an orderly and systematic basis all the applicable current regulations. Hence certain financial transactions requiring the provision of collateral will become more convenient owing to a substantial reduction in the requirements for providing and enforcing these guarantees.

The scope of application is financial contractual netting arrangements and financial collateral arrangements when the parties involved belong to one of the following categories: a) a public authority; b) the European Central Bank, the Banco de España, a central bank of an EU Member State, a central bank of a third-party State, the Bank for International Settlements, a multilateral development bank, the International Monetary Fund and the European Investment Bank; c) a credit institution; an investment services firm; an insurance undertaking; an undertaking for collective investment in transferable securities or a management company thereof; a mortgage securitisation vehicle, an asset securitisation vehicle or a securitisation vehicle

management company; and a pension fund, among others; and d) a secondary market governing body; a registration, clearing and settlement system management company; a central counterparty; a settlement agent; a clearing house; and similar entities operating in the futures, options and derivatives markets.

The Royal Decree-Law will also apply to financial contractual netting and financial collateral arrangements in which one of the parties is a legal person, provided that the other party belongs to one of the foregoing categories. Finally, in certain cases, one of the parties may be a natural person.

As regards the legal regime for arrangements of this type, it shall apply to financial transactions[1] carried out within the framework of a contractual netting arrangement, provided that the arrangement envisages the creation of a single legal obligation encompassing all the transactions included in this arrangement and under which, in the event of early maturity, the parties will only have the right to claim the net balance of the proceeds from the settlement of those transactions. The net balance must be calculated as specified in the contractual netting or related arrangements.

OTHER MEASURES TO SPUR PRODUCTIVITY

The main actions in the energy area focussed on the *electricity sector,* where essential reforms are urgently needed to adapt the market to the International Agreement on the creation of an Iberian Electricity Market (MIBEL), scheduled to enter into force by 30 June 2005. Other reforms focus on eliminating inefficient practices in the distribution area, such as the coexistence of various distributors in a single geographical area, which may lead to redundant facilities and raise maintenance costs, with the consequent loss of efficiency.

Finally, the Resolution of 1 April 2005 (publishing the Council of Ministers decision of 25 February) empowers the Ministry of Economy and Finance to draft legislation providing for the creation of official secondary energy futures and options markets for energy. In three months' time, this Ministry will implement Royal Decree 1814/1991 of 20 December 1991 regulating the official energy futures and options markets, for the purpose of regulating the official energy futures and options markets.

Further, certain reforms address the regime for the trading of *greenhouse gas emission allowances*, in application of the Kioto Protocol and, in particular, of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 (amended by Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004) establishing a scheme for greenhouse gas emission allowance trading within the Community.

In the *government arena*, public procurement was improved by adapting the revised General Government Contracts Law enacted by Legislative Royal Decree 2/2000 of 16 June 2000 to include certain aspects of the activity of public sector foundations and of agreements with other government areas.

Finally, the aforementioned Resolution of 1 April 2005 gives mandates to various ministries to develop promptly a set of measures to supplement and continue the strategy designed to boost productivity.

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1. For the purposes of this Royal Decree-Law, financial transactions are defined as, inter alia, the following: *a)* a financial collateral arrangement regulated in this section; *b)* a securities loan; *c)* a financial transaction involving certain financial instruments; *d)* an assignment, with or without repurchase, by way of guarantee or any other direct or indirect guarantee transaction linked to the contractual netting arrangement the subject matter of which is public debt, other marketable securities or cash; and e) a repo transaction, whatever the underlying asset, and, in general, any temporary assignment of assets.

Modification of the TARGET system: updating of the TARGET access system for the new participating Member States

Given that ten new Member States joined the European Union on 1 May 2004, the European Central Bank (ECB) decided that the rights and obligations of the central banks of these Member States in respect of connection to TARGET are the same as those of other connected central banks. This makes it necessary to amend Guideline ECB/2001/3 of 26 April 2001 on the Transeuropean Automated Real-Time Gross Express Transfer (TARGET) system.

To this end, the Governing Council of the ECB has published *Guideline ECB/2005/1 of the European Central Bank of 21 January 2005* (OJ of 3 February 2005) amending certain matters in Guideline ECB/2001/3.

The new Guideline basically provides for the possibility that the real-time gross settlement (RTGS) systems of the new Member States, which have not adopted the euro (non-participating Member States), may connect to the TARGET system via the usual interlinking or via a bilateral link, provided that they meet the minimum common requirements set out in Guideline ECB/2001/3 and can process the euro as a currency alongside their respective national currency.

