Financial regulation: second quarter of 2000

1. INTRODUCTION

Relatively few financial provisions were enacted during the second quarter of the year 2000, which coincided with the beginning of the seventh parliamentary session. However, they were of a certain importance.

At the Community level, the Governing Council of the European Central Bank (ECB) was authorised to increase its capital and to effect further calls of foreign reserve assets from the national central banks, in the event of need. Moreover, all the directives relating to the taking up and pursuit of the business of credit institutions were coded and grouped into a single directive.

The Banco de España (BE), meanwhile, published four provisions. The first reinforces the ordinary clearing and payment mechanisms by providing additional media to allow the remote exchange of data, and by integrating the unavailability of such media into the legal framework of the Spanish Electronic Clearing System *(Sistema Nacional de Compensación Electrónica – SNCE).* The second supplements the general rules of procedure of the Banco de España Settlement Service *(Servicio de Liq - uidación del Banco de España – SLBE)* and of the Public Debt Market Book-Entry System *(Central de Anotaciones del Mercado de Deuda Pública),* in accordance with Law 41/1999 of 12 November 1999 on payment and securities settlement systems. The third establishes the basic rules of procedure of the Spanish Interbank Payment Service *(Servicio Español de Pagos Interbancarios – SEPI),* currently operated by the Madrid Banking Clearing House. The fourth specifies the concept of net provisions for loan losses that credit institutions are required to set up, in relation to their statistical coverage.

With regard to financial institutions, a number of solvency standards were amended to enable Spanish institutions to compete with their Community counterparts on an equal footing.

As regards government debt, the legal regime for market makers and dealer entities has been revised to redefine and improve the conditions under which they engage in their activity, in the competitive environment in which they operate along with other euro area entities.

Two important provisions should be noted in relation to securities markets: first, under the regulation of securities issues and public offerings, a specific standard form is introduced for atypical financial contracts, since the existing standard forms are hardly appropriate for such

products. Second, and with respect to the management of investment portfolios, the rules of conduct that must govern the relations between the portfolio management entities and their clients are specified, as are the standard agreements in which such relations are formalised.

A series of liberalising and competition-enhancing measures and a package of fiscal measures favouring household saving are mentioned. They have been introduced by the government in order to maintain stable economic growth and reduce inflationary risks.

Finally, a procedure has been established for making withholdings or establishing exemption therefrom, in respect of interest and dividends arising from negotiable securities, that are received without a permanent establishment by taxpayers under the tax on the income of non-residents, when financial institutions domiciled in Spain are involved in the payment procedure.

2. EUROPEAN CENTRAL BANK: CAPITAL INCREASES

Article 28 of the Statute of the European System of Central Banks (ESCB) requires that the ECB be provided by the national central banks with capital of EUR 5000 million, which is to become operational upon the establishment of the ECB. This capital may be increased by such amounts as may be decided by the Governing Council of the ECB, within the limits and under the conditions set by the Council of the European Union (EU).

Pursuant to *Council Regulation (EC) 1009/2000 of 8 May 2000* (OJ of 16 May 2000), the Governing Council of the ECB has recently been authorised to increase the capital of the ECB by an additional amount of up to EUR 5000 million.

3. EUROPEAN CENTRAL BANK: FOREIGN RESERVE ASSETS

Article 30 of the Statute of the ESCB requires that the ECB be provided by the national central banks of participating Member States with foreign reserve assets up to an amount equivalent to EUR 50000 million. Likewise, further calls of foreign reserve assets beyond the said limit may be effected by the Governing Council of the ECB.

Pursuant to *Council Regulation (EC) 1010/2000 of 8 May 2000* (OJ of 16 May 2000), the Governing Council of the ECB may effect further calls of foreign reserve assets (1) from the national central banks beyond the limit set in Article 30, up to an amount equivalent to an additional EUR 50000 million, in case of need for such foreign reserve assets.

4. EUROPEAN DIRECTIVE RELATING TO THE TAKING UP AND PURSUIT OF THE BUSINESS OF CREDIT INSTITUTIONS

The Treaty establishing the European Community, signed in Rome on 25 March 1957, called for the creation of a large financial market. In 1985, the European Commission published a White Paper on the Internal Market, defined as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured", which should be achieved over a period expiring on 31 December 1992. In 1986, the Single European Act incorporated into the Treaties establishing the European Communities the basic principles set out in the White Paper, which thus acquired the nature of primary legislation.

In the financial sphere, the establishment of a single market required the abolition of obstacles to the free movement of capital and the freedom to provide financial services throughout the EU. Therefore, given the great diversity of conditions existing in the various Member States, the approach adopted in timetable form in the White Paper was to achieve essential legislative harmonisation and to apply the principle of mutual recognition. Essential harmonisation had to embody at least the regulations relating to the supervision of financial institutions and the protection of savers in order not to jeopardise the orderly and stable functioning of the European financial system and impair competition between these institutions.

