FINANCIAL REGULATION: 2005 Q4

Financial regulation: 2005 Q4

Introduction

As usual in recent years, the number of new financial provisions in 2005 Q4 was higher than in previous quarters.

First, the rules on the payment of Banco de España profits to the Treasury have been amended and extended to 2007.

In relation to the financial markets, regulations have been issued implementing the legislation on the supervision of financial conglomerates and the transposition of Community law to Spanish law has been completed.

With regard to securities markets, five provisions are notable: first, the new regulations for collective investment institutions (CIIs), which aim, inter alia, to make the framework for their activities more flexible and to increase investor protection; second, the transposition into Spanish law of Community law on insider dealing and the manipulation of securities markets (market abuse); third, the provision that adapts the Directive on admission to trading of securities on official secondary markets, offers of securities to the public and the related prospectuses; fourth, the new regulation of venture capital entities and their management companies, which reforms the previous provisions in order to make their administrative regime and the rules for investment more flexible, in line with the more advanced countries; and finally, that which broadens the types of future receivables that can be incorporated into financial vehicle corporations created to hold securitised assets (FVCs), specifying the terms of their assignment.

In the field of taxation, various Community tax directives applicable to the parent and subsidiary companies of different Member States have been incorporated into Spanish law, as has the tax regime for cross-border contributions to pension funds within the European Union.

Also at the Community level, the following legislation has been published: the directive on cross-border mergers of limited liability companies, the directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the regulation on controls of cash entering or leaving the Community.

A number of reforms have been introduced in various economic sectors to stimulate productivity in the Spanish economy, against a background of greater integration of European and world markets.

The European company has been regulated, following the guidelines set by the European Union and, finally, as usual in this period, the measures contained in the 2006 State budget, mainly monetary, financial and fiscal, are analysed.

Amendment of the rules on the payment of Banco de España profits to the Treasury

Royal Decree 1198/2005 of 10 October 2005 (BOE of 11 October 2005) on the rules governing the payment of the profits of the Banco de España to the Treasury has partially amended the previous rules[1], which are now extended to 2005, 2006 y 2007.

1. Royal Decree 1746/1999 of 19 November 1999 and Royal Decree 1080/2002 of 22 October 2002. See "Financial regulation: 1999 Q4", *Economic Bulletin*, January 2000, Banco de España, pp. 100-101 and "Financial regulation: 2002 Q4" *Economic Bulletin*, January 2003, Banco de España, pp 88 and 89, respectively.

The most important changes are as follows: first, the date of the second payment to the Treasury of Banco de España profits is put back from February to March; and, second, when authorised by the Council of Ministers, part of the profits shall be excluded from the November and March payments.

Thus, the percentages and periods for payment to the Treasury of the profits of the Banco de España shall be as follows:

a) On the first business day of November each year, 70% of the profits accrued and recorded to 30 September of such year. The payment resolution shall take into account profit forecasts to the end of the year.

b) On the first business day of the following March, 90% of the profits accrued and recorded to 31 December of the previous year, having deducted the payment referred to in the last paragraph.

   These payments to the Treasury shall be agreed by the Governing Council of the Banco de España after approval of the relevant income statement, taking into account the obligations of the Banco de España vis-à-vis the ESBC.

c) When authorised by the Council of Ministers, part of the profits shall be excluded from the November and March payments.

d) Finally, when the annual accounts and proposed distribution of profits formulated by the Governing Council of the Banco de España have been approved by the Council of Ministers, the Banco de España shall pay to the Treasury the rest of the profit for the year, except that part whose exclusion has been authorised by the Council of Ministers.

Supervision of financial conglomerates

Royal Decree 1332/2005 of 11 November 2005 (BOE of 23 November 2005) was published to implement Law 5/2005 of 22 April 2005 on the supervision of financial conglomerates amending other laws of the financial sector[2], and the transposition of Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002[3] was completed.

SCOPE

The Royal Decree adopts the new system of supplementary supervision designed by Law 5/2005. The entities subject to this system are credit institutions, investment firms and insurance and reinsurance undertakings, as well as CII management companies and pension funds (referred to generically both by the Directive and the Law as regulated entities) forming part of a financial conglomerate.

Also, it establishes the rules applicable to the calculations required to identify financial conglomerates, both in groups whose parent is a regulated entity and in those which, having no parent, carry out their activities primarily in the financial sector.

Non-consolidable mixed groups, for which Law 13/1992 of 1 June 1992 on own funds and supervision of financial institutions on a consolidated basis established a form of consolidation of limited scope whenever they could not be identified as financial conglomerates because they did not meet the sectoral diversification criteria, shall be subject to specific reporting requirements.

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2. See "Financial Regulation: 2003 Q1", *Economic Bulletin,* April 2003, Banco de España, pp. 83-99. **3.** See "Financial Regulation: 2005 Q2", *Economic Bulletin,* July 2005, Banco de España, pp. 111-125.

RELEVANT COMPETENT AUTHORITIES

The Royal Decree stipulates that the relevant competent authorities in the supervision of a financial conglomerate shall be as follows, in this order: a) the Spanish competent authorities and those of other EU Member States responsible for consolidated supervision of the regulated entities of a financial conglomerate; b) the co-ordinator designated pursuant to this Royal Decree, if different from the authorities referred to in the preceding point; c) other interested competent authorities, whenever so decided by mutual agreement of the authorities referred to in the preceding two points; and d) the Spanish competent authorities, in the case of a financial conglomerate whose foreign regulated entities do not belong to an EU State and which includes a Spanish financial institution. For this purpose, particular regard shall be had to the market share of the conglomerate's regulated entities in other EU Member States, particularly if it exceeds 5%, and to the importance within the conglomerate of any regulated entity established in another Member State.

DESIGNATION OF THE SUPERVISION CO-ORDINATOR

Law 5/2005 provided for a single co-ordinator as the competent authority responsible for exercising and co-ordinating supplementary supervision, given the possibility of there being a multiplicity of authorities if the financial conglomerate had a high degree of sectoral and territorial diversification. For its part, the Royal Decree establishes that, if the parent of a financial conglomerate is a Spanish regulated entity, the co-ordinator's function shall be exercised by the competent authority entrusted with monitoring and supervising the consolidable group of which that entity forms part or, if none, by the competent authority entrusted with monitoring and supervising the entity on an individual basis. In other cases, the function of co-ordinator shall be exercised by the competent authority responsible for supervising the Spanish regulated entity with the largest total balance sheet in the most important financial sector. Nevertheless, this criterion may also be changed by mutual agreement with the relevant competent authorities.

Finally, the Banco de España, the Spanish National Securities Market Commission (CNMV) and the Directorate General of Insurance and Pension Funds shall co-operate closely with each other and with the other competent authorities to identify the financial conglomerates in which Spanish entities are included, if any. For this purpose, they can call on any regulated entity falling within their competence to provide them with such information not in their possession as may be required to carry out such identification.

ELEMENTS OF SUPPLEMENTARY SUPERVISION AND REPORTING REQUIREMENTS

Capital adequacy policies are established and the eligible capital of financial conglomerates is defined. Also, the obligated entities of financial conglomerates must inform the co-ordinator with the periodicity specified by the latter, which must be at least once a year, of any significant intra-group transaction[4] of the regulated entities in the financial conglomerate and of any significant concentration of risk[5]; the co-ordinator must examine the possible risk of contagion and of conflict of interest within the financial conglomerate and the risk of evasion of sectoral rules and regulations, and the Ministry of economy is authorised to set quantitative limits and qualitative requirements in relation to such transactions.

