Financial regulation: 2002 Q1

1. INTRODUCTION

During 2002 Q1, few new financial provisions were enacted, though some were relatively important.

In respect of credit institutions, the calculation of contributions to the various deposit guarantee funds has been modified. This is because the base on which contributions are calculated has been affected by the regulatory stipulations regarding investor compensation arrangements.

Turning to government debt, two developments may be mentioned. First, the regulations laying down the issuance terms for the year 2002 and for the month of January 2003 have been enacted, with the limitation established in the State Budget law for 2002. And further, the conditions under which public debt market-makers collaborate with the Treasury on primary-market public debt securities placement and the related trading on the secondary market have been re-defined.

As regards payment systems, the regulation governing the SNCE (National Electronic Clearing System) has been revised with a view to limiting the effects of payment default by direct participants in respect of the indirect participants they represent. The revised regulation sets basic standards to which both sets of participants must adhere and the procedure to be followed in the event of a direct participant deciding unilaterally to cease representing another participant.

With regard to the European Central Bank, the conditions have been laid down to ensure appropriate procedures for access to the database of the new Counterfeit Monitoring System, while it has been established that each national central bank should set up its own national counterfeit monitoring centre.

Two directives relating to the regulation of certain undertakings for collective investment in transferable securities have been enacted. The first widens the investment scope of these undertakings, allowing them to invest in assets that are sufficiently liquid although also setting certain limits. The second adds the finishing touches to the regulations governing companies responsible for the management of collective investment undertakings (management companies), since the previous regulations did not provide for market-access rules and the conditions under which this activity might be engaged in, rules and conditions which must be the same across all the Member States.

Finally, certain amendments have been made to the Agreements for the Promotion of

Asset Securitisation Funds to enhance business financing. Also, new procedures, formalities, standardised systems and pre-formatted forms have been set up to facilitate the exercise of rights, actions and communications by insurance corporations and pensions funds through electronic, computerised and telematic techniques in their dealings with the Directorate General of Insurance and Pension Funds.

2. CREDIT INSTITUTIONS: CONTRIBUTIONS TO THE DEPOSIT GUARANTEE FUNDS

Royal Legislative Decree 12/1995 of 28 December 1995 (1) on urgent budgetary, tax and financial measures, and Royal Decree 2606/1996 of 20 December 1996 (2) on credit institutions' deposit guarantee funds, transposed the Community regulations on deposit guarantee systems in Directive 94/19/EC of 30 May 1994 to Spanish law. They further established that the annual contributions of institutions belonging to the funds should, at most, be 0.2% of the deposits covered by the guarantee as at the close of each year, although the contributions remained at their previous levels (0.2% for banks; 0.02% for savings banks and 0.1% for co-operatives). It was also foreseen that when the fund reached a sufficient amount to meet its intended ends, the Ministry of Economy, upon the proposal of the Banco de España, could agree to a reduction in the abovementioned contributions and even suspend them when the assets not committed to operations proper to the end-purpose of the Funds equalled or exceeded 1% of the deposits of the institutions affiliated thereto. In the case of savings banks, contributions were suspended altogether further to a communication from the Fund Management Committee in February 1996.

In this respect, and in view of the financial position reached by the Savings Banks' Deposit Guarantee Fund and the outlook for the sector, Ministerial Order ECO/136/2002 of 24 January 2002 (BOE of 30 January) set the amount of contributions (which had been suspended since 1996) at 0.04% of existing deposits as at 31 December 2000, in conformity with the definition of guaranteed deposits established in Royal Decree 2606/1996, and whose disbursement relates to the year 2001.

Royal Decree 948/2001 of 3 August 2001, on investor compensation arrangements, amended Royal Decree 2606/1996 so that the Deposit Guarantee Funds (DGF) may also offer investors safeguards in relation to the investment services provided to them by credit institutions. This affected the limits of the guarantee assumed by credit institutions whereby, further to the publication of the aforementioned Decree, the DGF do not only cover guaranteed deposits (as envisaged under the previous regulation) but also guaranteed securities (3).

Following these criteria, three ministerial orders have recently been enacted: Order ECO/3188/2002 of 14 February 2002 stipulating contributions to the Deposit Guarantee Fund of Banking Establishments (BOE of 20 February); Order ECO/317/2002 of 14 February 2002 stipulating contributions to the Deposit Guarantee Fund of Savings Banks (BOE of 20 February); and Order ECO/316/2002 of 14 February 2002 stipulating contributions to the Deposit Guarantee Fund of Credit Co-operatives (BOE of 20 February). Their significance lies in the fact that, for the first time, the basis on which contributions are calculated is made up – in accordance with the regulations laid down in Royal Decree 948/2001 – of both guaranteed deposits and guaranteed securities, the latter being weighted by their conversion factor (4) in keeping with the terms of article 3.2 of Royal Decree 2606/1996 amended by Royal Decree 948/2001. These rules will be applied – in all cases – to contributions made as from 1 January.

Contributions are set at 0.06% for banks (0.1% previously), and are maintained at 0.04% for savings banks and at 0.1% for co-operatives, but with the difference that this is now on the new basis (guaranteed deposits plus guaranteed securities).

3. GOVERNMENT DEBT: ISSUANCE CONDITIONS DURING 2002 AND JANUARY 2003

Law 23/2001 of 27 December 2001 (5) on the State Budget for 2002 authorised the government, on the proposal of the Ministry of

(1) See "Regulación financiera: cuarto trimestre de 1995", in *Boletín Económico,* Banco de España, January 1996, pp. 78-80.

(2) See "Regulación financiera: cuarto trimestre de 1996", in *Boletín Económico,* Banco de España, January 1997, pp. 106-109.

(3) For the purposes of Royal Decree 948/2001, negotiable securities and financial instruments envisaged under the Securities Market Law that have been entrusted to a credit institution in Spain, or any other country, for deposit or registration or for the performance of an investment service, shall be considered as guaranteed securities. Securities subject to repurchase agreements that remain entered or registered in the name of the vendor shall be included among the guaranteed securities.

(4) The conversion factor is 5% of the quoted value or the face or redemption value in the case of unquoted securities.

