Financial regulation: 2007 Q4

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Introduction

New financial legislation was more abundant in 2007 Q4 than in the same period of previous years.

Some changes were made to the monetary policy instruments and procedures of the Eurosystem and to the general clauses applicable to monetary policy operations and those relating to the uniform conditions for participation in TARGET by the Banco de España. Also, a regulation modifying the consolidated balance sheet of monetary financial institutions as a result of the entry of new Member States, and a regulation relating to the transitional provisions for application of minimum reserve requirements by the ECB after the introduction of the euro in Cyprus and Malta, were adopted.

In the field of credit institutions, first, the law on minimum own funds was amended so as to transpose partially the latest Community provisions in this respect, which require a level of own funds in consonance with the actual risk profile of these institutions, along with improved internal management of such risks. Second, mortgage market law was reformed, basically to address the expansion of the range of new products available, the improvement of financing instruments and the regulation of reverse mortgages and dependency insurance.

In the securities market, three pieces of legislation can be highlighted. First is the amendment of securities market law so as to incorporate into the Spanish legal system various Community directives which modernise the Spanish securities markets, broaden the range of investment services, regulate different systems or methods for the execution of transactions in financial instruments and strengthen investor protection. Second, the amendment of the pension scheme and pension fund regulations introduced changes in various sections of pension scheme legislation so as to incorporate the latest developments, particularly employee social insurance schemes. Third, the process of incorporating into Spanish law the Community regime on transparency of information about listed companies was completed.

The supervisory authorities published an information brochure on how the users of financial services should submit complaints and claims under the “one stop shop” system.

Regarding Community legislation, a directive on payment services in the internal market was published in order to establish a modern and consistent legal framework for payment services throughout the European Union.

In corporate law, as a result of the recent accounting harmonisation and adjustment to the criteria of international financial reporting standards (IFRSs), a new Spanish general chart of accounts was published, accompanied by a new general chart of accounts for small and medium-sized enterprises tailored to the special characteristics of the latter.

Lastly, the new developments, mainly relating to monetary, financial and tax matters, in the State Budget for 2008 are analysed.

Monetary policy instruments and procedures of the Eurosystem

The *Guideline of the European Central Bank (ECB/2007/10)* of 20 September 2007 (OJ of 30 October 2007) amending Annexes I and II to Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem was published in order to incorporate the decisions adopted recently by the ECB Governing Council.

First, it sets out the recent changes to the definition and implementation of the Eurosystem's single monetary policy. These refer, among other things, to the removal of outright transactions from the list of fine-tuning operations, and to changes relating to assets accepted as collateral in Eurosystem credit transactions.

Second, it amends the terminology contained in Guideline ECB/2007/2 of 26 April 2007 on a Trans-European Automated Real-time Gross settlement Express Transfer system, which establishes the TARGET2 system as a replacement for the current TARGET system.

Lastly, it includes some amendments derived from the enlargement of the euro area, given that the ECB Governing Council considered that Cyprus and Malta fulfil the necessary conditions for adoption of the euro on 1 January 2008[1].

The first two sections came into force on 19 November 2007 and the last on 1 January 2008.

Banco de España: amendment of the general clauses applicable to monetary policy operations and of those relating to participation in TARGET

The Law of Autonomy of the Banco de España, Law 13/1994 of 1 June 1994[2], adapted the legal status of the Banco de España to the provisions of the Treaty on European Union regarding monetary policy, relations with the Treasury and future links of the former to the ESCB. Subsequently, in application of the mandate of the Law of Autonomy, came the publication of the Regulation of the Banco de España by means of the Resolution of 14 November 1996[3] of the Governing Council of this Institution, later repealed by the Resolution of 28 March 2000[4], which constitutes the basic and highest ranking provision of the Institution's self-government regime. In addition, a Resolution of 11 December 1998[5] of the Executive Commission of the Banco de España established the general clauses applicable to monetary policy operations, constituting the general framework for such operations in accordance with the guidelines of the ECB, which have been amended on various occasions.

The adoption by the ECB of Guideline ECB/2007/10, mentioned in the preceding section, was followed by publication of the *Resolution of 21 September 2007* (BOE of 14 November 2007) of the Executive Commission of the Banco de España, which amended that of 11 December 1998 amending the general clauses applicable to the Banco de España's monetary policy operations, and of the *Resolution of 20 July de 2007* (BOE of 20 December 2007) of the Executive Commission of the Banco de España approving the general clauses relating to the uniform conditions of participation in TARGET2-BE, for the purpose of adapting the terminology of those clauses to the new TARGET, known as TARGET2-Banco de España (TARGET2-BE).

First, for technical reasons, the terminology of the clauses is adapted to the new TARGET, and so the references to the Banco de España Settlement Service (SLBE) are replaced by references to TARGET2-BE.

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1. Via Council Decision 2007/503/EC of 10 July 2007 and Council Decision 2007/504/EC of 10 July 2007. **2.** See "Regulación financiera: segundo trimestre de 1994", *Boletín Económico*, July-August 1994, Banco de España, pp. 86–92. **3.** See "Regulación financiera: cuarto trimestre de 1996", *Boletín Económico*, January 1997, Banco de España, pp. 104-106. **4.** See "Financial regulation: first quarter 2000", *Economic Bulletin*, April 2000, Banco de España. **5.** See "Financial regulation: fourth quarter 1998", *Economic Bulletin*, January 1999, Banco de España, pp. 79-82.

Second, Clause II "scope of application" provides for the possibility that the Banco de España may, if necessary for the implementation of monetary policy, share with other Eurosystem members individual information, such as operational data, related to counterparties participating in Eurosystem operations. However, such information is subject to the requirement for professional secrecy.

Also, the Resolution of 21 September updates the rest of the clauses through the introduction of other lesser amendments which, in accordance with the General Documentation on Eurosystem Monetary Policy Instruments and Procedures, were already being applied in monetary policy operations.