4. An intragroup transaction shall mean any transaction or agreement, whatever its nature, that directly or indirectly links the regulated entities of a financial conglomerate to other firms of the same group or to a natural or legal person closely related to the firms of that group for the fulfilment of an obligation, contractual or otherwise, whether or not for the purpose of payment. Any intragroup transaction of an amount exceeding 5% of the eligible capital of the financial conglomerate is considered to be significant, although the co-ordinator may define lower thresholds of significance for each case. **5.** Concentration of risk shall mean any exposure that may give rise to a loss borne by the entities of a financial conglomerate that is sufficiently important to jeopardise the solvency or general financial position of the regulated entities of the financial conglomerate. The exposure may derive from counterparty or credit risk, investment risk, insurance risk or market or other risk or from a combination or interaction of them. Also classed as a significant concentration of risk shall be those exceeding 10% of the eligible capital of the financial conglomerate, although the co-ordinator may define lower thresholds of significance for each case.

The obligated entities of financial conglomerates must send the co-ordinator the information, periodic or other, that the latter may require of them to verify compliance with their obligations. Also, they must attend to matters required of them by the co-ordinator and facilitate any inspections. Notwithstanding this, the competent authorities responsible for supervision of the entities or groups included in the conglomerate may address them directly in the exercise of their powers of individual or consolidated supervision of the entities included in the conglomerate.

Furthermore, financial conglomerates must have adequate risk management procedures and internal control mechanisms.

OTHER PROVISIONS

The final provisions established the revision of the sectoral (banking, securities and insurance) rules of regulatory rank in order to achieve an adequate consistency between them and bring them into line with the new regime for financial conglomerates. They also set common requirements for the commercial and professional integrity of certain supervised entities (including currency-exchange bureaux and appraisal companies), which seek to remedy the conceptual dispersion that has existed to date.

Finally, in the field of insurance the amendments included in the final provisions are used to establish an appropriate valuation of the real estate of insurance companies.

New regulations for collective investment institutions

Royal Decree 1309/2005 of 4 November 2005 (BOE of 8 November 2005), which approves the Regulations of Law 35/2003 of 4 November 2003[6] on collective investment institutions (CIIs) has recently been published.

The basic objectives of the Regulations are as follows: to make the *framework for the activities of CIIs more flexible*, to increase *investor protection* and to improve the *rules for official intervention*. It also updates the tax regime for CIIs, while repealing the previous Regulations contained in Royal Decree 1393/1990 of 2 November 1990, although these will remain temporarily in force insofar as they do not conflict with the new legislation. Finally, it completes the transposition to Spanish law of Directives 2001/107/EC and 2001/108/EC.

The most important aspects of these new Regulations are summarised below.

MAKING THE FRAMEWORK FOR THE ACTIVITIES OF CIIs MORE FLEXIBLE

The Regulations seek to give investors a more extensive range of products in which to invest, broadening the vocations and specialities of CIIs. The previous distinction, i.e. between those of a financial and a non-financial nature, is maintained, but the categories of CII are changed, as summarised in Table 1.

The aim of the new categories is to avoid unnecessary restrictions on the investment possibilities and activities of Spanish CIIs. Notable among the changes, first, is that it is now possible to set up umbrella mutual funds (both financial and non-financial), specifying rules for distributing costs, obligations and expenses between the various sub-funds. Each sub-fund shall have its own name, which shall include the term "*fondo*" (fund). Unlike in the case of mutual funds (which shall have a minimum of 100 shareholders), in the case of umbrella funds the minimum number in each sub-fund shall be 20, while the total number of shareholders in the fund shall not, under any circumstances, be less than 100.

Likewise, financial and non-financial umbrella investment companies may be set up that, with a single formation agreement and set of articles of association, have two or more sub-compa-

6. See "Financial regulation: 2003 Q4", *Economic Bulletin*, January 2004, Banco de España, pp. 84-87.

CATEGORIES OF COLLECTIVE INVESTMENT INSTITUTION TABLE 1

PREVIOUS REGULATIONS (RD 1393/1990)	CURRENT REGULATIONS (RD 1309/2005)
Financial	Financial
FIM (capital market MFs and FIAMM (money market asset MFs)	Mutual funds
Open-end investment companies (SIMCAV)	Open-end investment companies (SICAV)
Closed-end investment companies (SIMCF)	*Category disappears*
Index funds	Exchange traded funds
Funds of funds	*Category disappears*
CIIs specialised in untraded securities	Hedge funds
	Umbrella funds
	Funds of hedge funds
Non-financial	Non-financial
Real-estate mutual funds (FII)	FII, umbrella FII
Real-estate investment companies (SII)	SII, umbrella SII

SOURCES: Ministerio de Economía y Hacienda and Banco de España.

nies. Each sub-company shall have its own name, which shall include the term "*sociedad de inversión*" (investment company).

Another of the most significant features of the Regulations consists of the regulation of *hedge funds*, which are now therefore recognised by Spanish law. These institutions are characterised by greater freedom in their investment policy and greater flexibility in their compliance with reporting and liquidity requirements. In particular, they are exempted from compliance with a large number of the requirements and limits applicable to other institutions regulated in this chapter. Thus: a) the shares of these CIIs may be subscribed for or acquired by means of a minimum initial payment of €50,000; b) their marketing shall only be targeted at qualified investors; c) they shall have at least 25 shareholders; d) subscription for and redemption of mutual funds shares or, as the case may be, acquisitions and sales of the shares in investment companies may be carried out by means of the delivery of financial assets and instruments suitable for investment, that come within the investment vocation of the CII; e) they can have lock-up periods of up to six months; f) they may invest in financial assets and in financial derivatives, whatever the nature of their underlying, taking into account the principles of liquidity, diversification and transparency; g) they may assume debts of up to five times the value of their assets, and h) there shall be no legal limit to the fees they charge.

This exceptional regime is justified by the fact that these institutions are designed for qualified investors who can be assumed to have better judgement regarding their capacity to select and assume risks.

Funds of hedge funds, which give retail investors access to hedge funds, are also regulated. These institutions, as in the previous case, are exempted from compliance with many of the requirements and restrictions that apply to other financial CIIs, although the following are applicable to them: a) they shall invest at least 60% of their assets in Spanish hedge funds and in similar foreign CIIs (either domiciled in OECD countries or whose management has been entrusted to a management company subject to supervision domiciled in an OECD country), although they may not invest more than 10% of their assets in a single CII; b) they can have lock-up periods of up to six months; c) the limits on management, deposit, subscription and redemption fees in these Regulations shall not be applicable to them, and d) before subscribing for or acquiring shares, investors shall sign a statement that they understand the risks inherent in the investment, which shall be included, prominently, in the fund's prospectus and in all its promotional literature.

Exchange Traded Funds (ETFs) are also regulated. These resemble index funds, which were regulated in the previous legislation, but the acquisition or sale of their shares is now permitted not only once a day, but throughout the daily trading period on the relevant exchange. The Regulations define these funds as those whose shares are admitted to trading on a stock exchange. For the purposes of facilitating the alignment of the price with the net asset value estimated at different times during trading, there shall be institutions that undertake to quote firm bid and ask prices for the shares subject to a maximum spread. The Spanish markets are developing a new trading segment to give these funds liquidity.

As regards the investment policy of financial CIIs, their possibilities are broadened, under certain conditions, to include, inter alia, bank deposits, collective investment institutions, certain financial derivatives and unlisted money market assets. The minimum liquidity ratio for these CIIs is maintained at 3% of their assets. Table 2 sets out the most important changes in relation to minimum capital, investment policy and risk diversification.