First, this Guideline will mean that EU central banks whose settlement systems are not connected to TARGET will be able to participate directly in the settlement systems of the central banks connected to TARGET.

Second, it enables EU central banks to connect to TARGET via a correspondent relationship with a central bank that is in turn connected to TARGET via interlinking. The former will send payments originating in their banking community to the latter, which will distribute them to the beneficiary participants through the respective recipient central banks. When payments addressed to the participants in the RTGS of the central bank connected to TARGET via this correspondent relationship are from other participants in TARGET, they will follow the reverse process.

Third, it is established that the national central banks of the non-participating Member States whose RTGS systems are connected to TARGET may establish and maintain a list of eligible assets which can be used by institutions participating in their relevant national RTGS system. The assets on such list must meet the same quality standards and are subject to the same valuation and risk control rules as those prescribed for eligible collateral for monetary policy operations.

Fourth, the TARGET Compensation Scheme shall apply to all national RTGS systems (regardless of whether such RTGS systems are connected to TARGET via interlinking or through a bilateral link) and to the ECB payment mechanism and shall be available for all TARGET participants (including TARGET participants of national RTGS systems of participating Member States that are not counterparties to the Eurosystem monetary policy operations, and TARGET participants of national RTGS systems of non-participating Member States).

Finally, together with the agreements on cross-border payments made or to be made via interlinking, there are a number of provisions relating to cross-border payments to be made by a bilateral link.

In Spain, the Banco de España, using its powers under the Law on the Autonomy of the Banco de España (Law 13/1994 of 1 June 1994), has incorporated *Guideline ECB/2005/1* via the publication of *Circular CBE 1/2005 of 25 February 2005* (BOE of 7 March 2005) on adaptation of Banco de España Settlement Service rules to the ECB's TARGET Guideline amendments so as to permit connection to TARGET by means other than interlinking.

For this purpose, the Banco de España will establish the "technical applications" that may be required to implement the technical aspects of this Circular and, in particular, those relating to the processing of cross-border payments via this new mechanism.

State debt: terms of issue in 2005 and January 2006

Law 2/2004 of 27 December 2004 on the 2005 State budget[2] authorised the Minister of Economy and Finance to increase the State debt in 2005, subject to the limitation that the outstanding balance at year-end does not exceed that at 1 January 2005 by more than €14.01 billion.

As has become usual at this time of the year, the following legislation has been enacted: *Order EHA/73/2005 of 25 January 2005* (BOE of 27 January 2005), which establishes the creation of State debt during 2005 and January 2006 and delegates certain powers to the Director General of the Treasury and Financial Policy; and two *Resolutions of 28 January 2005* of the Directorate General of the Treasury and Financial Policy (BOE of 29 January 2005 and 3 February 2005), which provide for certain issues of Treasury bills and State bonds and publish the calendar of tenders for 2005 and January 2006.

Broadly, the terms of issue applied in previous years are retained, although the option to conduct tenders in terms of price or interest rate and certain minor changes to the dates thereof are incorporated. As in 2004, the Ministry of Economy may provide for debt to be created through the issuance of securities or credit transactions, in euro or other currency.

As regards the procedures for the issuance of State debt, the systems of previous years are retained. In particular, the following issuance procedures are kept: tenders (with competitive and non-competitive bidding), and any technique involving equal opportunities for potential acquirers.

As in previous years, public debt shall take the form of Treasury bills and State bonds and, in all cases, shall be represented solely by book entries

TREASURY BILLS

It has been considered desirable to reduce the number of maturities due to the current moderation in the total volume to be issued. In particular, in 2005 three-month Treasury bills will not be issued, although these maturities may be resumed in the future, alternating, if appropriate, with other maturities should this be considered suitable in view of investor demand or the Treasury's issuance policy. Accordingly, the new Treasury bills will have maturities of six, twelve and eighteen months and the current grouping of maturities will be retained in order to strengthen the Treasury bill market, ensure its liquidity and enhance competitiveness with other institutional issuers in the euro area.

Tenders will take place on the third Wednesday of each month, and this monthly periodicity will apply to twelve- and eighteen-month bill issues, while six-month bills will be issued on alternate dates, coinciding with the even months. That said, the original maturities may differ from those indicated by the number of days necessary to facilitate the grouping of maturities, so that the periodicity of the latter is two months, taking place in the even months and coinciding with issuance dates to facilitate reinvestment by holders.