(5) See "Financial regulation: 2001 Q4" in *Economic Bulletin,* Banco de España, January 2002, pp. 96-97.

Economy, to increase State debt during 2002 so that the outstanding stock of debt at the end of the year should not exceed that as at 1 January 2002 by more than €8.38 billion. This ceiling will be effective at the end of the year, and may be exceeded during the course of 2002. The limit may be revised if certain circumstances envisaged in the Law arise. Royal Legislative Degree 1091/1988 of 23 September 1988, which approved the consolidated text of the General Budget Law, empowers the Ministry of Economy to issue, place and manage State debt, subject to the government's criteria and within the quantitative limits set by the Budget. These powers corresponded to the Ministry of Economy further to Royal Decree 689/2000 of 12 May 2000, whereunder the basic organisational structure of the Ministries of Economy and of Finance is established.

As usual around the beginning of the year, the following legislation has been enacted: Royal Decree 61/2002 of 18 January 2002 (BOE of 29 January), providing for the creation of public debt during 2002 and January 2003; Order ECO/126/2002 of 24 January 2002 (BOE of 29 January), implementing the foregoing Decree and delegating specific powers to the Director-General of the Treasury and Financial Policy; and two Resolutions of 25 January 2002 (BOE of 29 and 30 January) of the Directorate General of the Treasury and Financial Policy, providing for specific issues of Treasury bills and of medium-and long-term government bonds, and releasing the tender operations calendar for the year 2002 and for January 2003.

Broadly, the continued use of the same instruments, techniques, practices and other aspects laid down for the year 2001 by Royal Decree 39/2001 of 19 January 2001 is foreseen. The debt issued or incurred by the State during the current year under all forms of State debt vehicles shall not exceed the limit for the increase in State debt stipulated in Law 23/2001 of 27 December 2001 on the State Budget for 2002. This will extend to the month of January 2003, under the terms established, up to a limit of 15% of the total debt authorised for 2002, with the amounts thus issued being counted within the limit envisaged in the State Budget Law for 2003.

Regarding State debt issuance procedures, the arrangements of prior years are retained. In particular, the following issuance procedures remain in place:

— Tenders (with competitive and non-competitive bidding), that will be conducted in accordance with rules published earlier. They may be for the general public, authorised placers or a restricted group of placers, who acquire special commitments with respect to the placement or trading of the debt.

— Any other technique that does not involve inequality of opportunity for potential purchasers.

As in previous years, public debt will be issued as Treasury bills and medium- and long-term government bonds, in all cases exclusively in book-entry form.

3.1. Treasury bills

Twelve- and eighteen-month bills will continue to be issued in 2002, without prejudice to additional issues being made with different maturities should reasons pertaining to market management or technique so advise.

Moreover, to increase the volume of all issues and enhance thereby their liquidity on the secondary market, the grouping of maturities initiated the previous year is to continue, so that periodicity changes as from next August from two to four weeks. Likewise, to focus demand on a fewer number of issues, given the lower borrowing requirement entailed by the budgetary control policy addressed in Law 18/2001 of 12 December 2001 on Budgetary Stability, the periodicity of tenders has also been reduced as from next August. Tenders will take place every four weeks, with issuance dates coinciding with maturities to facilitate reinvestment by holders.

In the course of tenders of both twelve- and eighteen-month bills, competitive (6) and non-competitive (7) bids may be made. The minimum nominal amount of competitive bids will be €1,000. Applications for higher amounts may be made in integer multiples of €1,000. Non-competitive bids follow the same rules, with a maximum nominal amount per bidder of €200,000. Nonetheless, the Wage Guarantee Fund, the Deposit Guarantee Funds of Credit Institutions, the Investment Guarantee Fund and Social Security Reserve Fund are permitted to submit non-competitive bids for a maximum nominal value of €100 million.

3.2. Medium- and long-term government bonds

The related annual regular tender operations calendar must still be made public, but it has

(6) Competitive bids are those in which the price a bidder is prepared to pay for the debt is indicated as a percentage of the face value.

(7) In non-competitive bids the price is not indicated.

been deemed advisable to make it more flexible than in 2001. Thus, even though tender dates are made public, bond maturities will be set quarterly, in accordance with market-makers, depending on market conditions and on issuance-related developments during the year. In any event, if market conditions or financing requirements so require, the Treasury may decide (in the monthly Resolution providing for the issuance of bonds for the following month) not to issue instruments at one or more of the maturities which, tentatively, were set in the quarterly calendar.

Issuance procedures are retained, with the exception of ten-year government bonds where, to smooth their distribution on international markets, it was deemed advisable to follow a new procedure at tenders. This differs from the usual means used to determine the acquisition price of securities and consists of allotting all the bids accepted at the bid price plus the amount of the accrued coupon interest.

During the first quarter the Treasury also issued fifteen-year bonds using the syndication procedure and with a short coupon, so that interest might be accrued as from the outset of the issue.

As regards competitive bids, the minimum nominal amount will, for the first time, be €1,000 (it was formerly €5,000), and bids may be formulated in multiple integers of this amount. With respect to non-competitive bids, the minimum nominal amount will be €1,000, and bids for higher amounts must be in multiple integers of this amount up to a maximum nominal amount per bidder of €200,000. However, as mentioned above, the Wage Guarantee Fund, the Deposit Guarantee Funds of Credit Institutions, the Investment Guarantee Fund and Social Security Reserve Fund are permitted to submit non-competitive bids for a maximum nominal value of €100 million.

4. AMENDMENT OF THE REGULATIONS GOVERNING MARKET-MAKERS

The Ministerial Order dated 10 February 1999 (8) implemented by the Resolution of 11 February 1999) and the Resolution of 4 March 1999 (9), both passed by the Directorate General of the Treasury and Financial Policy (hereafter, the Treasury), laid down the basic principles regulating Spanish government debt "market-makers" and "dealer entities". The function of market-makers was established in this Order as enhancing liquidity on the Spanish government debt market and co-operating with the Treasury in the dissemination of these instruments on the domestic and foreign fronts. Furthermore, this regulation empowered the Treasury to establish market-makers' commitments in the primary and secondary markets, and the specialties in the debt issuance and subscription procedures arising from their function.