Thus, Clause III "monetary policy operations" gives a new definition of open market operations[6] which, based on their purpose, periodicity or procedures, can be divided into various categories, and, furthermore, establishes that reverse transactions entered into by the Banco de España include repo transactions and collateralised loans . Lastly, an addition to the clauses provides that fine-tuning operations may be conducted on the last day of a minimum reserve maintenance period to counter liquidity imbalances which may have accumulated since the allotment of the last main refinancing operation.

A new development in Clause V "procedures applicable to monetary policy operations" with respect to bilateral operations is that the Banco de España may also execute outright transactions through stock exchanges and market agents. In these cases, the range of counterparties is not restricted a priori and the procedures shall conform to market conventions for the debt instruments involved in the transactions.

Finally, under Clause VI "collateral" the securities located in Spain eligible as collateral in monetary policy operations may be transferred through outright and repo transactions , in accordance with the procedures approved in each case.

Changes to the consolidated balance sheet of the monetary financial institutions sector

Regulation 1489/2007 (ECB/2007/18) of the ECB of 29 November 2007 (OJ of 15 December 2007) amending Regulation 2423/2001 (ECB/2001/13) of 22 November 2001 concerning the consolidated balance sheet of the monetary financial institutions (MFIs) sector was published as a result of the accession of new Member States to the European Union. From its entry into force on 4 January 2008, MFIs have to continue reporting quarterly statistical data by country and currency and their positions vis-à-vis counterparties resident in the territories of Member States, but taking into account the entry of the new Member States.

NCBs can decide to relieve small MFIs that are not credit institutions of full reporting requirements, although they have to continue, as a minimum, to collect data relating to the total balance sheet at least at an annual frequency so that the competent authorities can monitor small institutions. They may also exempt from the statistical reporting requirements individual electronic money institutions in certain situations. If an individual electronic money institution is not exempted from the minimum reserve requirements, it will be required to report, as a minimum, the quarterly data necessary to calculate the reserve base.

Finally, the conditions under which shares issued by MFIs should be classified as deposits instead of as capital and reserves are clarified. Specifically, they are as follows: if there is a

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6. Previously, open market operations were defined as operations conducted in financial markets at the initiative of the Banco de España involving one or more of the following transactions: outright purchase or sale of assets, either spot or forward; 2) purchase or sale of assets via a repo transaction; 3) extension of collateralised loans; 4) issuance of ECB debt certificates; and 5) taking of deposits.

debtor-creditor economic relationship between the issuing MFI and the holder (regardless of any property rights in these shares), and if the shares can be converted into currency or redeemed without significant restrictions or penalties. In addition, these shares must meet certain requirements set out in the Regulation.

European Central Bank: minimum reserves following the introduction of the euro in Cyprus and Malta

The Statutes of the European System of Central Banks and of the ECB require the Member States to adopt at national level the appropriate measures to collect the statistical information needed to fulfil the statistical reporting requirements of the ECB following the introduction of the euro.

The ECB Governing Council considered that Cyprus and Malta fulfil the necessary conditions for adoption of the euro on 1 January 2008[7]. This means that credit institutions and branches of credit institutions located in these countries will be subject to reserve requirements from that date. The integration of these institutions and their branches into the minimum reserve system of the ECB requires the adoption of transitional provisions in order to ensure smooth integration without creating a disproportionate burden for credit institutions in participating Member States, including Cyprus and Malta.

For this purpose, *Regulation (EC) No 1348/2007 of the European Central Bank of 9 November 2007* (OJ of 17 November 2007) concerning transitional provisions for the application of minimum reserves by the ECB following the introduction of the euro in Cyprus and Malta was published.

Institutions located in Cyprus or Malta will be subject to a transitional maintenance period from 1 January 2008 to 15 January 2008. The reserve base for this period shall be defined in relation to elements of their balance sheet as at 31 October 2007[8] and reported to their central banks in accordance with the ECB's reporting framework for monetary and financial statistics.

This transitional maintenance period shall not affect the maintenance period applicable to institutions located in other Member States. However, these institutions may decide to deduct from their reserve base for the maintenance periods from 12 December 2007 to 15 January 2008 and from 16 January to 12 February 2008 any liabilities owed to institutions located in Cyprus or Malta, even though at the time the minimum reserves are calculated such institutions will not appear on the list of institutions subject to reserve requirements. If they wish to deduct such liabilities, they shall, for the aforementioned maintenance periods, calculate their minimum reserves on the basis of their balance sheet at 31 October 2007 and 30 November 2007, respectively, and report a table (which can be found in the annex to the Regulation) in which institutions located in Cyprus or Malta are considered as already subject to the ECB's minimum reserve system.

Amendment of the law on minimum own funds and limitations on the activity of credit institutions for solvency reasons

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006[9] relating to the taking up and pursuit of the business of credit institutions (recast) replaced Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000[10] and proceeded to unify and codify all the directives relating to the taking up and pursuit of the business of credit institutions. The new directive, although retaining the basic principles of its predecessors (mutual recognition and supervision by the home Member State), substantially alters the

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7. Via Council Decision 2007/503/EC of 10 July 2007 and Council Decision 2007/504/EC of 10 July 2007. **8.** Except for small monetary financial institutions, which shall calculate a reserve base on the basis of their balance sheet as at 30 September 2007. **9.** See "Financial regulation: 2006 Q2", *Economic Bulletin,* July 2006, Banco de España, pp. 142-144. **10.** See "Financial regulation: 2000 Q2", *Economic Bulletin,* July 2000, Banco de España, pp. 82-83.

philosophy in respect of the treatment of credit institutions' solvency. Hence, to the basic aims of ensuring a sufficient level of solvency and achieving competitive equality among banks, it adds those of making the regulatory capital requirements more sensitive to actual risks and fostering improved risk management by institutions[11].

This directive has been partially transposed into Spanish law via *Law 36/2007 of 16 November 2007* (BOE of 17 November 2007) amending Title II of Law 13/1985 of 25 May 1985 on the investment ratios, own funds and reporting obligations of financial intermediaries and other financial system rules.