Regarding the manner in which bids are submitted, it has been considered desirable that it should continue to be in terms of interest rate, which is how the market price of bills is quoted on secondary markets, since this facilitates the submission of bids. Thus competitive bids will

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2. See "Financial regulation: 2004 Q4", *Economic Bulletin*, January 2005, Banco de España.

indicate the interest rate requested and those accepted will, in each case, be assigned at the price equivalent to the requested interest rates and the weighted average thereof, depending on the outcome of the tender.

Tender arrangements remain unchanged, and either competitive and non-competitive bids can be submitted. The minimum nominal amount of competitive bids is still €1,000, and larger bids shall be integer multiples of that amount. As for non-competitive bids, the minimum nominal amount is €1,000, and larger bids shall be integer multiples of €1,000, subject to a maximum nominal amount for each bidder of €200,000. However, this limit will be €100 million for certain entities, namely: the Wage Guarantee Fund, the Bank Deposit Guarantee Fund, the Savings Bank Deposit Guarantee Fund, the Credit Cooperative Deposit Guarantee Fund, Social Security Reserve Fund, the Investment Guarantee Fund and any other public-sector entity or government-owned company that may be determined by the Director General of the of the Treasury and Financial Policy.

Finally, provision is made for the possibility that, as with State bonds, there will subsequently be a second round reserved for those financial institutions with market-maker status. This second round shall be conducted in accordance with the law regulating such institutions.

State bonds

The features of State bond issuance are broadly the same as last year.

The maturities of this debt type will be as usual, i.e. three, five, ten, fifteen and thirty years, although to provide simultaneously for the moderation in the total volume to be issued and for the increased liquidity of the securities that are in the process of being issued, it has been considered advisable to temporarily discontinue the issuance of fifteen-year State bonds. The resumption of this instrument, or its alternation with other maturities according to investor demand, is not ruled out.

The tender arrangements remain unchanged and tenders will be followed by a second round reserved for those financial institutions with State bond market-maker status. Also maintained is the option of offering issues that are an extension of others made previously, in order to reach the issue volume currently required to ensure liquidity on the secondary markets.

As in the case of Treasury bills, the minimum nominal amount of competitive bids is still €1,000, and larger bids shall be multiples of that amount. As for non-competitive bids, the minimum nominal amount is €1,000, and larger bids shall be integer multiples of €1,000, subject to a maximum nominal amount for each bidder of €200,000. Nevertheless, for the entities stated in the preceding section, this limit shall be €100 million.

Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares

Directive 2005/19/EC of 17 February 2005 (OJ of 4 March 2005) amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

First, the scope of application of Directive 90/434/EEC is extended to cover entities which can carry out cross-border activities in the Community and which meet all the relevant requirements and to make provision for the transfer of the registered office of a European public limited liability company (SE) and of a European cooperative society (SCE) from one Member State to another, without that transfer giving rise to the dissolution of the company or to the creation of a new legal entity.

Second, a new feature envisaged is the *partial division* of a company, which is an operation whereby a company transfers, without being dissolved, one or more branches of activity to one or more existing or new companies, leaving at least one branch of activity in the transferring company, in exchange for the pro-rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10% of the nominal value or in the absence of a nominal value, of the accounting par value of those securities.

Third, the current definition of *exchange of shares* is extended to include other subsequent acquisitions in addition to the one ensuring a simple majority of voting rights.

As regards capital gains, Directive 90/434/EEC stipulated that when the beneficiary company held an interest in the capital of the transferring company, it could not apply any taxation to the capital gain accruing to the receiving company on the cancellation of its holding, although the Member States could make exceptions when the receiving company's holding in the capital of the transferring company did not exceed 25%. Directive 2005/19/EC now reduces this percentage to 20% and establishes that the percentage will be 15% from 1 January 2007 and 10% from 1 January 2009.

As to the rules applicable to transfer of the registered office of an SE or a SCE that is resident in one Member State and becomes resident in another Member State, the transfer of registered office or the cessation of residence shall not give rise to any taxation of capital gains in the Member State from which the registered office has been transferred. Also, the host Member State shall take the necessary measures to ensure that the provisions or reserves properly constituted by the SE or the SCE before the transfer of the registered office are partly or wholly exempt from tax and are not derived from permanent establishments abroad.

New organisational structure of financial services committees

Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005 (OJ of 24 March 2005) amending Directives 73/239/EEC, 85/611/EEC, 91/675/EEC, 92/49/EEC and 93/6/EEC of the Council and Directives 94/19/EC, 98/78/EC, 2000/12/EC, 2001/34/EC, 2002/83/EC and 2002/87/EC has been published. Its purpose is to establish a new organisational structure of financial services committees.