Real-estate CIIs will now include investments in a company whose assets consist not only of one property (as envisaged previously), but of more than one, provided that such properties are subject to a lease. Also, the investment limits for purchases of property before completion and for commitments to purchase are combined into a single limit of 40% of the institution's assets (previously 20% of the assets in each case).

INVESTOR PROTECTION

The Regulations specially regulate the fees applicable to mutual funds. As in the previous Regulations, the management fee may be based on assets, returns or both. However, an important change in the case of financial CIIs is that when their management fees are based on the fund's profits, they can only be charged on actual profits.

Except in the case of hedge funds, management fees cannot be charged that exceed the following limits: a) when the fee is calculated solely in terms of the fund's assets, 2.25% thereof; b) when it is calculated solely in terms of profits, 18% thereof, and c) when both variables are used, 1.35% of assets and 9% of profits. As long as former money market asset mutual funds (FIAMM) do not alter their investment policy, the rules on their commissions remain unchanged.

The reporting obligations of CIIs are a key element of investor protection. These regulations, which require CIIs to be sufficiently transparent, specify such obligations in detail. Thus, CIIs shall publish, for dissemination among their shareholders and the general public, a full prospectus, a simplified prospectus, an annual report, a half-yearly report and two quarterly reports, which are concisely detailed in the Regulations. The intention is that up to date information should be published promptly on all circumstances that might play a part in the determination of the value of the assets and the prospects of the institution, in particular, inherent risks and legal compliance.

Notably, rules are established to ensure that the calculation of the net asset value and redemptions and subscriptions does not involve inappropriate practices that may give rise to arbitrage or speculation against a fund. For this purpose, the net asset value applicable to subscriptions and redemptions must be that of the same day, or of the day following the application. The simplified prospectus shall indicate the subscription and redemption procedures, which shall ensure that subscription and redemption orders are accepted by the CII management company only if made at a time when the applicable net asset value is not known by the investor and it is impossible to estimate it with certainty.

INVESTMENT POLICY AND RISK DIVERSIFICATION OF FINANCIAL CIIs TABLE 2

PREVIOUS REGULATIONS (RD 1393/1990)	CURRENT REGULATIONS (RD 1309/2005)
MUTUAL FUNDS	
Minimum net assets: €3 million.	As previously.
	In the case of umbrella funds, each sub-fund shall have net assets of at least €600,000, without the total net assets of the fund being in any event less than €3 million.
There were FIM (capital market mutual funds) and FIAMM (money market asset mutual funds.	The category of FIAMM has disappeared.
Management fees were based on net assets, profits or both variables.	As previously. However, in the case of profit-based management fees, a procedure has been introduced to ensure that fees are only charged on actual profits. Also, hedge funds and funds of hedge funds are not subject to the regulatory limits. The former FIAMM shall maintain their special fee regime insofar as their investment policy permits them to continue to be considered as such.
INVESTMENT COMPANIES	
The minimum paid-up capital of financial investment companies shall be €2.4 million.	As previously.
INVESTMENT POLICY OF FINANCIAL CIIs	
Listed securities or financial instruments, shares and other equity of other harmonised CIIs, subject to a limit of 10% of net assets.	As previously.
Derivatives traded on regulated markets.	As previously.
OTC derivatives: underlying suitable for investment, supervised counterparty, price listed daily.	As previously.
	Also, shares in other non-harmonised CIIs (subject to requirements), deposits in credit institutions with maturity of less than twelve months and unlisted money market instruments.
Up to 10% of net assets in other assets: unlisted securities or securities listed on unregulated markets, with sufficient diversification in all cases.	As previously. Also, other non-harmonised CIIs; hedge funds and funds of hedge funds; shares in venture-capital funds or companies and other deposits in credit institutions.
RISK DIVERSIFICATION RULES	
The limit, 5% of net assets in securities of one single issuer, except: up to 10%, if the sum of these securities does not exceed 40% (15-16 issuers).	As previously.
Up to 35% if they are public-sector securities, even 100% (Fondtesoro)	As previously.
25% in the case of covered bonds, *cédulas territoriales* and FCVs created to hold securitised mortgage assets	As previously.
Exceptions are established for index funds: the limit for index funds was 35% of net assets in one security and 45% in a group.	Exceptions are established for index funds: CIIs that replicate an index the limit is raised to 20% of net assets in the securities of one single issuer, a single issuer may reach 35%. CIIs that take an index as benchmark: 10% of the net assets of the CII in securities of one single issuer plus another 10% by means of derivatives traded on official or foreign secondary markets, and up to 35% for a single issuer. New limits on counterparty risk.
Limits on the holding of a CII in an issuer: the securities of a CII must not exceed 5% of the outstanding securities issued by an entity; the CII of the same group or manager must not exceed 15%.	As previously. No more than 45% of the net assets in shares issued by a single harmonised CII or equivalent (except master-feeder funds).
Use of derivatives: the manager must have a risk-management system. the total exposure to market risk must not exceed the net assets.	As previously. The exposure to market risk of the underlyings is computed in the diversification coefficients (5%-10%, 20%, 35%), except in index funds.

SOURCES: Ministerio de Economía y Hacienda and Banco de España

MODERNISATION OF THE ADMINISTRATIVE REGIME

The Regulations make a significant change that will help speed up these procedures, especially in the case of mutual funds, namely the establishment of a *simplified procedure*. This enables the CNMV to approve, in a single act, the authorisation and registration of mutual funds, within three months from completion of the documentation required.

Also, the exercise by shareholders of their right to withdraw from the fund is developed. This right allows shareholders, in certain circumstances, to request the redemption or transfer of their shares without any redemption fee or other expense being payable.

Another notable change is the possibility that the shares in Spanish CIIs may be *marketed abroad* by foreign agents. The marketing in Spain of the shares of CIIs authorised in accordance with the Directive[7] shall be carried out by authorised intermediaries and on the conditions laid down in current law.

The new Regulations, unlike the previous ones, regulate, in a separate Title, the rules of conduct applicable to CII management companies, CIIs with company status whose management is not entrusted to a CII management company, entities other than CII management companies that manage the assets of a CII, marketing entities, and, in short, all those involved in the activity of these institutions. In particular, they shall prepare mandatory *internal rules of conduct*, which shall regulate the activities of their management bodies, employees and representatives.

Another notable section consists of the rules to ensure the transparency and control of *related party transactions*. Specifically, related-party transactions between CII management companies and investment companies that have not delegated the management of their assets to another entity, and those who discharge administration and management duties therein, shall, when they represent a significant volume of business, be approved by the board of directors, in accordance with certain rules.

Also the Regulations strengthen the requirement for separation between the management company and the depository by means of the establishment of a number of rules for those cases in which both entities belong to the same group. To ensure that they exercise their respective functions independently, the regulations require, among other rules of separation, that an independent committee be set up in the management company or the investment company to control compliance.

OTHER ASPECTS OF THE ROYAL DECREE

The final provisions comprise various amendments and developments in the area of taxation, both in relation to the CIIs themselves and in relation to the taxation of their shareholders. Royal Decree 867/2001 of 20 July 2001 on the legal regime for investment services companies is also amended in order to introduce improvements into the administrative procedure for authorisation of amendments to articles of association, and, finally, the regulations for credit co-operatives, approved by Royal Decree 84/1993 of 22 January 1993, are amended to adapt them to international accounting standards.