In regard to the minimum own funds requirements of credit institutions, the new Law establishes general guidelines to be amplified by subsequent implementing regulations. The Law itself includes a more extensive range of risks to be considered (as compared with the previous wording of the Law, which left the task of determining the different risk classes to the implementing regulations) under the calculation methods to be established in the regulations. These risk classes include the following: for all business activities, foreign-exchange risk, commodities risk and operational risk; for all business activities except trading book, credit risk and dilution risk; and, finally, for trading book business, position risk, settlement risk and counterparty risk. The implementing regulations shall specify the calculation methods for weighting the different investments, transactions or positions, the possible additional charges due to the institution's risk profile and the allowable credit risk mitigation techniques. The Banco de España shall be responsible for determining the conditions under which the more advanced risk measurement methods may be used.

The main new development is that, for some of these methods, external credit assessments provided by firms recognised by the Banco de España in accordance with the criteria established therefor may be used, evaluating in all cases the objectivity, independence, transparency and ongoing review of the assessment methodology applied. Also, the authorisation of the Banco de España, under the conditions stipulated by it, shall be required to use for these purposes the internal credit assessments or the internal methods of measuring operational and market risk developed by the institutions themselves.

Also, mention is made of the Banco de España's obligations as the authority responsible for supervising credit institutions and their consolidatable groups. These obligations include review of the systems, strategies, procedures or mechanisms of any type used in complying with solvency rules and the drafting and publication of guidelines for supervised institutions and groups, indicating the criteria, practices or procedures considered appropriate for properly assessing the risks to which they are or may be exposed and for optimum compliance with the organisational and disciplinary rules applicable to supervised entities. These guidelines may include the criteria that the Banco de España itself will follow in the exercise of its supervisory activities.

Similarly, the functioning of Community supervision on a consolidated basis is regulated, both when responsibility lies with the Banco de España and when it has to co-operate with the supervisor of the responsible EU Member State. In particular, the Banco de España shall: co-

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11. The directive incorporates the provisions of the document approved by the Basel Committee on Banking Supervision on 26 June 2004 (known as Basel II) establishing a set of structured measures based on three mutually reinforcing pillars: the adoption of uniform rules for determining minimum capital requirements on the basis of the risks assumed (Pillar 1); supervisory review to foster improved internal risk management by institutions (Pillar 2); and market disclosure of the key features of their risk profile, risk exposure and risk management practices (Pillar 3). These must all be taken into account simultaneously so that the level of own funds held by institutions is in accordance with their overall risk profile.

ordinate the collection of information and its dissemination to the other authorities responsible for supervising institutions in the group, and the dissemination of information that it considers important in both normal and urgent situations; plan and co-ordinate all supervisory activities in either type of situation; and co-operate closely with other competent authorities with supervisory responsibility for parent, subsidiary or investee foreign credit institutions in the same group. In particular, the Banco de España shall co-operate with the aforementioned competent authorities in the granting of authorisation for the use of internal credit assessments or internal operational risk measurement methods to be applied in Spanish groups of credit institutions.

Additionally, the obligations of credit institutions to report and disclose information to the public are specified. They have to publish at least once a year a document entitled *information of prudential significance*, which shall contain data on their financial situation and activity for the purpose of assessing the risks they face, their market strategy, their risk control, their internal organisation and their situation, so as to comply with the minimum own funds requirements specified in this Law. The minimum content of this document shall be set by the Banco de España to ensure comparability between institutions, but each institution has to define a formal policy of solvency disclosure to the public, compliance with which shall be overseen by the Banco de España.

Furthermore, the Banco de España is endowed with new executive powers to enable it to carry out its disciplinary tasks in regard to compliance by credit institutions with their solvency obligations. These tasks include, for example, obliging credit institutions to hold own funds additional to the minimum requirements in certain circumstances, seeing that credit institutions strengthen the procedures, mechanisms and strategies adopted to comply with such requirements, and restricting or limiting the business activity, operations or network of institutions.

The Law includes a transitional provision which sets a lower limit on the minimum own funds requirements established therein for the two years following its entry into force on 1 January 2008. This was done for reasons of prudence given the difficulty of evaluating the enormous changes in the calculation of minimum own funds requirements entailed by the Law.

Finally, the Law takes the opportunity to amend, first, Legislative Royal Decree 1298/1986 of 28 June 1986 on the adaptation of current law on credit institutions to European Community legislation and, second, Law 26/1988 of 29 July 1988 on the discipline and intervention of credit institutions. In the first case, the purpose is to specify the terms governing the exchange of information between competent authorities within the framework of supervision on a consolidated basis. In the second, the aim is to adjust the obligations of credit institutions, such as that of having an adequate organisational structure with well defined, transparent and consistent lines of responsibility or that of having robust corporate governance procedures, as specified by Directive 2006/48. Furthermore, new types of serious and very serious infringements are defined concerning non-compliance with certain obligations, such as deficiencies in organisational structures or in the internal control mechanisms of institutions, the failure to make prudential reporting disclosures or other breaches of specific policies set by the Banco de España.

Amendment of mortgage market law and regulation of reverse mortgages and dependency insurance

The regulation of the mortgage market, initially set out in Law 2/1981 of 25 March 1981 on mortgage market regulation, has been changed several times to adapt this market to new developments. Particularly noteworthy were, among others, the provisions relating to transparency, to loan securitisation mechanisms and to subrogation and novation, which were in-

troduced to protect the interests of mortgage customers, and Law 2/1994 of 30 March 1994[12] on subrogation and modification of mortgage loans, which adopted measures to promote competition and lower the cost of mortgage novation and subrogation. These measures were subsequently improved by Law 36/2003 of 11 November 2003[13] on economic reform measures, which in turn fostered the development and dissemination of new interest rate risk insurance products.