Following are brief comments on the amendments to the banking sector and securities market directives.

AMENDMENTS TO DIRECTIVES 93/6/EEC, 94/19/EC AND 2000/12/EC ON THE BANKING SECTOR

In Council Directive 93/6/EEC of 15 March 1993[3] on the capital adequacy of investments firms and credit institutions, Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994[4] on deposit-guarantee schemes and Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, the name "Banking Advisory Committee" is replaced by "European Banking Committee", this latter being set up pursuant to Commission Decision 2004/10/EC. Also, the competencies of the Banking Advisory Committee in monitoring the solvency and liquidity of credit institutions are abolished, since they are now considered unnecessary in view of the harmonisation of capital adequacy rules and of developments in the techniques used by credit institutions to measure and manage their liquidity risk.

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3. See "Regulación financiera: segundo trimestre de 1993", *Boletín Económico*, July-August 1993, Banco de España, pp. 108 and 109. **4.** See "Regulación financiera: segundo trimestre de 1994", *Boletín Económico*, July-August 1994, Banco de España, pp. 97 and 98.

Also, the regular monitoring by the Commission of certain individual supervisory decisions and, therefore, the systematic submission of reports to the Banking Advisory Committee, have been discontinued due to the progress made in cooperation and exchange of information between supervisory authorities.

Finally, the establishment of the European Banking Committee does not rule out other forms of cooperation between the different authorities involved in the regulation and supervision of credit institutions, in particular within the Committee of European Banking Supervisors established by Commission Decision 2004/5/EC.

AMENDMENT OF DIRECTIVES 85/611/EEC AND 2001/34/EC ON THE SECURITIES MARKET

Regarding Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), changes were made to delete the provisions regulating the organisation and functions of the present UCITS Contact Committee, except for its "comitology" tasks to assist the Commission, with respect to the technical amendments to be made to the Directive, and to transfer to the European Securities Committee established by Commission Decision 2001/528/EC, inter alia, the function of advice to the Commission in the exercise of its implementing powers held by the UCITS Contact Committee.

Regarding Directive 2001/34/EC of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, the changes consisted of deleting the provisions regulating the functions of the Contact Committee, the competencies of which are transferred to the European Securities Committee.

Finally, Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with Directive 2005/1/EC by 13 May 2005.

Measures to prevent capital laundering: amendment of the regulations

Law 19/1993 of 28 December 1993 on certain measures for the prevention of money laundering, implemented by Royal Decree 925/1995 of 9 June 1995 (hereafter "the Regulation"), transposed to Spanish law Directive 91/308/EEC of 10 June 1991. The purpose of this Law was to prevent the use of credit and financial institutions to launder money obtained from drug trafficking, terrorism and organised crime.

Subsequently, Law 19/2003 of 4 July 2003 on the legal regime governing capital movements and cross-border transactions and on specific measures for the prevention of money laundering, made certain amendments to Law 19/1993 in order to adapt to Spanish anti-money laundering law the provisions of Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001. In regard to this adaptation, certain provisions of Law 19/2003 require, if they are to be fully effective, appropriate amendment of the aforementioned Regulation.

In order to meet this legal requirement, *Royal Decree 054/2005 of 21 January 2005* (BOE of 22 January 2005) (hereafter "the Royal Decree") was promulgated to amend Royal Decree 925/1995 of 9 June 1995 and other banking, financial and insurance regulations.

Set forth below are succinct comments on the main developments.

SUBJECT PERSONS

First, as in the Law, this Royal Decree extends the list of parties deemed to engage in professional or business activities particularly prone to being used for money laundering. Specifically, in addition to those already specified in Law 19/1993, it includes natural or legal persons that in the exercise of their profession act as auditors, external accountants or tax advisers and

notaries, lawyers and *procuradores* (Spanish court attorneys) when they participate in conceiving, executing or advising on transactions for the account of customers relating to the purchase or sale of real estate or business entities; the management of funds, securities or other assets; the opening or management of bank accounts, savings accounts or securities accounts; or the organisation of contributions needed to set up, operate or manage trusts, firms or similar organisations, or when they act on behalf of and for the account of customers in any financial or real estate transaction. It also applies to the activity of professional carriage of funds or payment instruments; to the activity of international money order or transfer by postal services; and to the marketing of lotteries or other games of chance in respect of the prize payment transactions.