Insider dealing and the manipulation of securities markets (market abuse)

The transposition into Spanish law of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003[8] on insider dealing and market manipulation (market abuse) has been completed by means of *Royal Decree 1333/2005 of 11 November 2005* (BOE of 23 November 2005), which develops Law 24/1988 of 28 July 1988[9] on the securities market, in relation to market abuse.

7. Directive 85/611/EEC of the Council of 20 December 1985 **8.** See "Financial regulation: 2003 Q2", *Economic Bulletin*, July 2003, Banco de España, pp. 85-87. **9.** See "Regulación financiera: tercer trimestre de 1988", *Boletín Económico,* October 1988, Banco de España, pp. 56-58.

The Royal Decree adapts Spanish law to the following provisions that make up the regulatory framework for market abuse at the European level: a) Commission Directive 2003/124/EC of 22 December 2003 on the definition and public disclosure of inside information and the definition of market manipulation; b) Commission Directive 2003/125/EC of 22 December 2003 on the fair presentation of investment recommendations and the disclosure of conflicts of interest; and c) Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards 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. These directives, along with Commission Regulation (EC) No 2273/2003 of 22 December 2003 on exemptions for buy-back programmes and stabilisation of financial instruments, implement and complete the above-mentioned Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003.

INSIDE INFORMATION, MARKET MANIPULATION AND ACCEPTANCE OF MARKET PRACTICES

The Royal Decree considers *inside information* to be all information of a specific nature that refers directly or indirectly to one or more negotiable securities or financial instruments, or to one or more issuers of such securities or instruments, that has not been published and that, were it to be or have been published, could have or could have had a significant influence on dealing therein. Also considered inside information is all that transmitted by a client in relation to their own pending orders, that is specific and that refers directly or indirectly to one or more issuers of securities or financial instruments, or to one or more securities or instruments and that, were it published, could have significant repercussions on dealing in such securities (or financial instruments).

Information is considered, for these purposes, to be specific in nature if it indicates a series of circumstances that exist, or an event that has occurred, or that can be reasonably expected to exist or occur, when that information is sufficiently specific to enable conclusions to be drawn as to the possible effect of that series of circumstances or the event on the prices of the negotiable securities or financial instruments.

The Royal Decree details practices that may *distort price formation*, i.e. that may amount to *market manipulation*, which include the following: a) the action of one person or of several persons in concert to secure a dominant position over the supply or demand for a security or financial instrument, with the result that the purchase or selling prices or other non-equitable bargaining conditions are directly or indirectly fixed; b) the sale or purchase of a security or financial instrument at the moment the market closes, thereby misleading investors who act on the basis of closing prices and c) taking advantage of occasional or regular access to traditional or electronic media by expressing an opinion on a security or financial instrument or, indirectly on their issuer, after having taken positions in that security or financial instrument and having benefited, therefore, from the repercussions of the opinion expressed on the price of such security or financial instrument, without having adequately and effectively publicised that conflict of interest.

To determine whether conduct amounts to a practice that distorts price formation, i.e. market manipulation, the CNMV will ensure that certain signs detailed in the Royal Decree are taken into account, without prejudice to any others that the CNMV may determine in future. In addition, the CNMV is authorised to establish a non-exhaustive list and description of specific market practices expressly accepted or rejected for these purposes.

OBLIGATIONS OF ISSUERS AS REGARDS RELEVANT INFORMATION

Securities issuers are obliged to disseminate to the market, by means of notification to the CNMV, any relevant information or event. Also, when any significant change occurs in the relevant information that has been notified, it shall immediately be disseminated to the market in the same way. Issuers shall publish the content of such notifications on their websites. Issuers shall not combine, in a manner that may be misleading, the dissemination of relevant information with the marketing of their activities.

When an issuer's securities are admitted to listing on one or more markets regulated in the European Union, the issuer shall diligently attempt to ensure that the notification of relevant information is carried out in the most synchronised way possible across all the categories of investors of all the Member States in which the issuer has applied for or obtained admission to listing of such securities.

In the event that the issuer or a person acting on their behalf reveals relevant information in the normal exercise of their work, profession or duties, it shall rapidly be published in its entirety.

When the issuer is domiciled in Spain, its directors and executives[10], as well as persons with close links thereto[11], shall notify the CNMV of any transactions they may effect in relation to shares of the issuer admitted to listing on a regulated market or in relation to derivatives or other financial instruments linked to such shares. Such notification shall be made within five business days of the date of the transaction.

INVESTMENT RECOMMENDATIONS AND CONFLICTS OF INTEREST

A *recommendation* means any information addressed to the public, relating to one or more securities or financial instruments or to their issuers, including any report on the present or future value or on the price of such instruments, that advises or suggests an investment strategy, including: a) information prepared for such purposes by an independent analyst, an investment firm, a credit institution or by any other person whose main activity is to make recommendations, and b) information prepared by persons other than those mentioned above which directly recommends a specific investment decision with respect to a security or financial instrument.

Any recommendation shall clearly and prominently identify the person responsible for its preparation; in particular, stating the name and function of the individual who prepared the recommendation and the name of the legal person responsible for its preparation.

When the relevant person[12] is an investment services company or a credit institution, the recommendation shall refer to their competent supervisory authority. In other cases, if the relevant person is subject to standards of self-regulation or codes of conduct, such circumstances shall be expressly stated in the recommendation.

Unwritten recommendations shall refer to where the information is readily and directly available to the public, such as the relevant person's website.

The Royal Decree also establishes a number of rules for the impartial presentation of recommendations and for informing about conflicts of interest. In addition, investment services companies and credit institutions shall disclose, in general terms, the provisions of their internal conduct regulations to prevent and avoid conflicts of interest in relation to recommendations, including information barriers.

10. An executive shall be considered to be any person with high-level responsibilities and regular access to inside information relating directly or indirectly to the issuer who is competent to take management decisions. **11.** Persons with close links to directors or executives shall be understood to include: the spouse of a director or executive or any person with whom they have a similar personal relationship, in accordance with domestic law; their dependent children; other relatives living with them or dependent upon them, for at least one year before the date of the transaction; any legal person or trust in which the directors or executives occupy an executive post or have management responsibility; and nominees. **12.** Relevant person means any natural or legal person who prepares or disseminates recommendations in the exercise of their profession or the management of their business activity.

Finally, the Royal Decree establishes general rules for the dissemination of recommendations when they have been prepared by a third party, and the additional obligations of investment services companies and credit institutions in relation to such dissemination.

Official secondary markets: admission to trading of securities, public offerings and prospectuses

INTRODUCTION

Royal Decree 1310/2005 of 4 November 2005 (BOE of 16 November 2005), which partially implements Law 24/1988 of 28 July 1988 on the securities market, as regards the admission to listing of securities on official secondary markets, public offerings and the prospectus required for such purposes, has been published in order to complete the transposition to Spanish law of Directive 2003/71/EC, and to incorporate the articles currently in force of Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001. It also repealed, inter alia, Royal Decree 291/1992 of 27 March 1992 on securities issuance and public offerings.

In addition, pursuant to the authorisation of Royal Decree-Law 5/2005, *Order EHA/3537/2005 of 10 November 2005* (BOE of 16 November 2005) has also been published. This implements Article 27.4 of Law 24/1988 of 28 July 1988 on the securities market, repealing, inter alia, the Order of 12 July 1993 on prospectuses.