One of the first steps in this direction was the publication of Council Directive 73/183/EEC of 28 June 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions. This was followed by the publication of Council Directive 77/780/EEC of 12 December 1977 relating to the taking up and pursuit of the business of credit institutions, also called First Banking Co-ordination Directive. This directive stated that, in order to make it easier to take up

(1) In this regulation, foreign reserve assets mean any official foreign reserve assets of the participating Member States held by national central banks that comprise currencies, units of account or gold other than Member States' currencies, euro, IMF reserve positions and SDRs.

and pursue the business of credit institutions, it was necessary to eliminate the most obstructive differences between the laws of the Member States and to specify certain minimum requirements to be imposed by all Member States.

Subsequently, Council Directive 89/646/EEC of 15 December 1989 (2), the Second Banking Co-ordination Directive, was the cornerstone of a common sphere of activity for credit institutions. It was based on two principles: first, the right of establishment or single licence (3) to pursue the business of credit institutions throughout the EU, meaning that an institution authorised to carry on its activities within the territory of a Member State is automatically authorised to carry on such activities in the other Member States; second, the *principle of home Member State supervision and control.*

That same year, common basic standards for the own funds of credit institutions were set in Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions and Council Directive 89/647/EEC of 18 December 1989 (4) on a solvency ratio for credit institutions, which involved a change in the associated legal provisions. Directive 89/299/EEC harmonises the items that may be included, as a maximum, in the own funds of credit institutions to cover normal banking risks. This Directive establishes minimum requirements and the Member States remain free to apply more stringent provisions. As for the solvency ratio, it expresses own funds as a proportion of risk-adjusted total assets and off-balance sheet items. The minimum solvency ratio was set at 8 %, though Member States were authorised to set higher minimum ratios, if deemed necessary.

Two additional Directives were published in this field in 1992: Council Directive 92/30/EEC of 6 April 1992 (5) on the supervision of credit institutions on a consolidated basis and Council Directive 92/121/EEC of 21 December 1992 (6) on the monitoring and control of large exposures of credit institutions (i.e. exposures whose value is equal or exceeds 10 % of the credit institution's own funds). Directive 92/30/EEC establishes that all banking groups, including those whose parent undertaking is not a credit institution, should be supervised on a consolidated basis. Likewise, they should have sufficient own funds to cover the risks assumed by the group as a whole, thus being required to comply with the solvency ratio on a consolidated basis. Directive 92/121/EEC sets quantitative limits to large exposures. Specifically, a credit institution may not incur an exposure to a client or group of connected clients the value of which exceeds 25 % of its own funds, or large exposures which in total exceed 800 % of its own funds.

Since most of the aforementioned directives have been amended on several occasions, for the sake of rationality and clarity, they were coded and grouped in an orderly way into a single document: *Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000* (OJ of 26 May 2000). This new directive is organised under eight titles (7): definitions and scope; requirements for access to the taking up and pursuit of the business of credit institutions; provisions concerning the freedom of establishment and the freedom to provide services; relations with third countries; principles and technical instruments for prudential supervision; Banking Advisory Committee; powers of execution; and transitional and final provisions.

5. SPANISH ELECTRONIC CLEARING SYSTEM: COMMUNICATION MEDIA

Royal Decree 1369/1987 of 18 September 1987 (8), Ministerial Order of 29 February 1988 (9) and BE Circular 8/1988 of 14 June 1988 (10) regulated the structure and operation of the Spanish Electronic Clearing System *(Sistema Nacional de Compensación Electrónica – SNCE),* composed of the Spanish Exchange System *(Sistema Nacional de Intercambios – SNI)* and the Spanish Settlement System *(Sistema Nacional de Liquidación – SNL).* Later, BE Circular 11/1990 of 6 November 1990 (11) de-

(2) See "Regulación financiera: primer trimestre de 1990", in *Boletín económico,* Banco de España, April 1990, pp. 71 and 72.

(3) Single licence means that credit institutions authorised to carry on their activities within the territory of a Member State are automatically authorised to operate throughout the Community, either by the establishment of a branch or directly by way of the provision of services.

(4) See "Regulación financiera: primer trimestre de 1990", in *Boletín económico,* Banco de España, April 1990, p. 72.

(5) See "Regulación financiera: segundo trimestre de 1992", in *Boletín económico,* Banco de España, July-August 1992, p. 86.

(6) See "Regulación financiera: primer trimestre de 1993", in *Boletín económico,* Banco de España, April 1993, pp. 90 and 91.

(7) It also includes six annexes.

(8) See "Regulación financiera: cuarto trimestre de1987", in *Boletín económico,* Banco de España, January 1988, p. 51.

(9) See "Regulación financiera: primer trimestre de 1988", in *Boletín económico,* Banco de España, April 1988, p. 65.

(10) See "Regulación financiera: segundo trimestre de 1988", in *Boletín económico,* Banco de España, July-August 1988, p. 79.

(11) See "Regulación financiera: cuarto trimestre de 1990", in *Boletín económico,* Banco de España, January 1991, pp. 31 and 32.

fined the rules of procedure of the current account cheque and promissory note sub-system, which is integrated into the SNI and is regulated by SNCE Regulation 004 (hereafter SNCE-004). Subsequently, the aforementioned Circular was amended by BE Circulars 5/1991 of 26 July 1991 (12), 1/1995 of 30 June 1995 (13), 2/1998 of 27 January 1998 (14) and 9/1998 of 30 October 1998, which incorporated the clearing of new documents and payment means into this sub-system.