Law 41/2007 of 7 December 2007 (BOE of 8 December), amending Law 2/1981 of 25 March 1981 on mortgage market regulation and other mortgage and financial system rules, on the regulation of reverse mortgages and dependency insurance was enacted recently. The two basic lines of action are as follows: first, the removal of obstacles to the supply of new products and second, the provision of incentives for so-called reverse mortgages and the introduction of technical improvements in financing instruments.

TRANSPARENCY IN THE EXTENSION OF MORTGAGE LOANS

In regard to transparency in the extension of mortgage loans, the Ministry of Economy and Finance is empowered to determine the minimum information that credit institutions have to furnish to their customers before the signature of a contract. This precontractual information must enable the customer to ascertain the key characteristics of the products available and ascertain whether they are appropriate to his needs and financial situation. Also, the current information requirements are made extensive to mortgages of all kinds taken out by natural persons.

REFINANCING MECHANISMS: MORTGAGE COVERED BONDS AND MORTGAGE BONDS

The second area of modernisation addressed by the Law relates to the mechanisms for refinancing credit institutions through the issuance of mortgage covered bonds and mortgage bonds. The technical improvements are along two lines: the removal of administrative obstacles, which were particularly onerous in the case of mortgage bonds; and, more importantly, clearing the way for mortgage covered bond and mortgage bond issues to become increasingly sophisticated from the financial standpoint.

First, the mortgage loans and credits used to collateralise mortgage covered bonds may not include any loans or credits assigned to a mortgage bond issue or used for mortgage transfer. To facilitate the segregation of loans and credits in the pool of collateral and foster the transparency of that collateral, a special accounting register has been conceived. This register will include all mortgage loans and credits forming collateral for mortgage covered bonds and mortgage bonds and will identify those meeting the legal requirements. The annual accounts shall contain the essential elements of this register. Also, institutions may not issue mortgage covered bonds for an amount exceeding 80% of the outstanding principal of the mortgage loans and credits on their books (previously 90%), less the amount of those assigned to mortgage bonds. The present value of mortgage bonds may amount to 98% of the present value of the assets assigned to the issue.

Second, administrative obstacles hindering the development of mortgage bonds have been removed so as to achieve a more neutral administrative treatment of mortgage bonds as compared with mortgage covered bonds. To this end, the need to include a marginal note in the Property Register for each of the mortgages assigned is dispensed with and the previously compulsory setting-up of a bondholders' syndicate becomes optional. Also, as with covered bonds, these issues continue to be backed by the issuer's unlimited liability in the event the specific collateral does not cover the amount of the debt.

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12. See "Regulación financiera: segundo trimestre de 1994", *Boletín Económico,* July-August 1994, Banco de España, pp. 96-97. **13.** See "Financial regulation: 2003 Q4", *Economic Bulletin,* January 2004, Banco de España, p. 91.

Third, certain reforms in both covered bonds and mortgage bonds pave the way for the increased financial sophistication of issues. Noteworthy is the possibility of including substitute liquid assets either in the bond issue portfolio or for the total covered bonds issued (these assets must also be included in the aforementioned accounting register). This helps to cover liquidity risk in the event of insolvency proceedings and to facilitate the coverage of interest rate risk through financial derivatives contracts associated with an issue, which arises upon the entry of economic inflows generated by these instruments in favour of the institution into the pool of segregated assets over which the mortgage bondholder has a preferential claim.

APPRAISAL COMPANIES

With regard to appraisal companies, the Law acts in three areas, under the basic principle of preserving and strengthening the professionalism and independence of these companies. First, it establishes that, in certain cases[14], appraisal companies must have in place appropriate mechanisms to underpin their independence and avoid conflicts of interest.

Also, the credit institutions by which they are controlled shall set up a *technical committee* to verify compliance with the independence requirements contained in the aforementioned mechanisms. This committee shall draft a report every year and send it to the board of directors or equivalent body of the institution and to the Banco de España.

Second, the sanctioning regime of appraisal companies is modified. New infringements derived from the new obligations contained in the Law are defined and the existing infringements, which are included in full, are totally revised and updated.

Third, a regime is established for significant holdings[15], similar to that envisaged for credit institutions, which will enable the shareholder structure to be controlled. The direct or indirect acquisition of a significant holding in an appraisal company will entail the obligation to inform previously the Banco de España. The latter will have a maximum of three months to oppose the proposed acquisition.

SUBROGATION, NOVATION AND REPAYMENT OF MORTGAGE LOANS

The scope of application of the Law is specified in relation to subrogations and novations of mortgage loans and credits[16] in which the mortgage is over a dwelling and the borrower is a natural person or a legal person subject to the small-companies regime under corporate income tax.

The Law retains the tax benefits of subrogations and novations, which thus continue to be exempt from transfer tax and stamp tax.

The cases in which public deeds of mortgage loan subrogation or novation can be modified are extended. Previously, changes could only be made in the initially agreed or current ordinary or default interest rate conditions, in the loan maturity, or in both. This Law adds the following cases: capital increases or reductions, the repayment method or system and any other financial conditions of the loan, and the provision or modification of personal guarantees. These modifications shall in no case entail any alteration or loss of the rank of the reg-

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14. Specifically, when they provide services to credit institutions in their group, or when at least 25% of their total income in the regulatorily specified time period derives from their relationship with a credit institution or institutions in the same group, provided that one or more of said credit institutions has issued mortgage bonds that are in circulation. **15.** For the purposes of this Law, a significant holding in an appraisal company is defined as a direct or indirect interest of at least 15% of the capital or voting rights of the company, or one which, although not reaching this percentage, enables significant influence to be exercised in the company. **16.** Hereafter, the term "mortgage loans" will be used to refer to both concepts.

istered mortgage, except when they increase the amount of mortgage liability or lengthen the loan term due to this increase or lengthening. In these cases, acceptance by the holders of registered rights with a lower rank under current mortgage law is needed to preserve the mortgage's rank. In both cases, the change shall be entered in the register through a marginal note to the mortgage subject to the modifying novation. In no event may this be done if the register contains a request for information about the outstanding amount in an enforcement of subsequent liens.