CHANGES MADE IN RELATION TO THE ISSUANCE AND OFFERING OF SECURITIES

This decree seeks to simplify and reduce the costs of issuing and offering securities for sale or subscription, and to eliminate all registration, financial and commercial requirements that are not necessary for consumer protection or the proper functioning of the market. Specifically, the following changes have been made:

First, the recognition of the so-called *Community passport* for prospectuses approved within the European Union is regulated. Thus, a prospectus approved in one Member State, in accordance with the Directive, shall be valid for admission to trading on any European Union regulated market, so it will not be necessary to duplicate the documents for each Member State in which the offering is going to be made. The only requirement is that the supervisor that authorises the prospectus should notify host supervisors thereof.

Second, issuers of securities may select the competent authority to authorise the prospectus in the case of a public offering or application for admission to trading of certain categories of securities: all securities, other than shares, with a nominal value of €1,000 or more.

The Royal Decree completes the rules on responsibility for omissions and misstatements in prospectuses, thereby increasing the integrity, transparency and legal certainty of the Spanish securities market.

Finally, the definition of qualified investors is widened, the main change being that they can be individuals, and a register of such investors is required. Thus, investment services companies and credit institutions shall prepare a register of qualified investors, which shall include all those persons and entities that have applied to be included.

CHANGES TO THE CONTENT OF PROSPECTUSES

The content of the different types of prospectus shall be adjusted to the standard forms included in Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council, taking into account the type of issuer and the securities concerned.

The content of the prospectus shall refer to the issuer and to the securities. The summary shall have a predominant role, indicating, in comprehensible language, the characteristics and risks of the issue and of the securities. In addition, there is an obligation for at least the summary to be translated into Spanish, given that the Royal Decree enables the CNMV to authorise prospectuses presented in English, if the issuer decides to do this.

The CNMV may authorise the omission of certain information from the prospectus, where it considers that any of the following circumstances apply: a) that the dissemination of such information is contrary to the public interest; b) that the dissemination of such information would be seriously prejudicial to the issuer, provided that the omission is unlikely to mislead the public with regard to facts and circumstances that are essential to reach a well-founded view of the issuer or underwriter, and of the rights inherent in the securities to which the prospectus relates; c) that such information is of little relevance for a specific admission to trading on an official secondary market or on another regulated market domiciled in the European Union and such information has no influence on the assessment of the financial situation or on the expectations of the issuer or underwriter.

Venture capital entities and their management companies

The rules for venture capital have been reformed by the publication of Law 25/2005 of 24 November 2005 (BOE of 25 November 2005) regulating venture capital entities and their management companies, which repealed Law 1/1999 regulating venture capital entities and their management companies. The Law rearranges its articles to give greater clarity and legal certainty to the regulation of these entities.

The Law has three objectives: to improve the administrative arrangements for venture capital entities, to make their investment rules more flexible and to introduce operations accepted in the most advanced countries.

CHANGES TO THE ADMINISTRATIVE ARRANGEMENTS

In order to make the administrative arrangements for these entities more flexible, measures are introduced like the distinction, according to their openness, between ordinary-regime and simplified-regime entities, which are treated differently for administrative purposes. The rules on time periods are now more flexible and the rules on administrative silence for the procedures to authorise the formation of these entities and to alter their articles of association and management rules have been improved. The law also undertakes a significant rationalisation of powers in the area, with the bulk of the powers of authorisation contained in the law being conferred on the CNMV, as the venture capital supervisor.

The reform also seeks to make the activity more flexible by introducing financial concepts that are common in other industrial countries and that were restricted by the previous regulation. The scope of advice of the entities and their management companies is thereby broadened, although it is limited to firms in which the entities invest.

At the same time, venture capital entities are permitted to take holdings in non-financial firms listed on the first market, in order to exclude them from listing, so that an obligation is placed on them to exclude such companies from listing within a specified time period. Also, entities may invest in other venture capital entities subject to certain limits (see Table 3). Along with the foregoing, and with the same objective of reducing risk, new types of entity designed to diversify risk are introduced, such as funds and companies that basically invest in venture capital entities, with the aim of attracting retail investors to venture capital. These changes give the sector new and important tools that will certainly facilitate its productive investment activity.

As under the previous legislation, venture capital entities may adopt the legal status of venture capital companies or venture capital funds. At the same time, such entities may be of two types: ordinary-regime or simplified-regime.

INVESTMENT RULES FOR VENTURE-CAPITAL ENTITIES TABLE 3

LAW 1/1999 OF 5 JANUARY 1999	LAW 25/2005 OF 24 NOVEMBER 2005
Mandatory investment ratio	
60% of their eligible assets in shares and other securities or financial instruments that may, directly or indirectly, give entitlement to subscription or acquisition of them and holdings in the capital of companies that are the object of their activity.	As previously. Shares in non-financial firms listed or traded on a second market of a Spanish stock exchange or on equivalent markets of other countries that comply with certain characteristics indicated in the Law are also considered included in the mandatory ratio.
Within this percentage up to 30% of their total eligible assets may be assigned to participating loans in firms that are the object of their activity, whether or not the venture-capital entity has a holding in their capital.	As previously. Also they may assign up to 20% of their total eligible assets to the acquisition of shares in venture capital entities and in similar foreign entities domiciled in an OECD member state, provided that each of the venture capital entities or foreign entities in which they invest has not, in turn, invested more than 10% of its assets in other venture capital entities.
Unrestricted ratio	
Fixed-income securities traded on regulated markets or on organised secondary markets; holdings in the capital of companies other than those that are the object of its activity; cash; equity loans; financing of any type for investee companies that form part of its main object, and, in the case of venture capital companies, up to 20% of their share capital, in fixed assets necessary for the performance of their activity.	As previously.
Group limits	
They cannot invest more than 25% of their eligible assets at the time of the investment in a single company nor more than 35% in companies belonging to the same group. In the case of simplified-regime venture capital entities, the previous limits shall be extended to 40% of their assets, both for investment in a single company and in companies belonging to the same group.	As previously. In addition, they may invest up to 25% of their assets in companies belonging to their group or to that of their management company (previously not permitted), provided that the following requirements are fulfilled: a) that their articles of association or internal rules envisage such investments; b) that the entity or, where applicable, its management company has a formal procedure, specified in its internal rules of conduct, to enable conflicts of interest to be avoided and to ensure that the transaction is performed in the exclusive interest of the entity. An independent committee of the board of directors or an independent body to which the management company entrusts the function shall verify that these requirements are fulfilled, and c) that the prospectuses and periodic public information of the entity report in detail on the investments made in group entities.

SOURCE: Banco de España.

Simplified-regime entities shall have the following characteristics: a) their shares shall be offered on a strictly private basis, i.e. without any advertising; b) their shares shall be offered subject to a minimum investment commitment of €500,000 by each investor[13], and c) their shareholders shall number 20 or less, without taking into account any institutional investors or investors who are directors, executives or employees of the venture capital company or of the management company of the venture capital entity.

Ordinary-regime entities are those that do not have all the above-mentioned characteristics.

13. This minimum commitment shall not be required of institutional investors, such as pension funds, CIIs, insurance companies, credit institutions or investment services companies, which invest regularly and professionally in negotiable securities or financial instruments, or of investors who are directors, executives or employees of the venture capital company or of the management company of the venture capital entity.

The conditions for the taking up and pursuit of the activity are similar to those in the previous legislation in the case of ordinary-regime venture capital entities. However, for simplified-regime entities, there are certain exceptions set out in the legislation, for example, requiring the formation project to state the intention that the rules for simplified-regime entities should apply.