On certain occasions, the communication media customarily used by the SNI are wholly or partly unavailable, thus preventing the correct operation of the system. In these cases, data must be exchanged on magnetic media, which largely excludes the use of remote communication media. Besides, the exchange of media is not embodied into the legal framework of the SNCE.

BE Circular 2/2000 of 28 March 2000 (BOE (Official State Gazette) of 11 April 2000) was published to avoid these drawbacks by providing additional communication media to allow the remote exchange of data and by integrating the unavailability of such media into the legal framework of the SNCE.

As a result, when it is not possible, for any reason, to use ordinary logical media for the transmission of data evidencing documents, extraordinary logical media, which shall however be of the same nature as the unavailable ones, will be used. Similarly, when these extraordinary logical media are exceptionally unavailable, other physical and logical media (magnetic or other) will be used for the transmission of data evidencing documents, provided that they do not modify the nature of these data.

6. GENERAL RULES OF PROCEDURE OF THE BANCO DE ESPAÑA SETTLEMENT SERVICE AND THE SPANISH PUBLIC DEBT BOOK-ENTRY SYSTEM

Law 41/1999 of 12 November 1999 (15) on payment and securities settlement systems incorporated into Spanish legislation the requirements laid down in Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems, which basically aims at contributing to the efficient operation of cross-border payment and securities settlement arrangements in the EU by harmonising the laws of Member States. Furthermore, Law 41/1999 required designated payment and securities settlement systems to publish their general rules of procedure and membership in the Official State Gazette (BOE).

In relation to the two designated systems operated by the BE, i.e. the *Banco de España Settlement Service (Servicio de Liquidación del Banco de España – SLBE)* and the *Spanish Public Debt Book-Entry System (Central de Anotaciones del Mercado de Deuda Pública),* most of the requirements set out in the said law had already been published in previous provisions (16). A few pending aspects were recently regulated by *BE Circular 3/2000 of 31 May 2000* (BOE of 12 June 2000).

First, BE Circular 11/1998 of 23 December 1998 on the SLBE and BE Circular 16/1987 of 19 May 1987 (17) on public debt book entry are amended. Such amendments are intended to specify the moment when, in each of the aforementioned systems, transfer orders (of cash or securities, respectively) are considered to have been accepted and received, as provided for in Law 41/1999 with respect to the validity and finality of transfer orders and to the effects on transfer orders and netting.

Second, BE Circular 3/2000 introduces in the foregoing circulars the requirement laid down in Law 41/1999 that no transfer order by a participant that is subject to insolvency proceedings shall be accepted once the system is aware of the opening of such proceedings.

Finally, the new circular amends BE Circular 5/1990 of 28 March 1990 to make more flexible the holding of cash accounts with the BE, which may now be opened in exceptional cases, duly justified on technical grounds.

(12) See "Regulación financiera: tercer trimestre de 1991", in *Boletín económico,* Banco de España, October 1991, pp. 53 and 54.

(13) See "Regulación financiera: segundo trimestre de 1995", in *Boletín económico,* Banco de España, July-August 1995, p. 107.

(14) See "Financial regulation: first quarter of 1998", in *Economic Bulletin,* Banco de España, April 1998, pp. 104 and 105.

(15) See "Financial regulation: fourth quarter of 1999", in *Economic Bulletin,* Banco de España, January 2000, pp. 103 and 104.

(16) See, inter alia, BE Circular 5/1990 of 28 March 1990 (BOE of 23 April 1990), regulating the Money Market Telephone Service *(Servicio Telefónico del Mercado de Dinero),* as amended; BE Circular 11/1998 of 23 December 1998 (BOE of 30 December 1998) on the Banco de España Settlement Service; BE Circular 16/1987 of 19 May 1987 (BOE of 1 June 1987) on public debt book entry, as amended.

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

7. BASIC RULES OF PROCEDURE OF THE SPANISH INTERBANK PAYMENT SERVICE

The creation of the SNCE by Royal Decree 1369/1987 of 18 September 1987 was an important step in the modernisation of the payment system, which was provided with the infrastructure required to meet the demand for smooth transactions and their immediate finality on the national market. Since clearing houses are expected to disappear progressively on a voluntary basis or to be reorganised by their members as a result of the rapid expansion of electronic processes, the Ministerial Order of 26 February 1996 (18) simplified the administrative procedure to which they were subject. Moreover, the documents cleared in the traditional clearing houses are a minor portion of those cleared through current electronic systems. The special nature of these documents, which are difficult to shift to electronic systems, has led institutions to design a procedure, called the Single Clearing House System, which is in accordance with the requirements of the aforementioned Ministerial Order of 6 February 1996 and has been approved by the Banco de España.

The *Resolution of 19 May 2000* (BOE of 30 June 2000), recently published by the Executive Commission of the Banco de España, approves the basic rules of procedure of the Spanish Interbank Payment Service *(Servicio Español de Pagos Interbancarios – SEPI),* currently operated by the Madrid Banking Clearing House.

The function of the SEPI is to ensure the exchange, netting and settlement of payment orders in euro or in any other currency, as may be required. The SEPI also provides control mechanisms to monitor default risk, settlement being ensured even in the event that the participant with the largest debit position fails to settle its end-of-day debit obligations.

