

Financial regulation: 2004 Q2

Introduction

There were few new financial provisions during 2004 Q2.

First, Central Credit Register regulations specifying how declarations should be sent and the characteristics of holders to be declared have been amended, in step with the tenets of the rules being implemented.

Further, accounting standards and formats for investment services firms' financial statements and annual accounts were issued, and some of the accounting obligations for portfolio management companies were extended.

Finally, three Community directives worthy of mention were enacted in the European Union. The first affects public share purchase offers, and is aimed at co-ordinating Member States' legislation and at safeguarding the interests of holders of company securities that come under a Member State's law when such securities are subject to public share purchase offer or a change of control. The second directive extends the Community legal framework for investment services firms in respect of marketable securities and harmonises some of the rules governing the workings of regulated markets. Lastly, the third directive specifies a series of points for the application of the Directive on insider dealing and market manipulation (market abuse).

Amendment of the regulations on the Central Credit Register

Law 44/2002 of 22 November 2002¹ on financial system reform measures (hereafter, the Financial Law) laid down a legal regime for the Central Credit Register (hereafter, the CCR), conferring upon it the legal nature of a public service insofar as it assists the Banco de España in the exercise of its powers and gives greater stability to the Spanish credit system. It further empowered the Minister for the Economy or, further to this Minister's authorisation, the Banco de España to determine the types of credit risks that should be reported, the conditions to be met by periodical or supplementary declarations, and the content, form and periodicity of reports on the credit risks of individuals or corporations related to the reporting institutions.

Ministerial Order ECO/697/2004 of 11 March 2004² set the criteria the Banco de España must observe in regulating the CCR, indicating that CBE 3/1995 of 25 September 1995³ on the CCR will remain applicable, if it is not contrary to the Order, until the specific points envisaged in the Order are established by the Banco de España.

CBE 1/2004 of 29 July 2004 (BOE of 9 July 2004) amending CBE 3/1995 of 25 September 1995 on the CCR has recently been enacted to adapt the functioning of the CCR to law, initiating a staggered process of reforms affecting both the form and the substance of the data to be reported.

CBE 1/2004 amends CBE 3/1995, first, so that borrowers' personal data are reported continuously throughout the month, to bring forward as much as possible the rectification of potential errors in declarations; and further, to include new data facilitating their identification and allowing a better use of the information available, both for statistical and supervisory purposes,

1. See «Financial regulation: 2002 Q4», *Economic Bulletin*, Banco de España, January 2003, pp. 101-113. 2. See «Financial regulation: 2004 Q1», *Economic Bulletin*, Banco de España, April 2004, pp. 92-93. 3. See «Regulación financiera: cuarto trimestre de 1995», *Boletín Económico*, Banco de España, January 1996, pp. 82-83.

in step with the Law's demand that the data reported to the CCR be accurate and up-to-date.

The credit risk reporting threshold is maintained at €6,000. However, what is new here is that, in the calculation of the minimum amount of credit risks to be reported, regard must be had jointly, where appropriate, to both the amounts actually drawn down and the credit available. It is likewise established that the amounts of past-due loans of less than €6,000 relating to transactions reported with outstanding balances in order shall be reportable. Past-due loans of less than €1,000 shall be explicitly reported for a zero amount and the related default key.

Finally, as from the entry into force of the Circular, all communication of data between reporting institutions and the CCR, such as data declarations, rectifications and cancellations, along with requests for reports and non-resident codes, shall be made exclusively by telematic means. Exceptionally, in specific, justified instances and further to the approval of the Banco de España Financial Reporting and CCR Department, the data may be sent on a magnetic support.

**Investment services firms:
accounting standards,
restricted and public
formats for financial
statements and public
annual accounts**

Investment services firms (hereafter, ISFs) were regulated by Law 37/1998 of 16 November 1998, reforming Law 24/1988 of 28 July 1988⁴ on the Securities Market, and by Royal Decree 867/2001 of 20 July 2001⁵ on the legal regime for ISFs. Subsequently, Royal Decree 948/2001 of 3 August 2001⁶, on investor compensation schemes, made it obligatory for ISFs to adhere to the Investment Guarantee Fund. Nonetheless, the new formats giving uniformity to the restricted and public information that all ISFs had to send to the National Securities Market Commission (CNMV) had still to be adopted.

Consequently, CNMV Circular (CCNMV) 2/2004 of 31 March 2004 (BOE of 12 April 2004) on the accounting standards, restricted and public formats of financial statements and public annual accounts of ISFs was enacted, partially amending CCNMV 5/1990 of 28 November 1990 on the accounting standards, restricted and public formats of financial statements and public annual accounts of securities dealer firms and securities agencies. The Circular also determines the accounting treatment of gold as a currency.