There are few changes in the law for venture capital companies, their minimum subscribed share capital being kept at €1,200,000. However, the new law indicates how the net assets of venture capital companies are valued and how the net asset value of their shares is determined. The value of the net assets is obtained by deducting accounts payable from total real assets. Also, the value of each share shall be obtained by dividing the company's net assets by the number of shares outstanding. Finally, the cases of alteration of status, merger, splitting and other company operations that require the prior approval of the CNMV are specified.

There is a slight change to the minimum capital of venture capital funds, which is rounded to €1,650,000 (previously €1,652,783). Simplified-regime venture capital funds may issue shares with characteristics that differ from those of the fund's general shares, but they may only be subscribed for by the sponsors or founders.

The merger of venture capital funds, whether by takeover or by the formation of a new fund, shall require the prior authorisation of the CNMV. A merger project shall be presented first, that will differ according to whether the fund in question is an ordinary-regime or a simplified-regime fund.

The legislation for management companies of venture capital entities (SGECR) is unchanged, so that their initial minimum share capital is still €300,000. The functions of SGECR are the same as established in the previous law. However, those cases in which the authorisation may be revoked by the Minister of Economy and Finance, at the proposal of the CNMV, are specified. Also, the delegation of their management is regulated for the first time. With the prior authorisation of the CNMV, the SGECR may subcontract part of the management of the assets of the venture capital funds and venture capital companies they manage to a third party, without this having any effect on the liability of the management companies of venture capital entities, although they will be jointly and severally liable to the shareholders for any damages that may arise from the actions of the other entity.

INVESTMENT RULES

As mentioned above, one of the pillars of the reform is the increased flexibility of the investment rules for venture capital entities. Table 3 shows the most important changes with respect to the previous law.

Finally, the periods of temporary breach of the investment rules are unchanged. However, in the event of an increase in the capital of a venture capital company that is not required by law, or a new contribution of funds to venture capital funds, the ratios indicated previously may now be temporarily breached for a period of three years following the increase or new contribution.

OTHER ASPECTS

This law also amends the corporate income tax[14], as regards the tax regime for venture capital entities. In this respect, 99% of the income obtained by venture capital entities from the transfer of their shares in venture capital companies or entities remains exempt from tax, provided

14. Amending the consolidated text of the corporate income tax Law approved by Legislative Royal Decree 4/2004 of 5 March 2004.

that when the transfer takes place at least one year has elapsed from the moment they were acquired or excluded from listing, and no more than fifteen. This period may, exceptionally, be extended to twenty years.

However, in the case of income obtained from the transfer of shares in venture capital companies, in order for the exemption to be applicable, property representing at least 85% of the total book value of the property of the investee entity shall have been assigned, without interruption, during the whole period the shares have been held, to the pursuit of an economic activity in the terms of the personal income tax, other than a financial one, as defined in the law regulating venture capital entities and their management companies, or a real-estate one.

The 99% exemption shall not apply when the person or entity acquiring the securities is linked to the venture capital entity or to its shareholders, or when they are a resident in a country or territory deemed by regulations to be a tax haven, unless the acquirer is one of the following persons or entities: the investee entity itself, any of the shareholders or directors of the investee entity or other venture capital entity.

The reporting, audit and accounting obligations are specified in similar terms to those of the previous regulation, putting special emphasis on the auditors, who shall be appointed by the shareholders in general meeting of the venture capital companies or by the directors of the management companies of the venture capital funds. The last section of the law regulates conduct, supervision, inspection and sanctioning.

In particular, note that the SGECRs and the venture capital companies whose management is not entrusted to a management company, and those who perform management duties in all of them, and their employees, are subject to the rules of conduct laid down in Law 24/1988 of 28 July 1988 of the securities market, without prejudice to any adaptations that may be approved by the Minister of Economy and Finance or, with the express approval of the CNMV, as well as those contained in their internal rules of conduct. In this respect, such entities shall draw up an internal rules of conduct to regulate the actions of their governing bodies, management and employees.

FVCs: future receivables that can be incorporated into FVCs

Order EHA/3536/2005 of 10 November 2005 (BOE of 16 November 2005), which aims to specifically determine the types of future receivables that can be incorporated into an FVC, specifies the conditions for their assignment and expressly authorises the CNMV to issue specific rules on the accounting and reporting obligations of FVCs and their management companies.

Thus, this Order establishes that, inter alia, the following future receivables may be incorporated into FVCs: a) a lessor's right to receive amounts owed under a lease; b) the benefits or income arising from the use of a protected work or performance, and the benefits or income arising from the use of a duly registered trademark or trade name; c) the benefits or income arising from the use of an industrial design, patent or utility model; d) the right to receive consideration for the sale or supply of goods or the provision of services, on a one-off or successive basis, that gives rise to flows of payments of a recurrent or one-off nature, provided that such magnitude may be known or estimated; e) the future receivables corresponding to the income arising from loans, credits or other types of financing, and f) the financial value of usufructs and other rights in rem.

For this purpose, a number of conditions must be fulfilled: 1) the assignment of the future receivables shall be full and unconditional; 2) the deed of incorporation of the FVC shall indicate the terms of the agreement or activity pursuant to which the future receivables are going to be generated, and the powers of the assignor over such assigned receivables, and 3) the deed of incorporation of the FVC shall also contain the terms of the full and unconditional assignment of the future receivables with explicit reference to the term and to the division between the assignor and assignee of the risks inherent therein.

Finally, in accordance with the provisions of Royal Decree 926/1998, the Order authorises the CNMV to issue specific rules relating to the accounting, to the format and content of the annual accounts and management reports of FVCs, to the scope and content of special reports of auditors or other independent experts, and to the reporting obligations of FVCs and their managers.

Transposition of certain Community directives on taxation

Law 22/2005 of 18 November 2005 (BOE of 19 November 2005) has been published, incorporating into Spanish law various Community directives on the taxation of energy products and electricity, and the common system of taxation applicable to parent companies and subsidiaries of different Member States, and the tax regime for cross-border contributions to pension funds within the European Union.

Specifically, the following directives are transposed: Council Directive 2003/92/EC of 7 October 2003 amending Directive 77/388/EEC as regards the rules on the place of supply of gas and electricity; Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity; and Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

There follows a brief analysis of the most relevant aspects of this Law in the financial field.

ORDINARY TAX REGIME APPLICABLE TO PARENT COMPANIES AND SUBSIDIARIES OF DIFFERENT MEMBER STATES

Law 22/2005 has transposed Directive 2003/123/EC by amending the consolidated text of the Law on the tax on the income of non-residents, approved by Legislative Royal Decree 5/2004 of 5 March 2004[15]. Thus, with effect from 1 January 2005, a parent company shall be considered to be an entity that has a direct holding of at least 20% (previously 25%) in the capital of another company (called a subsidiary). This percentage will be 15% from 1 January 2007 and 10% from 1 January 2009.

TAX SYSTEM FOR CROSS-BORDER CONTRIBUTIONS TO PENSION FUNDS WITHIN THE EUROPEAN UNION

Law 22/2005 regulates the tax system for cross-border contributions to pension funds within the European Union by means of a number of amendments to the consolidated text of the personal income tax (IRPF) Law approved by Legislative Royal Decree 3/2004 of 5 March 2004, and to the consolidated text of the corporate income tax Law, approved by Legislative Royal Decree 4/2004 of 5 March 2004, so that, with effect from 1 January 2005, contributions to pension funds in other Member States can have the same tax treatment as those made to Spanish pension funds, and can, therefore, be deductible from personal income tax on the same conditions and in the same circumstances as those made to institutions domiciled in Spain. Also, the same tax limits are maintained, namely €8,000 per annum for the sum of contributions to pension plans, mutual social insurance companies and insured provision-for-retirement schemes. In the case of contributors to these schemes who are over the age of 52, the previous limit shall be increased by a further €1,250 for each year by which they exceed the age of 52, subject to a maximum limit of €24,250 for those aged 65 years or more.