The resolution includes, among others, the following sections:

— Conditions for participation in the SEPI as direct or indirect participants. Direct participants participate in the exchange of payment orders with the other direct participants and in the netting and settlement of such orders in accounts held with the Banco de España. Indirect participants participate in the exchange, netting and settlement of payment orders through a direct participant, which represents them for all purposes.

— Minimum settlement capacity. To be allowed to participate in the SEPI as direct participants, entities are required to be granted bilateral credit lines by at least 50 % of the other direct participants, for a minimum amount of EUR 600,000 per line.

— Collateral security. Direct participants shall provide collateral security to the clearing house to guarantee the settlement of both their multilateral debit position (defined in the operating instructions) and their additional settlement commitment.

— Daily settlement rules. Inter alia, opening hours, settlement and collateral provision procedure, realisation of securities provided as collateral and additional settlement commitment.

— Irrevocable payment orders.

— Obligations and liability of both direct and indirect participants and the clearing house.

Finally, mention should be made of the creation, within the clearing house, of a monitoring committee of experts appointed by the executive board and in charge of ensuring compliance with the basic rules and operating instructions.

8. AMENDMENT OF ACCOUNTING RULES FOR CREDIT INSTITUTIONS

BE Circular 4/1991 of 14 June 1991 (19) setting out the accounting rules and financial statement formats for credit institutions has frequently been amended to incorporate the changes which have affected the credit system. One of the latest amendments was made by BE Circular 9/1999 of 17 December 1999 (20), which introduced new coverage standards for the recognition and prevention of potential medium and long-term default risk. Specifically, BE Circular 9/1999 incorporated into the treatment of loan losses a provision for the statistical coverage of such losses, to be set up by charging to the profit and loss account of each financial year the positive difference between the statistical estimate of overall latent loan lasses in the various homogeneous risk portfolios and the *net provisions* for loan losses already realised as a result of default or other reasons. For the purposes of this Circular, net provisions for loan losses

(18) See "Regulación financiera: primer trimestre de 1996", in *Boletín económico,* Banco de España, April 1996, p.131.

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

(20) See "Financial regulation: fourth quarter of 1999", in *Economic Bulletin,* Banco de España, January 2000, pp. 101 and 102.

meant the difference between provisions for loan losses (specific and general coverage) plus writing-off of bad debts less recovery from the provision for loan losses (specific and general coverage) and recovered written-off assets.

BE Circular 4/2000 of 28 June 2000 (BOE of 1 July 2000) has recently specified the conceptual definition of net provisions, excluding changes in the general coverage from their calculation.

9. AMENDMENT OF SOLVENCY STANDARDS FOR FINANCIAL INSTITUTIONS

Law 13/1992 of 1 June 1992 (21) on own funds and supervision on a consolidated basis incorporated into Spanish legislation the requirements laid down in the Community Directives on own funds and solvency ratio. However, the scope of these directives was extended to other groups of financial institutions – securities dealer companies and agencies and insurance companies –, giving a homogeneous treatment to all of them. The aforementioned law was first implemented by Royal Decree 1343/1992 of 6 November 1992 (22), which gave a special treatment to three types of financial institutions: credit institutions, securities dealer companies and agencies and insurance companies, and their respective groups. Subsequently, the Orders of 30 December 1992 (23) and 29 December 1992 (24) implemented and specified capital requirements for credit institutions and their groups and securities dealer companies and agencies, respectively.

To enable Spanish financial institutions to compete in the euro area, Spanish legislation should not impose on them heavier burdens than those imposed on their Community counterparts.

The *Ministerial Order of 13 April 2000* (BOE of 26 April 2000), amending the Ministerial Order of 29 December 1992 on the own funds and supervision on a consolidated basis of securities dealer companies and agencies and their groups and the Ministerial Order of 30 December 1992 on solvency standards for credit institutions, was published to this end.

The Ministerial Order of 13 April 2000 transposes Directive 98/32/EC of 22 June 1998 (25), amending Directive 89/647/EEC on a solvency ratio for credit institutions, which allows supervisors to apply a 50 % weighting to securities backed by mortgages on property. This weighting is already applied to Spanish mortgage securitisation bonds. However, the range of eligible assets should be extended in compliance with the directive, so as to include, in particular, securities fully and directly backed by a pool of mortgages, which are in turn secured by a first mortgage on property, provided that the creditor's right associated with the securities is not of a subordinated nature with respect to other creditors of the issuer.

The foregoing Ministerial Order amends, in accordance with Community legislation, the weighting of mortgage bonds, which is lowered from 20 % to 10 %, owing to the high credit standard of these instruments. The treatment of these mortgage bonds is also improved in respect of the regulation of large exposures and specific trading portfolio risk. The 10 % weighting includes bonds issued by credit institutions authorised in the EU, to which the said weighting is applied by home supervisors.

The Ministerial Order also improves the treatment of asset securitisation regulated by Royal Decree 926/1998 of 14 May 1998 (26). Thus, bonds issued by asset securitisation funds, whose repayment is not subordinated to that of other bonds issued by the fund or of loans extended to the fund by credit institutions, will be given the weighting applied to the asset with the higher weighting in the fund.