Additionally, the Law changes the name of the prepayment penalty to "compensation for withdrawal" (*compensación por desistimiento*) and extends it not only to subrogations but to other loan transactions of this nature. Hence in the total or partial repayment of mortgage loans, the amount receivable by the creditor institution as compensation for withdrawal may not exceed:

1 0.5% of the principal repaid early if the prepayment was in the first five years of the term of the loan or credit, or

2 0.25% of the principal repaid early if the prepayment was at a later date.

If compensation for withdrawal of an equal or lower amount was agreed, the compensation receivable shall be that agreed upon.

Along with the compensation for withdrawal, the Law regulates the compensation for interest rate risk. The creditor institution shall not be entitled to receive compensation for interest rate risk in total or partial subrogatory or non-subrogatory settlements of mortgage loans taking place within an interest rate adjustment period the agreed duration of which is twelve months or less. The fee applicable to other mortgage loans shall be that agreed, although the creditor institution shall not be entitled to receive the fee if the loan settlement generates a capital gain in its favour[17].

Lastly, there are changes in the rates charged for subrogation, modifying novation and settlement of mortgage loans. Specifically, notary fees shall be calculated at the rates for *documentos sin cuantía* (documents with no stated amount) and registry fees shall be calculated at the rates for *inscripciones* (registrations), taking as a basis the amount of outstanding principal reduced by 90%.

Table 1 compares the regime applicable in mortgage loan subrogations and novations with that under previous legislation.

CAPPED MORTGAGES

Mortgage market flexibility is enhanced by the regulation of capped mortgages (*hipotecas de máximo*), also known in law as floating mortgages (*hipotecas flotantes*)[18], although they can only be constituted in favour of credit institutions as security for one or several present and/or future obligations of any type or in favour of government agencies holding tax or social security receivables. A novation agreement is not necessary for them.

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17. A capital gain arising from exposure to interest-rate risk is defined as the positive difference between the principal outstanding at the time of prepayment and the market value of the loan or credit. This shall be calculated as the sum of the present value of the outstanding payments up to the next interest rate adjustment and the present value of the outstanding principal that would remain at the adjustment date if the loan were not repaid early. When the difference is negative, a capital loss for the creditor institution is deemed to exist. **18.** The purpose of these mortgages is to provide backing. They are used to provide collateral for one or several obligations when the exact amount of these is not known and only the maximum mortgage liability can be specified.

CHANGES TO THE REGIME APPLICABLE TO MORTGAGE LOAN SUBROGATION AND NOVATION TABLE 1

MORTGAGE LOAN SUBROGATION		
LAW 2/1994 OF 30 MARCH 1994	LAW 36/2003 OF 11 NOVEMBER 2003 (ROYAL DECREE-LAW 2/2003 OF 25 APRIL 2003)	LAW 41/2007 OF 7 DECEMBER 2007
Cases	Cases	Cases
Improvements can only be made in the initially agreed or current ordinary or default interest rates.	As before, except that the term of the loan may be extended too, either on its own or in tandem with an improvement in the interest rate.	As before, except that the lender must be a credit institution, in which case the public deeds modifying the mortgage loan may refer to one or more of the following circumstances: 1) capital increases or reductions; 2) alteration of the loan term; 3) the initially agreed or current interest rate conditions; 4) the repayment method or system and any other financial conditions of the loan; 5) the provision or modification of personal guarantees.
The deed shall set out, inter alia, the new interest rate conditions.	As before, except that, where applicable, the new term of the loan shall be included.	These modifications shall in no case entail any alteration or loss of the rank of the registered mortgage, except when they involve an increase the amount of mortgage liability, and they shall be entered in the Register. In no event may this be done if the register contains a request for information about the outstanding amount in an enforcement of subsequent liens.
Tax concessions: exempt from the progressive rates of stamp duty.	No change.	No change.
Notary and registry fees	Notary and registry fees	Notary and registry fees
Notary and registry fees shall be calculated on the basis of the amount obtained by applying the difference between the existing and the new interest rates to the amount of the outstanding mortgage liability.	Notary and registry fees shall be calculated on the basis of the amount of outstanding principal at the subrogation date and the authorised document shall be deemed to contain a single item.	Notary fees shall be calculated at the rates for documents with no stated amount *(documentos sin cuantía)*. Registry fees shall be calculated at the rates for registrations *(inscripciones)*, taking as a basis the amount of outstanding principal reduced by 90%.
Prepayment penalty	Prepayment penalty	Compensation for withdrawal
In variable-rate mortgages, where a prepayment penalty of 1% or less has been agreed, the penalty payable shall be that agreed. In all other cases, it shall be 1%.	In variable-rate mortgages, where a prepayment penalty of 0.5% or less has been agreed, the penalty payable shall be that agreed. In all other cases, it shall be 0.5%.	Prepayment penalties cease to exist and are replaced by "compensation for withdrawal" (*compensación por desistimiento*). In this respect, in total or partial repayments of mortgage loans, the amount receivable by the creditor institution as compensation for withdrawal may not exceed: 1) 0.5% of the principal repaid early if the early repayment was in the first five years of the term of the loan or credit, or 2) 0.25% of the principal repaid early if the early repayment was at a later date. Where a compensation for withdrawal has been agreed that is equal to or less than this, the compensation receivable by the creditor institution shall be that agreed.
		Compensation for interest rate risk
		The creditor institution shall not be entitled to receive compensation for interest rate risk in subrogatory or non-subrogatory settlements of mortgage loans whose interest rate is subject to adjustment in a period of one year or less or which mature in one year or less from the settlement date. The fee applicable to other mortgage loans shall be that agreed, although the creditor institution shall not be entitled to receive the fee if the loan settlement generates a capital gain in its favour.