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15. See “Financial regulation: 2004 Q1”, *Economic Bulletin*, April 2004, Banco de España, pp. 99-100.

AMENDMENT OF THE LAW OF AUTONOMY OF THE BANCO DE ESPAÑA

Finally, Law 22/2005 adds a new additional provision seven to Law 13/1994 of 1 June 1994[16] of Autonomy of the Banco de España, which establishes that no court or administrative authority may issue an attachment order or process an execution order against goods and property rights belonging, possessed or managed by the Banco de España, when they are physically subject to the exercise of public functions or the exercise of administrative powers.

The same rules shall apply to the goods and property rights belonging, possessed or managed by foreign states or central banks in which foreign reserves are invested, and to those belonging, possessed or managed by the Bank for International Settlements, unless there are international treaties or agreements to which Spain is a party that establish otherwise.

Directive on cross-border mergers of limited liability companies

Cross-border company mergers within the Community have until now encountered many legislative and administrative difficulties. *Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005* (OJEU of 25 November 2005) on cross-border mergers of limited liability companies has recently been published to lay down Community provisions to facilitate the carrying out of this type of merger between limited liability companies governed by the laws of different Member States.

The Directive shall apply to mergers of limited liability companies when at least two of them are governed by the laws of different Member States, and they have their registered office, central administration or principal place of business within the European Union. It shall not, however, apply to cross-border mergers involving a company the object of which is the collective investment of capital provided by the public, which operates on the principle of risk-spreading and the units of which are at the holders' request, repurchased or redeemed, directly or indirectly, out of the assets of that company.

In addition, the Directive provides for a single set of common terms for all the members of the companies involved in a cross-border merger transaction.

Finally, it is provided that the Commission shall, after five years, review this Directive in the light of the experience acquired in applying it and, if necessary, propose its amendment. In the meantime the Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 15 December 2007.

Controls of cash entering or leaving the Community

Regulation (EC) No 1889/2005 of the European Parliament and of the Council of 26 October 2005 (OJEU of 25 November 2005) on controls of cash entering or leaving the Community lays down harmonised rules for the control, by the competent authorities, of cash entering or leaving the European Union.

Consequently, cash entering or leaving the European Union of a value of €10,000 or more, carried by any natural person, whether or not it belongs to such person, shall be declared to the competent authorities of the Member State through which he is entering or leaving the Community. The information shall be supplied in writing, orally or electronically, to be determined by the Member State concerned. However, where the declarant so requests, he shall be entitled to provide the information in writing.

Where there are indications that the sums of cash are related to any illegal activity associated with the movement of cash, even if such sum is below the threshold established, the information ob-

16. See "Regulación financiera: segundo trimestre de 1994", *Boletín Económico,* July-August 1994, Banco de España, pp. 86-92.

tained may be transmitted to competent authorities in other Member States. Also, if the sum of cash involves the proceeds of fraud or any other illegal activity adversely affecting the financial interests of the Community, the information shall also be transmitted to the Commission.

Finally, the Member States shall introduce penalties to apply in the event of failure to comply with the obligation to declare. Such penalties shall be effective, proportionate and dissuasive and shall be notified to the Commission by 15 June 2007, the date from which the Regulation shall apply in such States.

Directive on money laundering and terrorist financing

Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 (OJEU of 25 November 2005) on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, which repeals Council Directive 91/308/EEC of 10 June 1991, has been published.

OBJECTIVE AND SCOPE OF APPLICATION

This Directive updates the content of Directive 91/308/EEC and is in line with the new recommendations of the FATF (which were substantially revised and expanded in June 2003). Also, the Directive shall apply to most of the entities and persons it mentions: credit institutions and other financial institutions, auditors, external accountants and tax advisors; notaries and other independent legal professionals when they participate on behalf of and for their client in the planning or execution of certain transactions that could give rise to suspicion of illicit activities; real estate agents; other natural or legal persons trading in goods, only to the extent that payments are made in cash in an amount of €15,000 or more. This Directive also covers life insurance intermediaries and trust and company service providers, in order to prevent money launderers and terrorist financers using alternative methods to conceal the origin of the proceeds of crime.

At the same time, Directive 91/308/EEC, though imposing a customer identification obligation, contained relatively little detail on the relevant procedures, so that Directive 2005/60/EC introduces more specific and detailed provisions relating to the identification of the customer and of any beneficial owner and the verification of their identity, given the crucial importance of this aspect of the prevention of money laundering and terrorist financing, in accordance with the new international standards.

DUE DILIGENCE MEASURES

The Directive establishes detailed rules on customer due diligence. To fulfil the requirement to identify the beneficial owner, public records of beneficial owners may be used, clients may be asked for relevant data or the information may be obtained otherwise, taking into account the fact that the extent of such customer due diligence measures relates to the risk of money laundering and terrorist financing, which depends on the type of customer, business relationship, product or transaction.

The Directive also distinguishes between simplified and enhanced customer due diligence measures, on a risk-sensitive basis, and in situations which by their nature can present a higher or lower risk of money laundering or terrorist financing.

REPORTING OBLIGATIONS

Member States shall require the institutions and persons covered by this Directive, and where applicable their directors and employees, to cooperate fully, by promptly informing the financial intelligence unit[17] (FIU), on their own initiative, when they know, suspect or have reasonable

17. The Financial Intelligence Unit serves as a national centre for receiving, analysing and disseminating to the competent authorities suspicious transaction reports and other information regarding potential money laundering or terrorist financing. This should not compel Member States to change their existing reporting systems where the reporting is done through a public prosecutor or other law enforcement authorities, as long as the information is forwarded promptly and unfiltered to FIUs, allowing them to conduct their business properly, including international cooperation with other FIUs.

grounds to suspect that money laundering or terrorist financing is being or has been committed or attempted, promptly furnishing the UIF, at its request, with all the necessary information in accordance with the procedures established by the applicable legislation.

By 15 December 2009, and at least at three-yearly intervals thereafter, the Commission shall draw up a report on the implementation of this Directive and submit it to the European Parliament and the Council. For the first such report, the Commission shall include a specific examination of the treatment of lawyers and other independent legal professionals.

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 15 December 2007, forthwith communicating to the Commission how the provisions of this Directive correspond to the national provisions adopted.

Reforms to boost productivity

Law 23/2005 of 18 November 2005 (BOE of 19.11.05) on tax reforms to boost productivity and *Law 24/2005 of 18 November 2005* (BOE of 19.11.05) on reforms to boost productivity have been published. They contain a number of measures to boost and stimulate productivity in different spheres and with varying periods of execution, with the aim of invigorating the Spanish economy and facilitating the response to the increasing degree of economic integration in European and world markets.

The reforms adopted by these laws are part of a broader whole, which aims to provide confidence and a clear signal to the markets and economic agents of the wholehearted commitment of Spanish economic policy to productivity growth. Along with budgetary stability and the promotion of transparency, this is one channel through which to contribute to the objective of increasing citizens' welfare.

There follows a brief discussion of the most significant measures in various markets.

TAX REFORMS

As regards the law regulating corporate income tax, a new form of real-estate CII is introduced, which can engage in rented housing development activities. Such CIIs shall pay corporate income tax at a rate of 1%, on the condition that they comply with certain requirements designed to preserve the nature of these entities as instruments to channel savings.