The Resolution of 20 February 2002 (BOE of 26 February) of the Directorate General of the Treasury and Financial Policy (hereafter the Resolution) has recently been published. This regulates Spanish government debt market-makers and re-defines the conditions under which market-makers collaborate with the Treasury in respect of public debt placements on the primary market and trading thereof on the secondary market. It further eliminates Spanish public debt dealer entities, regulated by the Resolution of 4 March 1999, considering that the conditions justifying their appearance have changed.

The reasons behind the reform of the regime applicable to market-makers are the same as those that have driven the main regulatory reforms affecting financial markets in recent years: the introduction of the single currency and the incorporation of new information technologies in capital markets, which give rise to greater competition that agents must address. In the case of the Treasury, the main securities issuer in Spain, it seems advisable to bolster the activity of market-makers in the market for government debt so that such debt should not lose its attractiveness in terms of liquidity.

4.1. Requirements for acquiring market-maker status

The same requirements have been retained. Namely, they shall be market members of the Banco de España book-entry system; meet the requirements laid down in terms of the technical and human resources available to them; and satisfy the other economic and legal conditions needed for consideration as full-fledged members of one of the organised electronic trading systems, as so determined by the Treasury.

As to the procedure for access to this status, the Resolution clarifies certain aspects of the previous regulations. Thus, in addition to the application submitted by interested entities and a report setting out the technical and human resources for performing the activities that market-maker status entails, the Treasury may request the additional information it deems appropriate for the purpose

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

(9) See previous note.

of ensuring that applicants are solvent, that they are committed to the Spanish public debt market and, where necessary, that the information provided is accurate. The Treasury, further to a report by the Banco de España, may confer market-maker status provided that the entity's experience in the trading of Spanish public debt is deemed sufficient and there are assurances that the clearing and settlement of their operations on the debt market will offer security and efficiency. In its decision, the Treasury will likewise take into account other aspects such as the total number of market-makers, their geographical distribution and candidates' Spanish public debt subscription, quoting and distribution activity.

4.2. Rights of market-makers

Substantially, the same rights envisaged in the Resolution of 11 February are retained, i.e. participation in Treasury tenders and access to second rounds, among others. During the second round, each market-maker may submit bids, which will be allotted at the rounded average weighted price resulting from the tender phase. The maximum amount that the Treasury shall issue in the second round for each bond will be 24% of the nominal amount allotted (20% previously) in the tender phase of said bond. In this second round all market-makers may obtain, further to submitting the related bid, the maximum amount resulting from applying their percentage shares in the allotments of the last two tenders of this bond to the following three tranches (established for the first time): 10% of the nominal amount allotted in the tender phase; an additional 10% that the Treasury may grant to those market-makers which, during the last evaluation period prior to the tender, have complied with the public debt listing minimums established under this regulation; and a further 4% that the Treasury may grant those market-makers which, in accordance with the monthly evaluation, have been most active in the latest evaluation period prior to the tender. Finally, market-makers alone are authorised to strip and reconstitute bonds.

4.3. Obligations of market-makers

Market-makers' obligations are substantially modified as regards ensuring secondary-market liquidity. The listing conditions in terms of volume are a notable new feature. Thus, these conditions now cover not only a maximum spread but also a minimum quoted volume. The five bonds that are to be considered as market benchmarks, along with the novelty of three additional bond baskets, are to be defined at meetings between the Treasury and the market-makers. Each basket will contain a minimum of five strippable bonds that are not a benchmark, along with bonds that can be quoted in substitution of the strips and of the MEFF contract. Market-makers will be divided into three uniform groups, with each one having to quote all the market benchmark bonds and all those in the basket assigned to it, obligatorily observing the maximum bid-offer spreads (expressed in cent on the price) and minimum quoted volumes (in millions of euro), as indicated in the Resolution. They will also be obliged to quote two coupons or strips in accordance with the maximum spread (expressed in yield basis points) and volume (in millions of euro) conditions set by the regulation. Further, each market-maker shall quote two additional benchmarks, which will either be strips or the bonds replacing the strips that are assigned to the bond basket corresponding to the group of market-makers in question.

Moreover, they shall continue to quote the MEFF 10-year notional bond contract with a maximum bid-offer spread of 8 ticks and minimum amounts of 60 contracts for each position. The market-makers may replace this requirement with the quotation of a bond that will be specified at the meetings between the Treasury and the market-makers.

Further, the new regulation reduces, for all maturities, the maximum spread permitted between the purchase and sale price, and it increases, for each time of day, the proportion of time during which conditions must be maintained for them to be deemed satisfied.

Finally, market-makers shall 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.

4.4. Loss of market-maker status

The causes for which market-makers may lose their status remain unchanged. These are namely: *a)* communication of the relinquishment of such status by the market-maker to the Directorate General of the Treasury and Financial Policy; *b)* a decision to this effect by the Treasury, when it considers the market-maker is not maintaining its commitments to the Spanish public debt market in accordance with the evaluation criteria established in the Resolution; *c)* by decision by the Director General of the Treasury and Financial Policy, if a market-mak-

er has failed to comply with its obligations for three consecutive months; and d) by decision of the Treasury if an institution fails to comply with the arrangements in place for withholdings on account envisaged under the regulations in force applicable to it.

4.5. Evaluation of market-makers' activities

As was envisaged in the Resolution of 11 February, the Treasury will evaluate on a monthly basis the activities of market-makers in the following areas relating to government debt: subscription of securities at tenders; participation in tenders, in accordance with the criteria established in the aforementioned Resolution; participation in the public debt management or promotion operations undertaken by the Treasury; quotations in the organised electronic trading system or systems specified by the Treasury; participation in total monthly trading in the organised electronic trading system or systems specified by the Treasury; participation in monthly trading between members of the Book-Entry Public Debt Market; participation in trading by market-makers with entities that are not Book-Entry System members; stripping and reconstitution of strippable securities, and trading therein; and whatsoever other activity that reflects commitment to the Spanish public debt market.