SOURCES: BOE and in-house preparation

CHANGES TO THE REGIME APPLICABLE TO MORTGAGE LOAN SUBROGATION AND NOVATION (cont'd) TABLE 1

MORTGAGE LOAN NOVATION		
LAW 2/1994 OF 30 MARCH 1994	LAW 36/2003 OF 11 NOVEMBER 2003 (ROYAL DECREE-LAW 2/2003 OF 25 APRIL 2003)	LAW 41/2007 OF 7 DECEMBER 2007
Cases	Cases	Cases
Improvements can only be made in the initially agreed or current interest-rate conditions. A change to the loan term can also be agreed together with such improvement.	Modification refers to initially agreed or current interest-rate conditions, or to alteration of the loan term, or both.	No change
Tax concessions: exempt from the progressive rates of stamp duty.	No change	No change
Notary and registry fees	Notary and registry fees	Notary and registry fees
Notary and registry fees shall be calculated on the basis of the amount obtained by applying the difference between the existing and the new interest rates to the amount of the outstanding mortgage liability.	Notary and registry fees for these deeds shall be calculated on the basis of the amount obtained by applying the difference between the existing and the new interest rates to the amount of the outstanding principal at the novation date. In the case of novations which only alter the loan term, the basis for the calculation shall be 0.1% of the outstanding principal at the novation date.	As for subrogation
Fees for extending the loan term	Fees for extending the loan term	Fees for extending the loan term
Not envisaged.	In the case of novations which only alter the loan term, the basis for the calculation shall be 0.1% of the outstanding principal at the novation date.	As for subrogation

SOURCES: BOE and in-house preparation.

For the constitution of a mortgage of this kind, it shall suffice to specify such constitution in the mortgage deed and state the following details in the mortgage registration: its name and, if required, a general description of the basic legal acts from which the collateralised obligations derive or may derive in the future; the maximum amount of the claim on the property; the term of the mortgage; and the method of calculating the final net amount secured. The mortgage deed may also specify that the amount claimable in the event of foreclosure shall be the result of the settlement effected by the creditor financial institution in the manner agreed by the parties in the deed.

REGISTRATION OF RIGHTS IN REM UNDER A MORTGAGE

Other measures aim to specify the content of the registration of rights in rem under a mortgage and ensure that registry entries have a more uniform structure. For this purpose, the registration of rights in rem under a mortgage shall state the principal amount of the debt and, where applicable, that of the agreed interest, or the maximum amount of the mortgage liability, identifying the collateralised obligations, whatever their nature and term. The other financial clauses, such as those relating to early maturity, collateralised by the mortgage, shall be included in the entry in the terms set out in the mortgage deed, provided always that the clauses concerning rights in rem have been approved by the registrar.

REVERSE MORTGAGE

For the purposes of this Law, a reverse mortgage is a mortgage loan or credit taking the form of a mortgage over real property constituting the principal residence of the applicant, provided that it meets the following requirements: a) the applicant and any beneficiaries designated by him or

her must be of age 65 or over or in a situation of severe or considerable dependency; b) the mortgagor must draw the loan amount in periodic withdrawals or as a lump sum; c) the debt must only be claimable by the creditor and the security interest enforceable upon the death of the borrower or, if so stipulated in the contract, upon the death of the last of the beneficiaries; and d) the mortgaged residence must have been appraised and insured against damage.

The maximum amount drawable by the mortgagor shall be determined as a percentage of the appraisal value on the date of constitution. When this percentage is reached, the elderly person or dependent shall cease to draw income and the debt continues to incur interest. The credit institution normally recovers the credit drawn down plus interest as a lump sum upon the owner's death, through repayment of the debt by the heirs or enforcement of the mortgage by the credit institution.

The reverse mortgage envisaged in this Law may only be granted by credit institutions and by insurance companies authorised to operate in Spain, without prejudice to the limits, requirements or conditions imposed on insurers by their sectoral regulations.

The legal regime governing the transparency and marketing of reverse mortgages and the advisory services to those applying for this product shall be set in place subsequently by the Ministry of Economy and Finance.

The public deeds documenting these transactions shall be exempt from stamp tax. As for other mortgage loans, the notary fees for deeds of constitution, subrogation, novation and settlement shall be calculated at the rates for *documentos sin cuantía* (documents with no stated amount) and registry fees shall be calculated at the rates for *inscripciones* (registrations), taking as a basis the amount of outstanding principal reduced by 90%.

Finally, the Law provides that any amounts received periodically by the beneficiary as a result of a reverse mortgage may be used fully or partly to join an insured social welfare scheme. The mathematical reserve of the insured social welfare scheme may not be transferred to another social welfare instrument, nor may the vested rights or mathematical reserves of other social welfare systems be transferred to the former.

DEPENDENCY INSURANCE

With regard to dependency insurance, the Law includes the regulation of private dependency coverage instruments, whether in the form of insurance policies taken out with insurance companies, including social welfare mutual societies, or through pension schemes.

The coverage of dependency under an insurance policy obliges the insurer, in the event of a situation of dependency, to provide the agreed benefit in order to deal with, fully or partially, directly or indirectly, the detrimental consequences of this situation for the insured. This insurance may be arranged by insurance companies that have the required administrative authorisation to carry on life or sickness insurance activities. If a pension scheme provides for coverage in the event of dependency, this must be expressly stated in the specifications. Wherever provision has not been expressly made, the legislation regulating pension schemes and funds shall apply.

The Law came into force on 9 December 2007.

Amendment of securities market legislation

Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments established the general regulatory framework for financial markets in the European Union and set out, inter alia, authorisation and operating conditions for investment firms, the conditions under which investment services are to be provided, the organisational and

operational requirements to be met by regulated markets, and certain matters relating to the supervisory powers of national competent authorities and co-operation between them.

This Directive was subsequently implemented by two pieces of Community legislation: Commission Regulation 1287/2006 of 10 August 2006[19] implementing Directive 2004/39/EC as regards record-keeping obligations for investment firms, transaction reporting, market transparency and admission of financial instruments to trading; and Commission Directive 2006/73/EC of 10 August 2006[20] implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms.