In line with the foregoing, and in order to stimulate the performance of this activity, a number of restrictions that prevented this special regime from functioning properly have been eliminated and other requirements have been introduced to make its application more consistent. In particular, the 85% relief on gross tax payable is only maintained for income from the rental of housing and the relief for income arising from its transfer is abolished. Also, for the same purpose, notaries and registrars insofar as they receive government receipts, should collaborate in the public promotion of these entities by waiving their fees, without this having a significant effect on their fee income.

The deduction for research and development and technical innovation activities is amended to include textile samples within the concept of technical innovation. Also, in order to boost new technology in small and medium-sized firms, the percentage of the deduction for the promotion of information and communication technologies is raised by five percentage points from 10% to 15%.

With regard to VAT, the 4% rate applicable to housing acquired by entities in the house rental business is abolished, in accordance with the amendment to this special regime in the corporate income tax legislation.

In relation to the tax on property transfers and documented legal acts, approved by Legislative Royal Decree 1/1993 of 24 September 1993, the exemption and relief envisaged for real-estate CIIs are extended to those institutions whose activities include the development of property for rental, in accordance the new corporate income tax regime

FINANCIAL SECTOR REFORMS

The limits to the charges made by the CNMV for the provision of certain services have been substantially reduced in order to stimulate the competitiveness of the financial sector. This reduction in charges will involve a very significant saving for securities issuing entities, which will have a positive effect on the competitiveness of the financial market and will serve to better adapt the market to the new framework of greater competition imposed by Directive 2003/71/EEC of the European Parliament and of the Council of 4 November 2003.

Also, final provision two of Law 13/1985 of 25 May 1985 on financial intermediaries' investment ratios, own funds and reporting obligations is amended in order to be able to apply the tax regime for the preference shares of credit institutions[18] to securities listed on organised markets issued by the FVCs regulated by Law 19/1992 of 7 July 1992 and by those regulated by Law 3/1994 of 14 April 1994, which adapts Spanish law on credit institutions to the Second Banking Co-ordination Directive and introduces other changes to the financial system.

OTHER REFORMS

A number of improvements have been made to the administrative procedures that affect both individuals and companies. Formulae have been established to make the undoubted advantages of rapidity and simplicity entailed by the use of the company name established for the formation of a "new firm" private limited company (s*ociedad limitada nueva empresa)* compatible with the use, a posteriori, of other company names that are more attractive for the business.

Finally, the level of effective competition is boosted in various sectors of the economy, including energy markets, especially those for electricity and hydrocarbons. Also, the tobacco market distribution system is reformed and funerary services are liberalised further.

The European company with registered office in Spain

Law 19/2005 of 14 November 2005 (BOE of 15.11.05) on the European company (SE) with registered office in Spain has been published to adapt Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company with respect to European companies with registered office in Spain.

The Law implements this Regulation by adding a new chapter to the consolidated text of the Public Limited Companies Law (*Ley de Sociedades Anónimas*), approved by Legislative Royal Decree 1564/1989 of 22 December 1989, to specify those matters required by the Regulation to make it fully operational. It also incorporates mechanisms to protect the particular interests of members and creditors, and the protection and public–interest mechanisms deemed most appropriate in the current phase of construction of the European Union.

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18. The tax regime for preference shares is as follows: a) the income arising from preference shares shall be considered a deductible expense for the issuing entity; b) such income shall be classified as returns obtained on the transfer of own equity to third parties, in accordance with Law 40/1998 of 9 December 1998 on personal income tax and other tax rules. Also, they shall not be subject to any withholding, as the exemption established by Law 41/1998 of 9 December 1998 on the tax on the income of non-residents and other tax rules is applicable to them; c) in the event that the income is obtained by taxpayers of the tax on the income of non-residents without a permanent establishment, such income shall be exempt from this tax on the same terms as were established for returns arising from public debt in Law 41/1998 of 9 December 1998 on the tax on the income of non-residents and other tax rules, and e) finally, the operations arising from the issuance of preference shares shall be exempt from the modality of corporate operations of the tax on property transfers and documented legal acts.

The following are notable features of this Law:

SEs shall establish their registered office in Spain when their head office is within Spanish territory. Also, the formation and other acts of a European Company with its registered office in Spain that can be registered shall be registered in the Mercantile Register. As regards the formation of an SE which must have its registered office in Spain, the Law establishes that other companies, which do not have their head office in the Community, may participate, provided that they are formed under the law of a Member State, have their registered office in that Member State and have a real and continuous link with a Member State's economy.

Finally, the Law also introduces certain amendments to Law 24/1988 of 28 July 1988 on the securities market, in relation to listed companies. Specifically, when the listed company is an SE with registered office in Spain which has opted for the two-tier system, the annual report on corporate governance prepared by the management shall be accompanied by a report prepared by the supervisory organ on the exercise of its functions. Also, the obligations established for the directors of a listed company shall also apply to the members of the supervisory organ of a listed company SE with registered office in Spain.

State budget for 2006

As usual in December, the law on the State budget [*Law 30/2005 of 29 December 2005* on the State budget for 2006 (BOE of 30.12.05)] has been published. For only the second time since 1993 and for the second year running, the government has chosen to submit this Law to parliament on its own, the usual practice being for it to be accompanied by the so-called Law on Fiscal, Administrative and Social Measures.

The Law on the budget for 2006 confirms the reorientation of spending towards programmes to boost productivity. This is apparent in three types of measure: public investment in infrastructure, the research, development and technical innovation drive, and also spending on education. The Law also reflects the social slant the government is giving to its economic policy, through the implementation of measures that enable welfare and social cohesiveness to be increased, ensuring that the benefits of growth reach all citizens.

From the viewpoint of financial regulation, the following monetary, financial and fiscal sections are highlighted:

One of the additional provisions of the budget Law fixes the *capital of the Banco de España* at €1 billion. The increase in capital from the current figure (€5 million) to the figure mentioned above shall be made against the profits recorded by the Banco de España to 31 December 2005.

As usual, in relation to *State debt*, the authorised increase in the outstanding amount of State debt as at 31 December is specified. For 2006, the government is authorised to increase this amount, subject to the condition that, as at 31 December 2006, it shall not exceed the level at the beginning of the year by more than €14,082 million. This limit may be exceeded during the course of the year, with the prior authorisation of the Ministry of Economy and Finance, and those cases in which it shall be automatically revised are established.

With regard to taxes, the main measure in relation to the *personal income tax (IRPF)* is the updating of the two components of the tax rate, the State one and the regional or supplementary one. Also, for the purposes of calculating the capital gains arising on property, the coefficients for adjusting acquisition values have been raised by 2%. Also the provisions are established that enable the loss of tax benefits, with respect to those established in the IRPF Law

18/1991 of 6 June 1991, by certain taxpayers, such as lessees and purchasers of principal homes, to be offset with the current IRPF law.

In relation to *corporate income tax*, the measures are, as in the case of the IRPF, those with annual effectiveness referred to by the corporate income tax law. Thus, the coefficients applicable to real assets, to enable an adjustment to be made for monetary depreciation upon their transfer, are updated. Also the manner of determining the advance payments of the tax in 2006 is determined. Finally, in relation to local taxes, the rateable values of properties are raised by 2%.

Other provisions of a financial nature relate to the *legal interest rate* and to *default interest*, both of which are held unchanged at their current levels, i.e. 4% and 5%, respectively.

5.1.2006.