The Circular extends the scope of CCNMV 5/1990 to all institutions categorised as ISFs, including two new formats for restricted financial statements in which statistical information on portfolio management and the deposit of securities is required. It likewise establishes the obligation for portfolio management firms to send the same special report supplementing the auditing of accounts which, at present, is mandatory for securities dealer firms and agencies.

The documents required by the Circular, and the public formats established, shall be presented in rounded thousands of euro, unless it is expressly indicated otherwise. Irrespective of the foregoing, the CNMV may require of institutions, generally or individually, whatsoever information is needed to clarify and break down the foregoing statements, or to meet any other end that arises in the performance of the functions entrusted to it.

Finally, the presentation of the restricted and public statements should be via telematic means, using the CIFRADO/CNMV system, approved by the CNMV Resolution dated 11 March 1998, or some similar system.

4. See «Regulación financiera: tercer trimestre de 1988», *Boletín Económico*, Banco de España, October 1988, pp. 56-58. 5. See «Financial regulation: 2001 Q3», *Economic Bulletin*, Banco de España, October 2001, pp. 93-97. 6. See «Financial regulation: 2001 Q3», *Economic Bulletin*, Banco de España, October 2001, pp. 89-93.

Community Directive on takeover bids

In order to safeguard the holders of marketable securities in a Member State regulated market and, in particular, those with minority holdings when they are subject to a takeover bid or to a change in the control of the company, Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OJEC of 30 April) was enacted.

SCOPE

The Directive lays down measures co-ordinating the legal, regulatory and administrative provisions, codes of practice and other arrangements of the Member States, including those established by agencies officially authorised to regulate the markets, in respect of takeover bids, where all or some of these securities are traded on a regulated market in one or more Member States.

This Directive does not apply to takeover bids by companies whose corporate purpose is the collective investment of capital provided by the public, which operate on the principle of risk spreading and the units of which are, at the request of the holders, repurchased or redeemed, directly or indirectly, out of the assets of these companies. The Directive does not apply to takeover bids for securities issued by the central banks of the Member States.

SUPERVISORY AUTHORITY FOR TAKEOVER BIDS AND GENERAL PRINCIPLES

The Member States shall designate one or several authorities to take responsibility for supervising the aspects of the bid regulated by the present Directive, and to ensure compliance with the rules adopted in the Directive.

Member States should take the necessary measures to afford any offeror the possibility of purchasing a majority holding in other companies and of fully exercising control of such companies. To this end, restrictions on the transfer of securities and on voting rights, special appointment rights and multiple voting rights, inter alia, should be neutralised during the bid-acceptance period. Should holders of securities incur a loss as a result of the neutralisation of rights, fair compensation should be offered in accordance with the technical arrangements established by the Member States.

PROTECTION OF MINORITY SHAREHOLDERS, MANDATORY BID AND FAIR PRICE

If a natural or legal person, as a result of a purchase by them, or that of persons acting in concert with them, holds securities in a company directly or indirectly conferring a specific proportion of voting rights in this company and thereby giving control of said company, Member States shall ensure that such person is bound to make a takeover bid, so as to protect the minority shareholders of the company. The bid shall be addressed to all holders of securities for all their securities at the equitable price defined in this Directive.

Additional measures should be taken to protect the interests of holders of securities, such as the obligation to make a partial bid when the offeror does not acquire control of the company or the obligation to make a bid simultaneously with the acquisition of control of the company.

For the purposes of the Directive, an equitable price is considered to be the highest price paid by the offeror or the persons acting in concert with him for the same securities over a period to be determined by the Member States, which may not be less than six months or more than twelve months. If the offeror or persons acting in concert with him purchase securities at a higher price than that of the bid after such bid has been made public and before the offer closes for acceptance, the offeror must increase the price of the bid up to, at least, the highest price paid for the securities thus purchased.

INFORMATION ON THE BID

Member States must ensure that a decision to make a bid is made public without delay and that the supervisory authority is duly informed. Once the bid has been made public, the governing or managing bodies of the offeree company and of the offeror must inform the repre-

representatives of their respective employees or, failing this, the employees themselves. They must also ensure that the announcement of the bid guarantees its transparency and clarity for the market in respect of the securities of the offeree company, the offeror or any other company involved in or affected by the bid, so as to avoid, in particular, the release or dissemination of false or misleading data.