When the natural persons mentioned in this section exercise their profession in the capacity of employees of a legal person or they provide a legal person with permanent or sporadic services, the obligations imposed shall fall upon that legal person in respect of the services provided.

Further, under the Royal Decree it becomes compulsory for a prior declaration of the source, destination and holding of funds to be submitted by those natural and legal persons that, for their own account or that of third parties, carry out the following movements of payment instruments:

a) Exit from or entry into Spanish territory of coins, banknotes and bearer banker's drafts denominated in Spanish or any other currency and in any physical medium, including electronic ones, conceived for use as a payment instrument, in an amount exceeding €6,000 per person per trip.

b) Movements in Spanish territory of payment instruments consisting of cash, banknotes and bearer banker's drafts denominated in Spanish or another currency and in any physical medium, including electronic ones, conceived for use as a payment instrument, in an amount exceeding €80,500. The reference to electronic payment instruments does not include credit or debit cards issued to a named holder.

For these purposes, the source is defined as the security or legal act determining the legitimate holding of funds, and the destination is defined as the economic and legal purpose for which the funds are to be used.

IDENTIFICATION OF CUSTOMERS

As a general rule, subject persons shall require documents to be presented that accredit the identity of their customers, whether habitual or not, when entering into business relations or conducting any transactions. In addition to the obligations specified in the Regulation, the Royal Decree stipulates that subject persons shall take reasonable measures to check the true professional or business activity of their customers. Such measures shall consist of the establishment and application of procedures to verify the activities stated by customers.

Also, subject persons must take additional measures to identify and gain a knowledge of their customers so as to monitor the risk of money laundering in the more sensitive business areas and activities, particularly private banking, correspondent banking, remote banking, currency exchange, cross-border funds transfer and any others that may be determined by the Commission for the Prevention of Money Laundering and Monetary Offences.

In the case of funds transfers within Spain, the entity making the transfer shall hold the identification data of the originator and, where applicable, of the person on whose behalf the origi-

nator is acting, at the disposal of the receiving entity, to which they will be furnished immediately on request.

If the transfers are cross-border, the entities must include and, if applicable, hold the identification data of the originator in the transfer and in the messages related to it through the payment chain.

EXCEPTIONS TO THE OBLIGATION OF IDENTIFICATION

The Royal Decree establishes that the obligation of identification will be waived whenever the customer is a financial institution with registered office in the European Union or in such third State with equivalent requirements to those of Spanish legislation as may be determined by the Commission for the Prevention of Money Laundering and Monetary Offences. In addition, the obligation of identification shall be waived in the following cases:

a) Transactions with non-habitual customers not exceeding €3,000 or its equivalent in foreign currency. However, when it is observed that a customer divides the transaction into various parts to avoid the identification requirement, the amount of all the parts shall be summed and identification shall be required. Also, identification will be required in those transactions which, upon examination, show signs or certainty that they are related to money laundering, even when their amount is less than the aforementioned threshold.

b) Pension schemes or life insurance contracts entered into by virtue of an employment relationship or of the professional activity of the insured, provided that those contracts do not contain surrender clauses and cannot be used as security for a loan.

c) Life insurance and supplementary contracts thereto written by duly authorised companies, when the amount of the premium or of the periodic premiums to be paid during the year does not exceed €1,000; when there is a single-premium payment the amount of which is less than €2,500; and in the case of individual pension schemes in which the contribution or contributions per year do not exceed €1,000.

d) Life insurance and supplementary contracts thereto and pension schemes the consideration for which has to be debited to an account in the customer's name in a credit institution.

COMMUNICATION OF TRANSACTIONS TO THE EXECUTIVE BRANCH

The Regulation indicated that subject persons must cooperate with the Executive Branch and, to this end, must immediately communicate any event or transaction showing signs or certainty that it is related to money laundering and any circumstance relating to that event or transaction that may occur subsequently.

For this purpose, the Royal Decree adds the obligation to communicate transactions that manifestly depart from the nature, volume of activity or past operating record of customers whenever there is no apparent economic, professional or business justification for carrying out transactions linked to activities prone to being used for money laundering.

As a new development, it is provided that communications may be made electronically. For this purpose, the Executive Branch may establish technical communication procedures to ensure that information is transmitted rapidly and confidentially.

INTERNAL CONTROL MEASURES

The Regulation established that subject persons with more than twenty-five employees had to set up adequate internal control and communication procedures and bodies in order to gain knowledge of, safeguard against and prevent transactions related to money laundering.