Furthermore, risks secured by mutual guarantee companies are granted a treatment similar to that given to risks secured by credit institutions, i.e. a 20 % weighting. This is due to the fact that Law 1/1994 of 11 March 1994 (27) on the legal regime of mutual guarantee companies regulates the supervision of these institutions in a similar way to that of credit institutions. Therefore, the credit standard of the counterparty which issues the guarantee is similar to that of credit institutions.

Finally, in line with the changes in Community legislation, the period during which property

(21) See "Regulación financiera: segundo trimestre de 1992", in *Boletín económico,* Banco de España, July-August 1992, pp. 82-86.

(22) See "Regulación financiera: cuarto trimestre de 1992", in *Boletín económico,* Banco de España, January 1993, pp. 65-71.

(23) See Footnote 22.

(24) See Footnote 22.

(25) See "Financial regulation: third quarter of 1998", in *Economic Bulletin,* Banco de España, October 1998, pp. 75 and 76.

(26) See "Financial regulation: second quarter of 1998", in *Economic Bulletin,* Banco de España, July-August 1998, pp. 86-88.

(27) See "Regulación financiera: primer trimestre de 1994", in *Boletín económico,* Banco de España, April 1994, pp. 98 and 99.

leasing transactions concerning assets for public-service use are applied a 50 % weighting is extended from 31-12-2000 to 31-12-2006.

10. STATE DEBT: CHANGES IN THE REGULATIONS FOR "MARKET MAKERS" AND "DEALER ENTITIES"

A resolution of the Banco de España Executive Commission dated 19 January 1988 established the status of market maker *(creador de mercado)* and specified the requirements for acquiring and retaining such status, as well as the relations between market makers and the Banco de España.

These requirements have been revised on a fairly regular basis by various ministerial orders (28). The most recent is the Ministerial Order of 10 February 1999 (29), which was implemented by the Resolutions of the Directorate General of the Treasury and Financial Policy (DGTPF) of 11 February 1999 (30) and of 4 March 1999 (31). It laid down the basic principles for the regulation of Spanish government debt market makers and dealer entities *(entidades negociantes),* as well as the procedure for acquiring such status, the rights and obligations inherent thereto, the criteria for assessing their activity and the circumstances that give rise to the loss of such status or of some of their rights.

The introduction of the single currency, by reducing the differences between the national markets for euro-denominated government bonds, has made the products issued by the Treasuries of the euro area more substitutable one for another. To compete in this new environment it is necessary to have a group of institutions committed to the liquidity of the government bond market. Also, the growing importance of electronic platforms in the trading of fixed-income securities has made it necessary to redefine the conditions under which the entities that work with the Treasury to ensure the liquidity of the secondary market operate.

These two needs have given rise to two *DGTPF Resolutions of 10 April 2000* (BOE of 18 April 2000), which amend the Resolutions of 11 February 1999 and of 4 March 1999, respectively.

With regard to access to second rounds, a system of incentives has been created for the most active *market makers.* In general, each market maker may obtain in the second round the maximum amount resulting from applying their percentage shares in the allotments of the last two auctions. However, the Treasury shall be entitled in each auction to increase by 20 % the percentage shares of those market makers who, according to the monthly assessment, were most active during the period preceding the auction.

As regards their obligations, market makers shall continue to ensure secondary market liquidity, but the specific conditions under which they shall quote certain issues of government bonds chosen as benchmarks (32) are amended. As well as establishing maximum bid-offer spreads they shall also specify minimum volumes. The conditions for the obligatory quotation of four series of non-benchmark government bonds are also amended. There is also a new obligation to quote, in accordance with the maximum bid-offer spread and minimum volume conditions specified in the resolution, two government bond strips and, in addition, two further issues which may be either strips or bonds with residual maturities of more than five years. Likewise, they shall continue to quote the MEFF 10-year notional bond contract with a maximum bid-offer spread of 10 ticks and minimum amounts of 40 contracts for each position. Those market makers who, for technical reasons, are unable to quote the MEFF notional bond future, shall instead quote an amount of the ten-year benchmark bond equivalent to the said 40 contracts. Finally, there is a new obligation to ensure through their actions the smooth working of the market, respecting the operational obligations that may be established. Specifically, they shall take such measures as are necessary to ensure the maintenance of complete separation of the operations of members of the electronic dealing system and third parties.

Finally, the areas of activity to be considered by the Treasury in its monthly assessment of market makers have been widened, and the circumstances established in the Resolution of 11 February 1999 for loss of market maker status are tightened.

As regards government debt *dealer entities*, they shall no longer have exclusive access to

(28) The Ministerial Order of 24 July 1991, partially amended by the Ministerial Order of 29 March 1994, which defined their functions and the content of the obligations and rights inherent to their status, and the Ministerial Order of 19 June 1997 which regulated the stripping and reconstituting of government bonds and empowered the Treasury to authorise specific market-makers to undertake stripping and reconstituting operations, provided that they undertook to meet the requirements laid down by the Treasury.

(29) See "Financial Regulation: first quarter of 1999", in *Economic Bulletin,* Banco de España, April 1999, pp. 60-62.

(30) The Resolution of 11 February 1999 was subsequently amended by another DGTPF Resolution of 23 July 1999.

(31) See Footnote 29.