Further, Member States must ensure that the offeror draws up and publishes a bid offer document containing the necessary information so that the holders of the securities of the offeree company can take a properly informed decision. Before releasing the bid document, the offeror shall send it to the supervisory authority and, once it is published, the governing or managing bodies of the offeree company and of the offeror will send it to the representatives of their respective employees or, failing this, the employees themselves.

It is also laid down that the time allowed for the acceptance of a bid may not be less than two weeks or more than ten weeks from the date of publication of the offer document. However, Member States may provide for the period exceeding ten weeks provided that the offeror notifies, with at least two weeks' notice, his intention to close the bid.

Finally, Member States must adapt the necessary legal, regulatory and administrative provisions to comply with the provisions in this Directive by no later than 20 May 2006.

Community directive on investment companies and on regulated markets for financial instruments

Council Directive 93/22/EEC of 10 May 1993⁷ on investment services in the securities field, which has now been repealed, laid down the conditions in which ISFs and authorised banks could provide specific services or open branches in other Member States on the basis of home country authorisation and supervision. The Directive thus sought to harmonise the requirements for the initial authorisation and workings of ISFs, the conduct of business rules and some of the conditions governing the operation of regulated markets.

In recent years the number of investors participating in financial markets has increased, and they face a much more complex range of services and instruments. These developments advise extending the Community legal framework, which should cover the entire range of activities at the service of investors. To this end, it would be desirable to achieve the degree of harmonisation needed to offer investors a high level of protection and allow ISFs to provide services throughout the Community, since what is involved is a single market, taking home country supervision as a basis.

In view of the foregoing, Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 (OJEC of 30 April) on markets in financial instruments was published, amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

SCOPE

This Directive will apply to ISFs and to regulated markets, and to authorised credit institutions when they provide one or more services or perform one or more investment activities in the European Union.

It will not apply, among other cases, to insurance companies; to persons providing investment services exclusively to their parent companies, to their subsidiaries or to other subsidiaries of their parent companies; to the members of the European System of Central Banks; to other

7. See «Regulación financiera: segundo trimestre de 1993», *Boletín Económico*, Banco de España, July-August 1993, pp. 106-108.

national agencies with similar functions; to other public agencies entrusted with the management of public debt or which intervene in the public debt market; and to collective investment undertakings and pension funds, whether co-ordinated or not at the Community level, and to the depositaries and managers of these undertakings.

CONDITIONS GOVERNING THE
AUTHORISATION AND OPERATION
OF INVESTMENT FIRMS

As laid down in Directive 93/22/EEC, Member States shall require that the provision of services or performance of investment activities in a professional capacity or as an habitual activity be subject to authorisation. Such authorisation will be granted by the competent authority designated by the home Member State. ISFs will provide all the information (including a programme of operations setting out, *inter alia*, the types of business envisaged and the organisational structure) needed to enable the competent authority to satisfy itself that the investment firm has established, at the time of initial authorisation, all the necessary arrangements to meet its obligations.

Remaining virtually unchanged are the procedures for granting and refusing requests for authorisation and for withdrawing authorisations, the requirements in respect of the repute of the persons actually running the business, and the regime governing qualifying holdings.

In a similar fashion to Directive 93/22/EEC, Member States shall periodically review the conditions under which the initial authorisation operates. To this end, they will require the competent authorities to establish the appropriate methods for supervising investment firms' compliance with this obligation and, where appropriate, require investment firms to notify the competent authorities of any material changes to the conditions for initial authorisation.

In the case of investment firms which solely provide investment advice or engage in the business of the reception and transmission of orders, Member States may allow the competent authority to delegate administrative, preparatory or ancillary tasks related to the granting of authorisation or to the review of the conditions for initial authorisation.

TRADING PROCESS AND
FINALISATION OF TRANSACTIONS
IN A MULTILATERAL TRADING
FACILITY (MTF)

Member States shall require that ISFs or market operators operating an MTF establish transparent and non-discretionary rules and procedures for fair and orderly trading, set objective criteria for the efficient execution of orders and lay down transparent rules regarding the criteria for determining the financial instruments that can be traded under its systems.

They shall also require that investment firms or market operators operating an MTF provide sufficient publicly available information to enable its users to form an investment judgement, taking into account both the nature of the users and the types of instruments traded.

RELATIONS WITH THIRD
COUNTRIES

As indicated in Directive 93/22/EEC, Member States shall inform the Commission of any general difficulties which their investment firms encounter in establishing themselves or providing investment services and/or performing investment activities in any third country. Should it appear that Community investment firms in a third country are not granted national treatment affording the same competitive opportunities as are available to domestic investment firms and that the conditions of effective market access are not fulfilled, the Commission may initiate negotiations in order to remedy the situation.