Finally, the Treasury shall establish the criteria for evaluating operations performed by market-makers with government debt, having regard to the market-making component they entail. Specifically, priority shall be given to quoting and dealing in the organised electronic trading system or systems specified by the Treasury, and to the greater residual maturity of the securities being traded or tendered. According to the results of the evaluation performed, the Treasury shall, each month, communicate with those market-makers deviating from the mean position of the group analysed. Annually, the Director General of the Treasury and Financial Policy will disclose which market-makers, on the basis of the abovementioned evaluation, have been most active in terms of market-making during the year.

5. AMENDMENT OF REGULATIONS GOVERNING THE SNCE (NATIONAL ELECTRONIC CLEARING SYSTEM)

Royal Decree 1369/1987 of 18 September 1987 (10), the Ministerial Order of 29 February 1988 (11) and Banco de España Circular 8/1988 of 14 June 1988 (12) regulated the structure and functioning of the National Electronic Clearing System (hereafter, SNCE), made up of the National Exchange System (SNI) and the National Settlement System (SNL). Later, BE Circular 11/1990 of 6 November 1990 defined 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, 1/1995 of 30 June 1995, 2/1998 of 27 January 1998 and 9/1998 of 30 October 1998, which incorporated the clearing of new documents and payment means into this sub-system.

The regulations of the SNCE oblige direct participants to assume joint and several liability for the operations conducted in each sub-system by the entities they represent. And this liability extends to the settlement phase. This joint and several obligation entails a financial risk for direct participants representing other entities, making it necessary to define the effects to which a payment default situation might give rise and, in turn, to set basic rules to which both direct and indirect participants may adhere in the daily settlement of the bilateral operations arising from their engagement in exchanges via the SNCE.

To this end, BE Circular 1/2002 of 25 January 2002 (BOE of 2 February) was published. It amends both Circular 8/1988 of 14 June 1988, which approved the Regulation of the SNCE, and Circular 11/1990 of 6 November 1990.

In this respect, the Circular stipulates that, among the conditions and the means of joining the different exchange sub-systems, there will be an obligation for direct participants to assume jointly and severally the liability arising from the operations conducted in the sub-system by the entities they represent (indirect participants). This liability will be limited to operations exchanged in the session or, where applicable, in sessions prior to the SNCE settlement date on which the settlement default between direct and indirect participants should have arisen.

Regarding the loss of member status and suspension, the Circular adds that an SNCE participant which is subject to insolvency pro-

(10) See "Regulación financiera: cuarto trimestre de 1987" in *Boletín Económico,* Banco de España, July-August 1988, p. 51.

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

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

ceedings shall be suspended immediately from participation once firm knowledge of the initiation of such proceedings becomes available. For these purposes, insolvency proceedings will be deemed to have been initiated against an SNCE participant once a state of bankruptcy has been declared or an application for the suspension of payments to creditors has been admitted for consideration.

Furthermore, the procedure to be followed in the event of a direct participant deciding unilaterally to cease to represent an indirect participant is established. In this respect, when an SNCE direct participant wishes to cease representing an indirect participant, it shall duly inform the Banco de España and the entity concerned. Thereafter there will be a period of thirty-five calendar days within which the end of the relationship will take effect. This will only be interrupted if, during this period, there is a failure to settle the final net multilateral position or if the indirect participant has a direct participant at hand to assume its representation. As from the time the direct participant communicates its wish to cease representation, both the direct and indirect participants will be subject to special monitoring arrangements carried out by the related Banco de España services, so as to verify timely compliance with the settlement of the final net multilateral position (13) between the indirect and the direct participant.

The Circular also stipulates that SNCE direct participants shall, before 12 noon, communicate to the Banco de España Settlement Service (SLBE) the final net multilateral position of each of the indirect participants they represent. As a general rule, the final net multilateral position should be settled between the direct participant and the indirect participant it represents on the same National Settlement System date to which it corresponds.

Finally, the effects arising from default in the settlement of positions between SNCE direct and indirect participants are envisaged:

a) If the party defaulting on the payment of its debit position is the indirect participant, its participation in the SNCE will be suspended forthwith, this being effective in the very same session of exchanges commencing on the SNCE settlement date on which the default has occurred. This suspension will be subject to resolution of the related disciplinary proceedings initiated against the indirect participant, in accordance with the provisions of the SNCE Regulation. The direct participant, for its part, will assume the unsatisfied settlement, without prejudice to the legal action that may correspond to it.

b) If the party defaulting on the payment of its debit position is the direct participant, the related proceedings will be initiated against it.

Default shall be reported by the creditor entity of the funds, and it is for the latter, likewise, to provide the data and documents required to demonstrate such default. Refunds relating to those exchange sessions already over, including that in which settlement default took place, will be necessarily adapted to the reasons established for each sub-system, and their exchange and settlement will be conducted following the procedures established by the Banco de España. Consequently, the direct participant may not proceed with the refund of previously settled operations solely because the indirect participant it represents has defaulted on payment of the final net multilateral position. If the suspension is communicated to the other participants when the exchanges of the following session have already begun, the entity acting as a direct participant will proceed with the refund of the operations that the other participants may present to it, at the expense of the suspended participant.

6. CONDITIONS OF ACCESS TO THE SYSTEM FOR CONTROL OF MONEY COUNTERFEITING

Council Regulation (EC) No 1338/2001 of 28 June 2001 laid down measures necessary for the protection of the euro against counterfeiting, and established certain measures in connection with the collection and storage of data related to counterfeit banknotes and coins and with access to these data. Subsequently, Regulation (EC) 1339/2001 of 28 June 2001 extended such measures to those Member States that had not adopted the euro as their single currency.

The *Decision of the European Central Bank of 8 November 2001* (OJ of 20 December 2001) has recently been published, which seeks to build on the mechanisms already in place for the analysis of counterfeits and for the collection of information relating to counterfeiting.