(32) Standard bond benchmark.

the Network of Book-Entry Government Debt Inter-Dealer Brokers, which shall in future be known as INFOMEDAS (33). However, the possibility of acquiring the status of market maker in the way and on the conditions established previously for the latter is maintained.

The obligations established in the Resolution of 4 March 1999 are partially amended and new ones are added. As regards the former, the increase in the requirement for the share of dealer entities in monthly INFOMEDAS dealing, which rises from 1 % to 2 % of total turnover, should be noted. For the purposes of compliance with this obligation, the trading of government bonds on other electronic platforms determined by the Treasury may also now be taken into consideration.

With reference to the new obligations, they shall provide such information as the Treasury may request on the government debt market in general and the activity of the dealer entity in particular, as well as ensuring the smooth operation of the market, respecting the operating conditions that may be established. Finally, the Treasury shall assess monthly the compliance of dealer entities with their obligations, anticipating that in exceptional market circumstances it may exempt them from complying with some of these obligations.

11. SECURITIES MARKET: PROSPECTUSES FOR ATYPICAL FINANCIAL CONTRACTS

Law 37/1998 of 16 November 1998 (34) to reform Securities Market Law 24/1998 of 28 July 1998 (35) extended its scope of application to include, in addition to negotiable securities issued by public and private-sector individuals and entities, several financial instruments. The rules laid down in this law for negotiable securities were, with the necessary modifications, to be applicable to such instruments.

Recently, credit institutions have been entering into financial contracts with investors with diverse economic and legal characteristics. Many of these contracts have linked the funds raised to the performance of one or more listed securities or of an index. While this extends merely to the remuneration of such funds, then the transactions are deposits with variable remuneration, but when credit institutions do not agree to full and unconditional repayment of the principal, this also being linked to the performance of the price of the securities, the transaction cannot be so clearly classified as a deposit. It may instead resemble the sale of a financial derivative instrument and require instruments for investor protection similar to those applied to the latter. It has also been shown that the standard forms established for prospectuses for negotiable securities, in general, are hardly appropriate for such products, which means that it is necessary to regulate a new standard form better adapted to their characteristics and to the type of investor to whom they are offered.

Meanwhile, Royal Decree 2590/1998 of 7 December 1998 (36), which amended Royal Decree 291/1992 of 27 March 1992 (37) on issues and public offerings of securities, introduced important changes into the regulation of public offerings and issues of securities. Inter alia, it authorised the CNMV to approve the standard forms for prospectuses in accordance with the particular characteristics of the issuer, of the amounts of the issue concerned or of the securities in question. Pursuant to this authorisation, CNMV Circular 2/1999 of 22 April 1999 (38), amended certain types of prospectus that are currently regulated to adapt them to the special characteristics of the issues.

Recently, the CNMV has published *CNMV Circular 3/2000 of 30 May 2000* (BOE of 13 June 2000) which amends CNMV Circular 2/1999 in order to introduce the standard form for prospectuses for atypical financial contracts. The Circular defines them as contracts that are not traded on organised secondary markets, under which the credit institution receives money or securities, or both, from their customers and assumes a repayment obligation consisting either of the delivery of such unlisted securities or the payment of a sum of money, or both, in accordance with the performance of the price of one or more securities or the performance of a stock index, without undertaking to repay the entire amount of the principal received.

Credit institutions which enter into atypical financial contracts with their customers shall be required to incorporate into the contract which

(33) The possibility remains open for other types of entity with special articles of association to operate in INFOMEDAS.

(34) See "Financial Regulation: fourth quarter of 1998", in *Economic Bulletin,* Banco de España, January 1999, pp. 90-98.

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

(36) See Footnote 35.

(37) See "Regulación financiera: primer trimestre de 1992", in *Boletín ecónomico,* Banco de España, April 1992, pp. 70-72.

(38) See "Financial regulation: second quarter of 1999", in *Economic Bulletin,* Banco de España, July 1999, pp. 65-66.

they sign the text of the prospectus (form CFA1, which appears in the annex to the Circular) verified by the CNMV.

12. GENERAL CODE AND RULES OF CONDUCT FOR THE MANAGEMENT OF INVESTMENT PORTFOLIOS AND STANDARD FORMS FOR STANDARD MANAGEMENT AGREEMENTS

Securities Market Law 24/1988 of 28 July 1988 (39) included in its recitals the need to incorporate into Spanish law certain minimum rules of conduct for those operating in the securities markets, basically to defend the interests of investors and to safeguard market transparency at all times. These principles were implemented by Royal Decree 629/1993 of 3 May 1993 (40), on rules of conduct in securities markets and compulsory registrations, the purpose of which was to contribute to market transparency and to the protection of investors, establishing a general code of conduct to govern relations between entities operating in the market and their clients. It also gave the CNMV responsibility for verifying that the standard agreements regulating activities or operations in the securities market contain all the information required by current legislation.