Also, Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006[21] on the capital adequacy of investment firms and credit institutions, based on international projects to harmonise supervisory tasks (which, together with Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006, incorporated the 2004 Basel II Capital Accord into the European regulatory framework), sought to bring the measurement of risk by supervisors to determine own funds requirements more into line with the institutions' own measurement mechanisms. It also aimed to stimulate the development of appropriate internal risk management procedures in investment firms, and required these to disclose publicly significant information on key aspects of their business profile, risk exposure and risk management processes.

Recently, *Law 47/2007 of 19 December 2007* (BOE of 20 December 2007) amending Law 24/1988 of 28 July 1988 on the securities market was enacted to incorporate into Spanish law Directive 2004/39/EC and certain aspects of Directives 2006/73/EC and 2006/49/EC.

PURPOSE OF THE REFORM

The main aims of the reform are as follows. First, the Spanish securities markets are modernised to adapt them to current needs. To do this, the Law introduces new types of investment firms, widens the range of investment services they can provide, extends the gamut of negotiable financial instruments and recognises that transactions in financial instruments may be executed by systems or methods different from those in traditional secondary markets.

Second, investor protection measures are strengthened and the need to differentiate between different types of investors according to their knowledge is recognised. Hence the Law sets out extensive rules with which investment service providers must comply.

Third, the organisational requirements to be met by firms providing investment services are adapted to ensure that their organisation is suitable for the complex range of services offered by them. Also, in regard to financial requirements, firms must adapt to the new risk management processes in the area of solvency. Finally, the supervisory powers of the CNMV are extended and the instruments and mechanisms for fostering national and international co-operation between supervisors are strengthened.

SCOPE OF APPLICATION

A new list of financial instruments is included and legal status is afforded to the concept of negotiable securities, which are defined as any rights to assets, by whatever name they may be known, which, owing to their particular legal structure and transfer rules, are suitable for general, impersonal trading on a financial market, and a list of those currently existing is set out. Also enumerated are the other financial instruments, which include, in addition to negotiable securities, the different contracts of options, futures, swaps, forward rate agreements and other

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19. See "Financial Regulation: 2006 Q3", *Economic Bulletin,* October 2006, Banco de España, p. 148. **20.** See "Financial Regulation: 2006 Q3", *Economic Bulletin,* October 2006, Banco de España, pp. 146-147. **21.** See "Financial Regulation: 2006 Q2", *Economic Bulletin,* July 2006, Banco de España, pp. 144-146.

derivative financial instrument contracts relating to different variables, derivative financial instruments for the transfer of credit risk, and financial contracts settled net, among others.

Finally, the concept of group is redefined to clarify that its meaning is as set out in Article 42 of the Spanish Commercial Code[22], as worded in Law 16/2007 of 4 July 2007 on reform and adaptation of accounting-related corporate law for international harmonisation according to European Union law.

OFFICIAL SECONDARY SECURITIES MARKETS (REGULATED MARKETS)

Directive 2004/39/EC on markets in financial instruments was transposed to Spanish law, although Spain retained the term *mercados secundarios oficiales de valores* (official secondary securities markets) because it is deeply rooted in the Spanish legal system.

A significant new development is that the Law breaks with the principle that shares are traded exclusively on the stock exchanges. Hence, each regulated market will decide on the financial instruments that can be traded on it, provided that legal requirements are met. In addition, the Law recognises and regulates multilateral trading facilities (MTFs) and the systematic internationalisation of orders as financial instrument trading systems, with a view to encouraging competition between the different ways of executing transactions.

Furthermore, the body responsible for authorising the creation of official secondary markets will be the Ministry of Economy and Finance, instead of the Council of Ministers as in the past. This change is mainly due to the particularly technical nature of such authorisation and to the need to speed up the process so as to raise the competitiveness of Spanish securities markets compared with European competitors.

The legal regime governing official secondary markets is completed with the specific market regulations which have to be authorised by the Ministry of Economy and Finance.

A new regime for the suspension and removal of financial instruments from trading is set in place. Thus, to the CNMV's continuing powers to adopt these decisions in similar terms to those so far in place are added the new powers of the operator of the official secondary market to 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 investors' interests or to the orderly functioning of the market.

The Law regulates a new transparency regime for shares traded on official secondary markets, so that the market is sufficiently informed of the transactions that can be carried out at any time and of completed transactions in shares. In short, it seeks to set in place a pre-trade and post-trade transparency regime for share transactions on official secondary markets. This transparency regime is completed with that required of MTFs and of systematic internalisers in the trading of such shares.

MULTILATERAL TRADING FACILITIES

The Law regulates MTFs for the first time, although it does not considered them to be regulated markets. MTFs are systems operated by an investment firm, by an operator of an official

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22. Article 42 establishes that a group exists if a company directly or indirectly controls or can control one or more others. In particular, control shall be presumed to exist when an company, denoted the parent, has any of the following relationships with another one, denoted the subsidiary: a) the parent holds a majority of the voting rights in the subsidiary; b) the parent has the power to appoint or remove a majority of the members of the board of directors of the subsidiary; c) through agreements with third parties, the parent can exercise a majority of the voting rights in the subsidiary; and d) the parent has, with its votes, appointed most of the members of the board of directors of the subsidiary in office at the time the consolidated accounts have to be prepared and during the two immediately preceding accounting periods.

secondary market or by a company set up for the purpose by one or more market operators that has the sole corporate purpose of managing the system and is fully owned by one or more market operators. These systems bring together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract.

MTFs may be freely set up, subject to the regime of prior verification and supervision by the CNMV. These systems shall be overseen by an operator, which shall be responsible for their internal organisation and functioning and shall hold the resources needed to manage the market.