(13) The final net multilateral position of indirect participants is the algebraic sum of the net operational totals corresponding to each indirect participant, aggregating all the SNCE sub-systems in which it is represented by the same direct participant. To calculate these operational totals, all exchanged operations (via the direct participant representing it) with each of the other System members will be taken into account. Included here, therefore, will be not only the operations exchanged with the other direct and indirect participants but also those exchanged with the direct participant representing it and the other indirect participants represented in the SNCE by the aforementioned direct participant.

In this respect, the European Central Bank (ECB) has reorganised the Counterfeit Analysis Centre and the Counterfeit Currency Database, renaming the latter the "Counterfeit Monitoring System" (CMS). The CMS consists of a central database containing all technical and statistical information on the counterfeiting of euro banknotes and coins originating in the Member States or in third countries. It also includes browsing and editing applications, facilities for the downloading and uploading of data, and networks linking the different users of the CMS to the CMS.

Also, the ECB specifies the conditions that ensure the appropriate procedures for access to CMS data, requiring all national central banks (NCBs) of the European System of Central Banks to establish their respective national counterfeit centres (NCCs), as well as the role of security administrator for each such centre (14). Also the ECB reaches the necessary arrangements and agreements with the Commission and Europol to provide for their appropriate access to CMS data and for the access of the European Technical and Scientific Centre. The confidential nature of the data means that the information that each of the users of the CMS obtains from the CMS should be used exclusively for the purpose of fulfilling their responsibilities in the fight against counterfeiting of the euro.

Finally, the ECB will approve a manual of procedures and minimum security standards in connection with the CMS, which will not be published due to the confidential nature of the data, but which may be consulted in the CMS.

7. AMENDMENT OF THE DIRECTIVE ON UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES

Council Directive 85/611/EEC of 20 December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), partially amended by Council Directive 88/20/EEC of 22 March 1988, attempted to co-ordinate the national laws regulating UCITS with a view to approximating the conditions of competition between them at the Community level while at the same time ensuring more effective and more uniform protection for unit-holders.

The scope of application of Directive 85/611/EEC was initially limited to undertakings for collective investment of the open-ended type which promote the sale of their units to the public in the Community and the sole object of which is investment in transferable securities (15). However, the Directive envisaged subsequent co-ordination of those UCITS outside its scope of application.

Recently, *Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002* (OJ of 13 February 2002) has been published, amending Directive 85/611/EEC, with regard to investments of UCITS, widening the investment objective of UCITS, in order to permit them to invest in financial instruments, other than transferable securities, which are sufficiently liquid, namely money market instruments (16).

In accordance with the foregoing and taking into account market developments over the years, the Directive establishes new forms of investment, so that UCITS, in addition to the forms already authorised, can invest in:

a) Units of UCITS authorised according to this Directive and other collective investment undertakings, should they be situated in a Member State or not, provided that: 1) such other collective investment undertakings are authorised under laws which provide that they are subject to supervision considered by the UCITS' competent authorities to be equivalent to that laid down in Community law, and that, inter alia, co-operation between authorities is sufficiently ensured and the level of protection for unit-holders in the other collective investment undertakings is equivalent to that provided for unit-holders in a UCITS; 2) the rules on assets segregation, borrowing, lending, and uncovered sales of transferable securities and money market instruments are equivalent to the requirements of this Directive; 3) the business of the other collective investment undertakings is reported in half-yearly and annual reports to enable an assessment to

(14) This measure was adopted by Spain by means of Law 24/2001 of 27 December 2001 on Fiscal, Administrative and Social Measures, whereby an additional provision was introduced into Law 46/1998 of 17 December 1998 on the introduction of the euro. Thus, it is stipulated that, without prejudice to the powers attributed to other State government or Regional Government bodies, the Banco de España shall be the national authority responsible for the detection of counterfeit euro-denominated notes and coins, and it is designated as the National Centre of Analysis (CNA) and the National Centre of Analysis of the Currency (CNAM) on behalf of the Treasury.

(15) Equivalent to Spanish *sociedades de inversión mobiliaria* and *fondos de inversión mobiliaria.*

(16) For the purposes of this Directive, money market instruments are deemed to be those instruments normally dealt in on the money market which are liquid, and have a value which can be accurately determined at any time.

be made of the assets and liabilities, income and operations over the reporting period; and 4) no more than 10 % of the UCITS' or the other collective investment undertakings' assets, whose acquisition is contemplated, can, according to their fund rules or instruments of incorporation, be invested in aggregate in units of other UCITS or other collective investment undertakings.

b) Deposits with credit institutions which are repayable on demand or have the right to be withdrawn, and maturing in no more than 12 months, provided that the credit institution has its registered office in a Member State or, if the registered office of the credit institution is situated in a non-Member State, provided that it is subject to prudential rules considered by the UCITS' competent authorities as equivalent to those laid down in Community law.

c) Financial derivative instruments, including equivalent cash-settled instruments, dealt in on a regulated market and financial derivative instruments dealt in over-the-counter ('OTC derivatives'), provided that: *a)* the underlying consists of financial indices, interest rates, foreign exchange rates or currencies, in which the UCITS may invest according to its investment objectives as stated in the UCITS' fund rules or instruments of incorporation; *b)* the counterparties to OTC derivative transactions are institutions subject to prudential supervision, and belonging to the categories approved by the UCITS' competent authorities; and *c)* the OTC derivatives are subject to reliable and verifiable valuation on a daily basis and can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the UCITS' initiative. Investment in this type of instrument shall be subject to the limitations laid down in the abovementioned Directive.

d) Money market instruments other than those dealt in on a regulated market, if the issue or issuer of such instruments is itself regulated for the purpose of protecting investors and savings, and provided that they are:

— Issued or guaranteed by a central, regional or local authority or central bank of a Member State, the European Central Bank, the European Union or the European Investment Bank, a non-Member State or, in the case of a Federal State, by one of the members making up the federation, or by a public international body to which one or more Member States belong, or issued by an undertaking any securities of which are dealt in on regulated markets.

— Issued or guaranteed by an establishment subject to prudential supervision, in accordance with criteria defined by Community law, or by an establishment which is subject to and complies with prudential rules considered by the competent authorities to be at least as stringent as those laid down by Community law.