The Royal Decree adds, as a new development, that these internal control and communication procedures must be examined annually by an outside expert. The results of the examination are to be set forth in a confidential written report describing in detail the internal control measures in place, assessing their operational effectiveness and proposing, if appropriate, any rectifications or improvements.

Also, subject persons not of a financial nature can opt for the external examination regulated in the preceding paragraph to be conducted every three years, provided that every year they assess internally in writing the operating effectiveness of their internal control and communication procedures and bodies. Both the external and the internal report must be at the disposal of the Executive Branch for the six years following their preparation.

SANCTIONING PROCEDURE

The Royal Decree retains the sanctioning procedure set forth in the Regulation and additionally provides that the failure to report when it is mandatory or the lack of truth of the reported data will, if considered particularly important, give rise to seizure by the State security forces/corps or by the Customs and Excise Tax Department of all the payment instruments found. The seizure record, which will be transferred immediately to the Executive Branch for investigation by it and to the Secretary of the Commission to institute the appropriate proceedings, must clearly reflect whether the payment instruments were found in a place or situation indicating a clear intent to conceal them. The payment instruments seized must be sent in all cases to the Banco de España or made available, in the currency of the seized items, in the accounts held at the Banco de España by the Commission for the Prevention of Money Laundering and Monetary Offences.

CHANGE TO THE LEGAL REGIME AND CREATION OF FINANCIAL INSTITUTIONS AND INSURANCE COMPANIES

The additional provisions of the Royal Decree change most of the regimes for the creation of financial institutions, including that of the insurance sector. In particular, they amend, among others: Royal Decree 1245/1995 of 14 July 1995 on the creation of banks, cross-border activities and other matters related to the legal regime of credit institutions; Decree 1838/1975 of 3 July 1975 on the creation of savings banks and distribution of their net income; the implementing regulations of Law 13/1989 of 26 May 1989 on credit cooperatives, approved by Royal Decree 84/1993 of 22 January 1993; and Royal Decree 692/1996 of 26 April 1996 on the legal regime of specialised credit institutions.

In all of them, it is established that it shall be the responsibility of the Ministry of Economy and Finance, acting on a prior report from the Banco de España and the *Commission for the Prevention of Money Laundering and Monetary Offences*, insofar as its area of competence permits, to authorise the creation of the related credit institution. A new requirement to be met by credit institutions in order for them to engage in their activity is to have adequate internal control and communication procedures and bodies to safeguard against and prevent transactions related to money laundering as set out in this Regulation. Finally, the programme of operations must include the type of operations it is intended to conduct, the administrative and accounting organisation, the internal control procedures *and the internal control and communication procedures and bodies established to safeguard against and prevent transactions related to money laundering.*

Procedure for applying European Community directives on exchange of tax information

Council Directive 77/799/EEC of 19 December 1977 on mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums provided the Member States with the necessary legal framework for the exchange of tax information in the area of direct and indirect taxes. This Directive was incorpo-

rated into Spanish law by Royal Decree 1326/1987 of 11 September 1987 establishing the procedure for applying European Community directives on the exchange of tax information.

This Royal Decree was subsequently amended to comply with the provisions of Council Directive 92/12/EEC of 25 F ebruary 1992 providing for excise duties on manufactured products within its scope of application and Council Directive 2003/93/EC of 7 October 2003, which excluded value added tax from, and included the tax on insurance premiums in, its scope of application.

Recently *Royal Decree 161/2005 of 11 February 2005* (BOE of 12 February 2005) amending the aforementioned Royal Decree 1326/1987 has been published. The main changes made by it are as follows:

— First, it updates the names of the taxes included and expressly incorporates the tax on income of non-residents, which was nonetheless already included in the scope of application of Royal Decree 1326/1987.

— Second, it incorporates the principle of action on one's own behalf, whereby the tax authorities may not, for reasons of law or administrative practice, treat the requests for information from other Member States differently from their own information gathering actions carried out for merely domestic purposes. This principle means not only that each competent authority must act with due diligence in gathering information, but also that in each Member State there must be a single set of provisions regulating the information gathering actions of tax authorities, without any distinction as to whether the information is gathered for domestic purposes or at the request of the competent authority of another Member State.

— Third, it revises the sections concerning confidentiality and limitations on the use of information obtained from the tax authorities.

— Finally, two new precepts are added. One provides for mutual assistance in the notification of actions to apply taxes and in the imposition of sanctions in other Member States. The other provides for simultaneous monitoring in two Member States in order to exchange the information obtained, provided that it is considered that such monitoring will be more effective than that conducted by a single Member State.

11.4.2005