Subsequently, the Ministerial Order of 7 October 1999 (41) adapted the general code and rules of conduct of Royal Decree 629/1993 to the particularities of investment portfolio management, in order to create a body of rules of conduct specifically designed to govern the relations between entities managing portfolios and their clients. In particular, it established that the relations between clients and their portfolio managers should be properly formalised through a standard portfolio management agreement, in accordance with the provisions of the Ministerial Order of 25 October 1995 (42). It also specified the minimum content of such agreements in greater detail than the said Ministerial Order. Further, it authorised the CNMV to develop the content of such agreements and in particular to approve the standard forms for standard agreements, as well as to establish deadlines for adapting those agreements entered into in the past.

Exercising this power, the CNMV has issued *CNMV Circular 2/2000 of 30 May 2000* (BOE of 13 June 2000), which establishes an optional standard form for standard contracts for the management of portfolios. At the same time, it took the opportunity to specify certain aspects of the minimum content of standard contracts for the deposit of financial assets and of the filing of the supporting documentation for specific orders received from clients with portfolio management agreements. Finally, the Circular establishes the requirements that must be met by global accounts ("omnibus" accounts) for their use in portfolio management activity.

The entities can adopt as their standard portfolio management agreement the *standard form* annexed to the Circular, in which case they must send the CNMV a letter certifying that the entity has adopted said standard form. Otherwise, the agreements drawn up by the entities shall contain at least the points required in the regulatory provisions in force from time to time. In all cases they shall specifically state whether or not the content chosen by the entity is in line with the standard form approved by the CNMV. The text of the standard form is the minimum content of such standard agreements.

The accounts for securities and financial instruments and for cash subject to the management shall be identified in the clauses of the standard agreement or else in its annexes. The deposit or recording of such assets shall be carried out in individual accounts opened in the name of the client, either directly by the client or through the management entity under a specific power of attorney. Cash accounts must be opened at a credit institution. However, in the case of temporary vehicle credit accounts, they may also be opened with securities-dealer companies and securities agencies.

Finally the acquisition or disposal of securities or financial instruments on behalf of clients may be recorded in *global accounts* ("omnibus" accounts) when the entity operates in foreign markets in which normal practice requires the use of global accounts for securities or financial instruments for all the clients of each entity. Before opening global accounts, entities must fulfil the following requirements: *a)* the control unit of the management entity shall issue, for each financial institution with which it is intended to open an account, a report on its credit rating and its risks; *b)* the own account of the entity

(39) See Footnote 36

(40) See "Regulación financiera: segundo trimestre de 1993", in *Boletín ecónomico,* Banco de España, July 1993, pp. 105-106.

(41) See "Financial regulation: fourth quarter of 1999", in *Economic Bulletin,* Banco de España, January 2000, pp. 107-108.

(42) This ministerial order partly implemented Royal Decree 629/1993 of 3 May 1993 on rules of conduct in securities markets and compulsory registrations, and established the system of tariffs to be applied by the entities to their clients, the rules they must respect on making available to their clients securities and funds corresponding to the transactions executed, as well as the delivery of the relevant contractual documentation.

and that of third parties shall be completely separate, with no possibility of the positions of the entity and of its clients being recorded in the same account; *c)* the entity shall establish an internal procedure enabling the position of each client to be individually ascertained; *d)* it shall be necessary to obtain the written authorisation of each client, informing them of the risks they assume as a consequence of the operations, as well as of the identity and credit rating of the financial institution acting as depository for the global accounts.

13. URGENT MEASURES TO STIMULATE HOUSEHOLD SAVING, SMALL AND MEDIUM-SIZED BUSINESSES AND COMPETITION, AND MEASURES TO LIBERALISE CERTAIN SECTORS

For the purpose of ensuring stable economic growth and forestalling possible upsurges in inflation, several royal legislative decrees have been promulgated. These approve a package of liberalising and competition-enhancing measures that affect certain sectors as well as a series of fiscal measures to favour household saving.

There follows a brief account of the most important aspects of those measures of a financial and fiscal nature, that are contained in *Royal Legislative Decree 3/2000 of 23 June 2000* (BOE of 24 June 2000), to approve a package of urgent fiscal measures to stimulate small and medium-sized businesses and in *Royal Legislative Decree 6/2000 of 23 June 2000* (BOE of 24 June 2000) on urgent measures to strengthen competition in goods and service markets (43).

13.1. Financial system

In the financial sphere, transparency has been increased in prospectuses relating to the execution of *mortgage loans* to private individuals for the acquisition of housing, to give borrowers the right to participate in the designation of the agents involved in the operation. Credit and other financial institutions shall thus state in the prospectus the right of the borrower to designate, with the agreement of the lender, the person or entity that is to carry out the appraisal of the property to be mortgaged, the person or entity that will be responsible for the administration of the operation, as well as, if applicable, the insurance company which, is going to cover the contingencies that the lender requires to be covered for execution of the loan.

13.2. Collective investment

With regard to *mutual funds,* in view of the sharp fall in interest rates and the reduction in the range of currencies in which assets are denominated, the ceilings for management fees have been reduced.

As regards *pension funds,* first, the general limits for deducting contributions to pension schemes from the tax base are raised, as are those applicable in the case of elderly and disabled contributors. Specifically, the general limits have been increased from ESP 1,100,000 to ESP 1,200,000, and from 20 % to 25 % of net income from employment and from economic activities. In the case of the elderly, the contribution ceilings are raised by ESP 300,000 and 20 percentage points, to stand at ESP 2,500,000 and 40 % of income, respectively. Finally, in the case of the disabled, the absolute limit is raised by ESP 300,000, to stand at ESP 2,500,000.