— Issued by other bodies belonging to the categories approved by the UCITS' competent authorities provided that investments in such instruments are subject to similar investor protection to the previous cases and provided that the issuer is a company whose capital and reserves amount to at least EUR 10 million and which presents and publishes its annual accounts, or an entity which, within a group of companies which includes one or several listed companies, is dedicated to the financing of the group or is an entity which is dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line.

The management or investment company involved in the above operations must employ a risk-management process which enables it to monitor and measure at any time the risk of the positions and their contribution to the overall risk profile of the portfolio, and also to assess accurately and independently the value of OTC derivative instruments. It must communicate to the competent authorities regularly and in accordance with the detailed rules they shall define, the types of derivative instruments, the underlying risks, the quantitative limits and the methods which are chosen in order to estimate the risks associated with transactions in derivative instruments regarding each managed UCITS.

Notwithstanding, the Member States may authorise UCITS to employ techniques and instruments relating to transferable securities and money market instruments under the conditions and within the limits which they lay down provided that such techniques and instruments are used for the purpose of efficient portfolio management. Under no circumstances shall these operations cause the UCITS to diverge from its investment objectives as laid down in the UCITS' fund rules or prospectus. If these operations involve the use of derivatives, the UCITS shall ensure that its global exposure relating to derivative instruments – which shall include the

current value of the underlying assets, the counterparty risk, future market movements and the time available to liquidate the positions – does not exceed the total net value of its portfolio. Also the exposure to risk in the relevant underlying asset shall be taken into account for the purposes of calculating the limits laid down for UCITS investments.

As regards the quantitative limits on investments, a UCITS may invest no more than 5 % of its assets in transferable securities or money market instruments issued by the same body. Also, a UCITS may not invest more than 20 % of its assets in deposits made with the same body. Furthermore, an upper limit is established for the counterpart risk in OTC derivatives transactions equal to 10% of assets if the counterparty is a credit institution and 5% in other cases. Member States may raise the general limit from 5% to a maximum of 10%. However, the total value of the transferable securities and the money market instruments held by the UCITS in the issuing bodies in each of which it invests more than 5 % of its assets must not then exceed 40 % of the value of its assets. These general limits may be raised by Member States to 35%, depending on the type of instrument, the issuer and market circumstances.

An OICVM may acquire the units of another UCITS or of other collective investment undertakings, provided that no more than 10 % of its assets are invested in units of a single institution. The Member States may raise the limit to a maximum of 20 %. Investments made in units of collective investment undertakings other than UCITS may not exceed, in aggregate, 30 % of the assets of the UCITS.

The prospectus shall indicate in which categories of assets a UCITS is authorised to invest, whether transactions in financial derivative instruments are authorised and the impact of the latter on the risk profile. When a UCITS is high risk, this fact should also be indicated in the prospectus.

8. AMENDMENT OF THE DIRECTIVE ON UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES, WITH A VIEW TO REGULATION OF MANAGEMENT COMPANIES AND SIMPLIFIED PROSPECTUSES

Council Directive 85/611/EEC of 20 December 1985 on undertakings for collective investment in transferable securities, made a significant contribution to the achievement of the Single Market in this field, laying down (for the first time in the financial services sector) the principle of mutual recognition of authorisations and other provisions which facilitate the free circulation within the European Union of the units of the collective investment undertakings (established as unit trusts/common funds or investment companies). However, Directive 85/611/EEC did not regulate to a great extent the companies which manage collective investment undertakings [so-called “management companies (17)"], since it did not lay down provisions ensuring in all Member States equivalent market access rules and operating conditions for such companies, nor did it regulate the establishment of branches and the free provision of services by such companies in Member States other than their home Member State.

These gaps have now been filled by *Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002* (OJ 041/2002 of 13 February 2002) amending Council Directive 85/611/EEC with a view to regulating management companies and simplified prospectuses.

The approach adopted by the Directive is similar to that established in Community law with respect to the single space in the financial services field, i.e. to ensure the essential harmonisation necessary and sufficient to secure the mutual recognition of authorisation and of prudential supervision systems, making possible the granting of a *single authorisation valid* throughout the European Union and the application of *home Member State supervision*. At the same time, authorisation granted in the management company’s home Member State should ensure *investor protection* and the *solvency* of management companies, with a view to contributing to the stability of the financial system. By virtue of mutual recognition, management companies authorised in their home Member States should be permitted to engage in the services for which they have received authorisation throughout the European Union by establishing branches or under the freedom to provide services.

The activity of management of portfolios of investments is an investment service already covered by Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field. Directive 2001/107/EC, in order to ensure a homogeneous regulatory framework in this area, establishes that management companies whose authorisation also covers invest-

(17) Their normal business is the management of UCITS established in the form of unit trusts/common funds and/or investment companies (UCITS’ collective portfolio management).

ment services are subject to the operating conditions laid down in that Directive, so that for various aspects of the regulation of management companies the provisions of Directive 93/22/EEC will apply.

The most important points of this Directive are discussed in detail below:

8.1. Access to the business of management companies

Access to the business of management companies is subject to prior official authorisation to be granted by the home Member State's competent authorities. Such authorisation shall be granted when the applicant company fulfils the following requirements:

a) It must have an initial capital of at least EUR 125,000. When the value of the portfolios (18) of the management company, exceeds EUR 250 million, the management company shall be required to provide an additional amount of own funds. This additional amount of own funds shall be equal to 0.02 % of the amount by which the value of the portfolios of the management company exceeds EUR 250 million. The required total of the initial capital and the additional amount shall not, however, exceed EUR 10 million. However, Member States may authorise management companies not to provide up to 50 % of the additional amount of own funds if they benefit from a guarantee of the same amount given by a credit institution or an insurance undertaking. The credit institution or insurance undertaking must have its registered office in a Member State, or in a non-Member State provided that it is subject to prudential rules considered by the competent authorities as equivalent to those laid down in Community law.

b) The persons who effectively conduct the business of a management company must be of sufficiently good repute and are sufficiently experienced also in relation to the type of UCITS managed by the management company.

c) The application for authorisation must be accompanied by a programme of activity setting out, inter alia, the organisational structure of the management company.

d) Both its head office and its registered office must be located in the same Member State.

e) It must inform the competent authorities of the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings (19) and of the amounts of those holdings.