PROVISIONS TO ENSURE
INVESTOR PROTECTION

The rules of business conduct laid down in Directive 93/22/EEC, which ISFs must observe at all times when providing investment services to clients, have been extended. In particular, when providing investment advice or portfolio management, ISFs shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his in-

vestment objectives so as to enable the firm to recommend the investment services and financial instruments best suited for him.

Further, ISFs shall establish a record including the document or documents agreed between the firm and the client that set out the rights and obligations of the parties, and the other terms on which the firm will provide services to the client. The client must receive from the ISF appropriate reports on the service provided to its clients. These reports shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the client.

Member States shall require that ISFs take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.

FREEDOM OF ESTABLISHMENT AND TO PROVIDE SERVICES

As indicated in Directive 93/22/EEC, Member States shall ensure that all ISFs authorised and supervised by the competent authority of another Member State (along with credit institutions authorised in compliance with the Directive regulating them at Community level) may freely provide services, engage in investment business and offer ancillary service in their territory provided that such services and business are duly authorised. They may only provide ancillary services together with an investment service or activity.

Member States shall, without further legal or administrative requirements, allow ISFs and market operators operating MTFs of other Member States to provide appropriate arrangements on their territory so as to facilitate access to and trading on those markets by remote members or participants established in their territory.

Member States shall ensure that investment services and/or activities as well as ancillary services may be provided within their territories through the establishment of a branch provided that those services and activities are covered by the authorisation granted to the ISF or the credit institution in the home Member State. Ancillary services may only be provided together with an investment service and/or activity.

In cases where an ISF uses a tied agent established in a Member State outside its home Member State, such tied agent shall be assimilated to the branch and shall be subject to the provisions of this Directive relating to branches.

Member States shall provide that, where an ISF authorised in another Member State has established a branch within its territory, the competent authority of the home Member State of the ISF, in the exercise of its responsibilities and after informing the competent authority of the host Member State, may carry out on-site inspections in that branch.

REGULATED MARKETS IN FINANCIAL INSTRUMENTS

Authorisation as a regulated market shall be granted only where the competent authority is satisfied that both the market operator and the systems of the regulated market comply at least with the requirements laid down in the Directive.

The operator of the regulated market shall provide all information, including a programme of operations setting out inter alia the types of business envisaged and the organisational structure, necessary to enable the competent authority to satisfy itself that the regulated market has established, at the time of initial authorisation, all the necessary arrangements to meet its obligations.

Member States shall require the operator of the regulated market to perform tasks relating to the organisation and operation of the regulated market under the supervision of the competent authority. Specifically, they shall require the operator: (a) to provide the competent authority with, and to make public, information regarding the ownership of the regulated market and/or the market operator, and in particular, the identity and scale of interests of any parties in a position to exercise significant influence over the management; (b) to inform the competent authority of and to make public any transfer of ownership which gives rise to a change in the identity of the persons exercising significant influence over the operation of the regulated market.

The competent authority shall refuse to approve proposed changes in the identity of the persons controlling the regulated market and/or the market operator where there are objective and demonstrable grounds for believing that they would pose a threat to the sound and prudent management of the regulated market.

Member States shall require that regulated markets have clear and transparent rules regarding the admission of financial instruments to trading. These rules shall ensure that any financial instruments admitted to trading in a regulated market are capable of being traded in a fair, orderly and efficient manner and, in the case of transferable securities, are freely negotiable.

In the case of derivatives, the rules shall ensure in particular that the design of the derivative contract allows for its orderly pricing as well as for the existence of effective settlement conditions.

The operator of the regulated market may (as may the competent authority) suspend or remove from trading a financial instrument which no longer complies with the rules of the regulated market unless such a step would be likely to cause significant damage to the investors' interests or the orderly functioning of the market.

Member States shall require the regulated market to establish and maintain transparent and non-discriminatory rules, based on objective criteria, governing access to or membership of the regulated market. These rules shall specify any obligations for the members or participants arising, *inter alia*, from the constitution and administration of the regulated market; professional standards imposed on the staff of the investment firms or credit institutions that are operating on the market; and the rules and procedures for the clearing and settlement of transactions on the regulated market.

Regulated markets may admit as members or participants investment firms, credit institutions authorised under Directive 2000/12/EC and other persons who: (a) are fit and proper; (b) have a sufficient level of trading ability and competence; (c) have sufficient resources for the role they are to perform, taking into account the different financial arrangements that the regulated market may have established in order to guarantee the adequate settlement of transactions.