Second, the tax regime for pension schemes has been extended to spouses who work at home. The measure incorporated into the decree entails a favouring of household saving and responds to a currently existing social demand. With this amendment, up to ESP 300,000 per annum of contributions made to pension schemes in the name of spouses with earnings from employment and economic activities of less than ESP 1,200,000 can be deducted from the tax base of the other spouse.

Finally, in addition to the improvements in the tax regime for pension schemes, the taxation of payments under *life assurance* is also improved, with an increase in the reducing coefficients that are applied to determine the relevant net income.

13.3. Changes to personal income tax

With regard to *personal income tax,* the tax treatment of capital gains and losses has been improved. First, those arising from the transfer of assets acquired more than one year previously are included in the special part of the tax base, which involves a reduction in the two-year period hitherto in force. At the same time, the rate of tax applicable to this type of income is reduced from 20 % to 18 %, which brings it into line with the lower rate at which tax is charged on the general part of the tax base. Second,

(43) For further details of the rest of the urgent measures adopted which affect, inter alia, small and medium-sized businesses, the property and transport sectors, spending on pharmaceutical products, goods and services markets, the telecommunications sector, see Boxes 1 and 2 of the "Quarterly report on the Spanish economy" in this bulletin.

and consistent with the new tax rate, the withholding applicable to income obtained as a consequence of transfers or redemptions of shares or other holdings in portfolio investment institutions is reduced from 20 % to 18 %. Third, in order to complete the reform of personal income tax with respect to the treatment of habitual dwellings and taking into account the complementary nature that their treatment should have under the wealth tax, the taxpayer's habitual dwelling is exempt from this latter tax, at least insofar as its tax value does not exceed ESP 25,000,000. Finally, the tax regime for securities loans is established under personal income tax and corporate income tax, in order to facilitate these operations in Spanish financial markets.

14. TAX ON THE INCOME OF NON-RESIDENTS: PROCEDURE TO MAKE WITHHOLDINGS OR TO ESTABLISH EXEMPTION

Law 41/1998 of 9 December 1998 on the income of non-residents and tax provisions, regulated the taxation of non-residents under income taxes in one single text. The law determined the persons obliged to make withholdings and payments on account, with respect to the income subject to this tax, indicating their limits or, where applicable, the rules established in an applicable convention for the avoidance of double taxation.

The current system of withholdings and payments on account requires that, in the payment of interest or dividends arising from the issuance of negotiable securities, the withholder must know the status of the recipient as a taxpayer of the tax on the income of non-residents owing to the receipt of income without having a permanent establishment, as well as, where applicable, the recipient's country of residence for tax purposes, in order either to effect the withholding or payment on account of interest and dividends, or to establish their exemption owing to their treatment as exempt income. However, the fact that negotiable securities are generally deposited with certain financial institutions gives rise to practical problems in applying withholdings, since the withholder-issuer makes the income payments to the depository financial institutions, so that the latter may, in turn, pay the holders of the securities, without the issuer knowing the status of the final recipients or their country of residence.

A *Ministerial Order of 13 April 2000* (BOE of 18 April 2000) has been published to overcome these problems. It establishes a procedure for making withholdings at the rate applicable in each case, or for establishing exemption from withholdings, in respect of interest or dividends arising from negotiable securities, obtained without a permanent establishment by taxpayers of the tax on the income of non-residents, when financial institutions domiciled, resident or represented in Spain are involved in the payment process, whether as depositories or as managers of the receipt of the income on such securities. Interest on government securities is excluded from the scope of application of this Order, as it is subject instead to a different procedure with a similar purpose.

The procedure for establishing exemption from withholding, or for making the withholding at a reduced rate owing to application of the limits on taxation established in conventions for the avoidance of double taxation signed by Spain, shall comply with certain requirements. The issuer shall transfer to the depository on each interest payment date or at the time of distribution of the dividends the net amount resulting from application of the general withholding rate in force under personal income tax and corporate income tax rules (currently 18 %). Before the 10th day of the month following the month in which the coupon matured or the dividend was paid, the depository shall submit to the issuer a list of the holders who are taxpayers under the tax on the income of non-residents owing to their receipt of income in Spain without a permanent establishment. This list shall include certain information, such as the Taxpayer Identification Number *(NIF)* of the holder of the securities, the country code of the holder's tax residence and the excess percentage and amount withheld for each holder. As soon as the issuer has received the list of holders, it shall transfer to the depository the amounts withheld from the taxpayers entitled to exemption from withholding or the amounts withheld in excees of the taxation limits established in the respective conventions. Finally, the depository shall pay these amounts to the taxpayers concerned forthwith.

To evidence their tax residence, the said holders shall present a certificate issued by the tax authorities of their country of residence evidencing the reasons for exemption from withholding, either through the application of Spanish domestic law or of a particular convention.

Likewise, similar requirements must be fulfilled with respect to the procedure to carry out the withholding at the general rate of article 24.1.*a)* of Law 41/1998 (set at 25 %), when the issuer entity has initially made the withholding at the general rate under personal income tax and corporate income tax.

10.7.2000.