The competent authorities shall refuse authorisation if, taking into account the need to ensure the sound and prudent management of a management company, they are not satisfied as to the suitability of the aforementioned shareholders or members. Also, they should not grant or should withdraw authorisation where factors, such as the content of programmes of operations, the geographical distribution or the activities actually carried on indicate clearly that a management company has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry on or does carry on most of its activities.

8.2. Operating conditions

Directive 85/611/EEC limited the scope of management companies to the sole activity of management of unit trusts/common funds and of investment companies (collective portfolio management). In order to take into account recent developments in national legislation of Member States and to permit such companies to achieve important economies of scale, the Directive revises this restriction permitting such companies to carry out also the activity of management of portfolios of investments on a client-by-client basis (individual portfolio management) including the management of pension funds as well as some specific non-core activities linked to the main business.

With regard to collective portfolio management (management of unit trusts/common funds and investment companies), the authorisation granted to a management company authorised in its home Member State should permit the company to carry on in host Member States the following activities: to distribute the units of the harmonised unit trusts/common funds managed by the company in its home Member State; to distribute the shares of the harmonised investment companies, managed by such a company;

(18) Investment funds and the investment companies administered by the management company will be considered as portfolios of the management company, as will other collective investment undertakings administered by the management company, including portfolios whose management this company has delegated, but not the portfolios that said company may be administering by delegation.

(19) A qualifying holding is a direct or indirect holding in a management company that represents 10% or more of its capital or voting rights or which enables a significant influence to be exerted over the management of the management company in which the holding is held.

to perform all the other functions and tasks included in the activity of collective portfolio management; to manage the assets of investment companies incorporated in Member States other than its home Member State; to perform, on the basis of mandates, on behalf of management companies incorporated in Member States other than its home Member State, the functions included in the activity of collective portfolio management.

8.3. Investor protection

For this purpose, management companies shall have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms. Also, they shall not be permitted to invest all or a part of the investor's portfolio in units of unit trusts/common funds or of investment companies it manages, unless it receives prior general approval from the client, and shall be subject with regard to investment services to the provisions of Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes. Finally, each Member State shall draw up rules of conduct which management companies authorised in that Member State shall observe at all times.

8.4. Right of establishment and freedom to provide services

Member States shall ensure that a management company may carry on within their territories the activity for which it has been authorised, either by the establishment of a branch or under the freedom to provide services. Member States may not make the establishment of a branch or the provision of the services subject to any requirement for additional authorisation, to any requirement to provide endowment capital or to any other measure having equivalent effect.

Any management company wishing to establish a branch within the territory of another Member State shall notify the competent authorities of its home Member State and provide the following information: *a)* the Member State within the territory of which the management company plans to establish a branch; *b)* a programme of operations setting out the activities and services envisaged and the organisational structure of the branch; *c)* the address in the host Member State from which documents may be obtained; *d)* the names of those responsible for the management of the branch. They shall also communicate details of any compensation scheme intended to protect investors.

Any management company wishing to carry on business within the territory of another Member State for the first time under the freedom to provide services shall communicate its intention to the competent authorities of its home Member State stating the Member State within the territory of which the management company intends to operate, and shall send a programme of operations stating the activities and services envisaged. The competent authorities of the home Member State shall forward such information to the competent authorities of the host Member State. They shall also communicate details of any applicable compensation scheme intended to protect investors.

8.5. Review of the regulations on investment companies

The Directive takes the opportunity to update the law on investment companies, specifically for those that have not designated a management company. They shall be subject to conditions for taking up business and operating conditions similar to those which apply to the latter. Thus they must evidence an initial capital of at least EUR 300,000, the authorisation application must be accompanied by a programme of activity setting out, inter alia, the organisational structure of the investment company, and the directors of the investment company shall be of sufficiently good repute and be sufficiently experienced also in relation to the type of business carried out by the investment company.

Investment companies may only manage assets of their own portfolio and may not, under any circumstances, receive any mandate to manage assets on behalf of a third party. Also, the home Member State, having regard also to the nature of the investment company, shall require that the company has sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing.

8.6. Obligations of management companies and investment companies with regard to the publication of simplified prospectuses

To take into account the development of the obligations relating to investor information included in Directive 85/611/CEE (29), both the management company, for each of the mutual

(20) A full prospectus, an annual report for each financial year and a half-yearly report covering the first six months of the financial year.

funds it manages, and the investment company shall publish, in addition to the existing full prospectus, a simplified prospectus. Such a new prospectus should be designed to be investor-friendly and should therefore represent a source of valuable information for the average investor. Such a prospectus should give key information about the UCITS in a clear, concise and easily understandable way. However, the investor should always be informed, by an appropriate statement to be included in the simplified prospectus, that more detailed information is contained in the full prospectus and in the UCITS' yearly and half-yearly report, which can be obtained free of charge at his/her request. The simplified prospectus should always be offered free of charge to subscribers before the conclusion of the contract.

Member States may permit that the simplified prospectus be attached to the full prospectus as a removable part of it. The simplified prospectus can be used as a marketing tool designed to be used in all Member States without alterations except translation. Member States may therefore not require any further documents or additional information to be added. Both the full and the simplified prospectus may be incorporated in a written document or in any durable medium having an equivalent legal status approved by the competent authorities.

9. ASSET SECURITISATION FUNDS: PROMOTION AGREEMENTS (FTPYMES)

Royal Legislative Decree 3/1993 of 26 February 1993 on urgent budgetary, tax, financial and employment measures, and additional provision five of Law 3/1994 of 14 April 1994 (21), which introduced the Second Banking Co-ordination Directive into Spanish law, empowered the government to extend the regime established in Law 19/1992 of 7 July (22) for mortgage securitisation funds (*fondos de titulación hipotecaria*), with the necessary adjustments, to the securitisation of other loans and creditors' rights, including those arising from leasing transactions, and those relating to the activities of small and medium-sized businesses, the funds arising from such securitisation to be known as asset securitisation funds *(fondos de titulación de activos*, FTAs). The government, exercising this power, enacted Royal Decree 926/1998 of 14 May 1998 on the regulation of FTAs and their management companies, which established the frame of reference for asset securitisation in Spain.