Member States shall, without further legal or administrative requirements, allow regulated markets from other Member States to provide appropriate arrangements on their territory so as to facilitate remote access to and trading on those markets. The regulated market shall communicate to the competent authority of its home Member State the Member State in which it intends to provide such arrangements. The competent authority of the home Member State shall communicate, within one month, this information to the Member State in which the regulated market intends to provide such arrangements. It will, on the request of the competent authority of the host Member State and within a reasonable time, also communicate the iden-

tity of the members or participants of the regulated market established in that Member State.

The competent authority of a regulated market may not oppose the use of central counterparties, clearing houses or settlement systems in another Member State except where this is demonstrably necessary in order to maintain the orderly functioning of that regulated market.

In order to avoid undue duplication of control, the competent authority shall take into account the supervision of the clearing and settlement system already exercised by the national central banks as overseers of clearing and settlement systems or by other supervisory authorities with competence in relation to such systems.

The Directive entered into force on 30 April 2004.

Clarification of the measures implementing the Directive on insider dealing and market manipulation (market abuse)

Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003⁸ on insider dealing and market manipulation (market abuse), which repealed Directive 89/592/EEC of 13 November 1989, co-ordinating regulations on insider dealing, was intended to ensure the integrity of Community financial markets and, consequently, to increase investors' confidence in these markets in the face of practices involving price manipulation and the dissemination of misleading information.

Recently, Commission Directive 2004/72/EC of 29 April 2004 (OJEC of 30 April) was published to implement Directive 2003/6/EC regarding accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions.

ACCEPTED MARKET PRACTICES

Member States shall ensure that the following factors, inter alia, are taken into account when assessing whether they can accept a particular market practice: a) the level of transparency of the relevant market practice to the whole market; b) the degree to which the relevant market practice has an impact on market liquidity and efficiency; c) the extent to which the relevant practice takes into account the trading mechanism of the relevant market and enables market participants to react properly and in a timely manner to the new market situation created by that practice; and d) the risk inherent in the relevant practice for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the whole Community.

Member States shall ensure that competent authorities, before accepting or not the market practice concerned, consult appropriate relevant bodies such as representatives of issuers, financial services providers, consumers, other authorities and market operators.

INSIDER DEALING RELATING TO DERIVATIVES ON COMMODITIES

Users of markets on which derivatives on commodities are traded should receive information relating, directly or indirectly, to one or more of these derivatives when such information is routinely made available to the users of these markets, or is required to be disclosed in accordance with legal or regulatory provisions, market rules, contracts or customs on the relevant underlying commodity market or commodity derivatives market.

LISTS OF INSIDERS

Member States shall ensure that lists of insiders include all persons who have access to inside information relating, directly or indirectly, to the issuer, whether on a regular or occasional basis.

8. See «Financial regulation: 2003 Q2», *Economic Bulletin*, Banco de España, July-August 2003, pp.85-87.

These lists shall state, at least, the identity of any person having access to inside information, the reason why any such person is on the list and the date at which the list was created and updated. Member States shall ensure that lists of insiders will be kept for at least five years after being drawn up or updated.

NOTIFICATION OF MANAGERS'
TRANSACTIONS

Member States shall ensure that all transactions related to shares admitted to trading on a regulated market, or to derivatives or other financial instruments linked to them, conducted on the own account of managers of the issuing entities or persons linked to them are notified to the competent authorities. The rules of notification which those persons have to comply with shall be those of the Member State where the issuer is registered. The notification to the competent authority of that Member State shall be made within five working days of the transaction date.

Member States may decide that, until the total amount of transactions has reached €5,000 at the end of a calendar year, no notification is required or notification may be delayed until 31 January of the following year.

The notification shall contain, *inter alia*, the following information: a) the name of the person discharging managerial responsibilities within the issuer, or, where applicable, the name of the person closely associated with such a person; b) the reason for the responsibility to notify; c) the name of the relevant issuer; d) a description of the financial instrument and nature of the transaction; and e) the price and volume of the transaction.

NOTIFICATION OF SUSPICIOUS
TRANSACTIONS

Member States shall ensure that competent authorities receiving the notification of suspicious transactions transmit such information immediately to the competent authorities of the regulated markets concerned. The content of the notification shall, among other aspects, include the following information: a) a description of the transactions; (b) the reasons for suspicion that the transaction might constitute market abuse; c) the capacity in which the person subject to the notification obligation operates; and d) any other pertinent information relating to the suspicious transactions.

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 12 October 2004 at the latest.