Subsequently, the 1999 State Budget Law 49/1998 of 30 December 1998 (23) empowered the Ministry of Economy and Finance (MEH) to guarantee fixed-income securities issued by FTA established under agreements between the MEH and their management companies and, also, to establish the rules and requirements for such agreements. To this end, the Ministerial Order of 28 May 1999 (24) was published, which establishes the regime for and content of the promotion agreements that can be entered into by the MEH – acting through the Treasury – with the management companies of FTA, in order to promote the creation of FTA which, under the trade name FTPYME, may benefit from a State guarantee for the fixed-income securities they issue in order to stimulate business financing. In fact, the Order provides for the possibility that the Treasury may guarantee some of the bonds issued by FTAs whose assets include loans granted by credit institutions to non-financial corporations, of which a certain percentage must be small- and medium-sized enterprises (SMEs). This affords the credit institutions that originated the Fund's assets a way of refinancing their loans to SMEs.

In the light of the experience gained in this area it has been considered desirable to make certain amendments to the Ministerial Order of 28 May 1999. These have recently been implemented by the *Ministerial Order of 28 December 2001* (BOE of 1 February 2001) on FTA promotion agreements to stimulate business financing.

First, as regards the credit rating of the bonds the Treasury may guarantee, the Ministerial Order of 28 May 1999 provides that securities with at least a rating prior to the guarantee of BBB/Baa or the equivalent can be guaranteed. FTPYME have been shown to be viable without it being necessary for the State to assume risk beyond guaranteeing series with a rating of A or AA/Aa, so that this Order removes the possibility of guaranteeing bonds with lower ratings. Second, the percentage of the assets of FTPYMEs that small- and medium-sized enterprises must represent is adjusted, and the percentage of liquidity obtained by the assigning credit institutions which the latter must reinvest in loans to SMEs. Specifically, financing to

(21) See "Regulación financiera: segundo trimestre de 1994", in *Boletín Económico,* Banco de España, July-August 1994, pp. 92-96.

(22) See "Regulación financiera: segundo trimestre de 1992", in *Boletín Económico,* Banco de España, July-August 1992, pp. 93-94.

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

(24) See "Financial regulation: second quarter of 1999", in the *Economic Bulletin,* Banco de España, July 1999, p. 67.

small- and medium-sized enterprises must represent at least 50% (previously 40%) of FT-PYMEs' assets and the assigning credit institutions must, for their part, reinvest 50% of the volume of assets they sell to the Fund in new financing to SMEs (previously they were obliged to reinvest 50% of the assets less the financing they had granted to the FTA). Also, the procedure is homogenised with that of the granting of other guarantees by the Treasury, in which it is the managing body itself that is responsible for the procedure and subsequently for making the proposal to the Treasury for the granting of a guarantee. Finally, and in this same sense, the operation and administrative location of the Commission (25) responsible for assessing the FTA projects that wish to take advantage of the benefits of this Order is specified.

10. NEW PROCEDURES, FORMALITIES, STANDARDISED SYSTEMS AND PRE-FORMATTED FORMS TO EFFECT THE EXERCISE OF RIGHTS, ACTIONS AND COMMUNICATIONS BY TELEMATIC TECHNIQUES IN THE AREA OF INSURANCE CORPORATIONS AND PENSION FUNDS

An Order of 26 December 2001 laid down general criteria for the telematic processing of certain procedures by the Ministry of Economy and the public bodies attached thereto and created a telematic registry for the presentation of documents and applications, assuming powers to include new procedures, formalities and communications, new standardised and pre-formatted forms to effect the exercise of rights, actions and communications through electronic, data-processing and telematic techniques.

At the same time, the law regulating the ordering and supervision of private insurance and pension schemes and funds established specific information duties for the entities subject to its provisions, which require certain documentation to be sent periodically to the body responsible for supervision. Thus, insurance undertakings, in accordance with Law 30/1995 of 8 November 1995 on the Ordering and Supervision of Private Insurance and the Regulation on the Ordering and Supervision of Private Insurance, approved by Royal Decree 2486/1988 of 20 November 1998, are required to send to the Directorate General of Insurance and Pension Funds, among other documentation, certain statistical and accounting information, the standard forms for which were approved by the Order of 23 December 1998.

As regards the management entities of pension funds, Law 8/1987 on the Regulation of Pension Schemes and Funds and its Regulations, approved by Royal Decree 1307/1988, of 30 September 1988 specify the statistical and accounting information that the managing entities of pension funds must submit to the Ministry of Economy, the standard forms for which were approved by the Order of 12 March 1996. All these communications and actions, together with other procedures within the scope of the powers of the Directorate General for Insurance and Pension Funds can now be processed telematically.

For this reason, *Order ECO/586/2002 of 8 March 2002* (BOE 065/2002 of 16 March 2002) has recently been published. It includes new procedures, formalities, standardised systems and pre-formatted forms for effecting the exercise of rights actions and communications by electronic, data-processing and telematic techniques in the area of the Directorate General of Insurance and Pension Funds. They include the following:

1. The sending by insurance undertakings of quarterly and annual statistical and accounting information.

2. The sending by entities required to prepare consolidated accounts of consolidated statistical and accounting information.

3. The sending by entities belonging to consolidated groups of insurance undertakings of half-yearly statistical and accounting information.

4. The sending by entities managing pension funds of the annual statistical and accounting documentation of the managing entities and of the pension schemes and funds.

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(25) This Commission is made up of two representatives of the Directorate General of Policy for the Small- and Medium-Sized Enterprise, two from the Directorate General of the Treasury and Financial Policy and one from the Secretary General for Economic Policy and the Protection of Competition, which shall be appointed by the respective Directors or Secretary Generals. The Presidency shall correspond to one of the representatives of the Directorate General of Policy for the Small- and Medium-Sized Enterprise, with one of the representatives of the Directorate General of the Treasury and Financial Policy acting as secretary.