Furthermore, specific pre-trade and post-trade requirements are established to promote MTF transparency and an efficient price formation process. Hence MTFs have to provide publicly available information on transactions in shares admitted to trading which, in turn, are admitted to trading on regulated markets, on the purchases and sales at any given time, and on completed transactions in MTFs.

The supervision of MTFs is the responsibility of their operators, which shall communicate to the CNMV any significant breach of their rules or market abuse.

Finally, the operators of Spanish MTFs may establish appropriate mechanisms to facilitate remote access to and use of their systems to users or members established in other Member States. Analogously, the operators of a MTF in another EU Member State may establish in Spain similar mechanisms to facilitate remote access to and use of their systems to users or members established in Spain. In both cases, it will be necessary to previously notify the respective competent authorities.

SYSTEMATIC INTERNALISATION

Another change introduced by the Law is systematic internalisation, which is actually a third alternative form of trading financial instruments, outside regulated markets and MTFs. The Law sets out the rules applicable to credit institutions and investment firms which deal on own account by executing client orders regarding shares admitted to trading on regulated markets, whenever this is done on an organised, frequent and systematic basis and the orders are for amounts less than or equal to the standard market size for the security in question[23].

The Law establishes rules and obligations for systematic internalisers. If there is a liquid market, they have to publish a firm quote of a general nature that is readily available to interested parties on reasonable commercial terms. In the case of shares for which there is not a liquid market, it shall suffice to disclose quotes to the clients on request.

Also, they have to make public the volume and price of their transactions outside regulated markets or MTFs in shares admitted to trading on a regulated market and the time at which they were concluded. This information shall be made public as soon as possible, on a reasonable commercial basis, and in a manner which is easily accessible to interested parties.

Internalisers shall regulate their clients' access to their quotes and observe the principle of best execution.

TRANSACTION CLEARING AND SETTLEMENT

The Law stipulates that regulated markets and MTFs are free to choose a clearing and settlement system of another EU Member State. The consequences of this are twofold: first, the

23. The standard market size for each class of share shall be a size representative of the arithmetic average value of the orders executed in the market for the shares included in each class of shares.

corporate purpose of the system operator[24] is broadened to allow it to clear and settle transactions on regulated markets and MTFs of other EU Member States. Second, Spanish official secondary markets and MTFs are permitted to conclude agreements with entities of other EU Member States to entrust them with the clearing and settlement of transactions. These agreements must be approved by the CNMV, which can oppose them if they could be detrimental to the orderly functioning of Spanish markets and MTFs.

Members of official secondary markets and of MTFs can freely designate the system for the settlement of transactions in those venues subject to certain conditions and regardless of the settlement system of the official secondary market or MTF.

PUBLIC-DEBT BOOK-ENTRY MARKET

It should be noted that under the new Law the public-debt book-entry market no longer has the sole purpose of the trading of fixed-income securities represented by book entries issued by public agencies or entities. Now, other financial instruments can be traded on it provided they comply with the applicable regulations and with its technical specifications.

The Banco de España continues to be the market operator, although the Public Debt Book-Entry Market Advisory Committee has ceased to exist and the Banco de España will carry out securities financial services when this is agreed with the issuers. To become a market member, which previously required the authorisation of the Ministry of Economy and Finance at the proposal of the Banco de España, the procedure will now be the same as for any other market.

REGIME GOVERNING THE REPORTING OF TRANSACTIONS IN FINANCIAL INSTRUMENTS

Another new feature of the Law is the regime under which investment firms and credit institutions report to the CNMV all transactions in financial instruments carried out by them, regardless of the market, system or mechanism in or by which they were executed. This obligation aims to make it easier for the CNMV to carry out its supervision and inspection duties as rapidly and efficiently as possible.

In this respect, investment firms and credit institutions executing transactions in financial instruments have to report them to the CNMV as quickly as possible, and provide the related basic identification data no later than the close of the following working day. Excluded from this obligation are transactions in units or shares in collective investment institutions not admitted to trading on regulated markets or MTFs.

This reporting task should be carried out by the institution itself, by a third party acting on its behalf, by the operator of the regulated market or MTF through which the transaction was carried out, or by a trade-matching or reporting system approved by the CNMV. Additionally, it must furnish to the CNMV, in the manner, level of detail and periods stipulated by law, the identity of the clients for the account of which the transactions were carried out.

Finally, the Ministry of Economy and Finance is empowered to establish any additional reporting requirements it considers necessary to enable the CNMV to carry out its functions properly, provided that certain requisites set out in the Law are met.

INVESTMENT FIRMS

The list of investment services grew notably owing to two major additions: first, investment advice, defined as the provision of personal recommendations to a client relating to financial instruments. For this purpose, the Law creates a new type of investment firm authorised solely to engage in such advisory services: *the financial advice firm*. Under the authorisation

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24. The system operator is the entity currently entrusted with carrying out the functions of clearing and settlement of transactions on Spanish securities markets such as stock exchanges and the public-debt book-entry market.

and operating regime set in place by the Law, these services can be provided by both natural and legal persons. Like portfolio management companies, these firms may not carry out transactions in securities or cash on their own behalf, except to administer their own assets and subject to the constraints established by law. Nor are they authorised to hold clients' funds or securities and for that reason are not allowed at any time to place themselves in debit with their clients. Finally, their activities shall not be covered by the Investment Guarantee Fund.

Second, management of the MTFs described above is legally considered a financial service. The inclusion of such management in investment services means that it is restricted exclusively to firms duly authorised to provide investment services. When MTFs are to be managed by official secondary market operators or by entities formed ad hoc by one or more market operators, which must have the sole corporate purpose of system management and be fully owned by one or more market operators, such operators must meet the requirements laid down by the Law for the authorisation of investment firms.

Also, the performance on a professional basis of the activities of marketing investment services and financial instruments and of attracting clients is restricted to investment firms and their agents, since these activities are closely related to the provision of investment services.

In any event, as has been the case so far, credit institutions may carry out any investment service, provided that their legal regime, their articles of association and their specific authorisation permit them to do so. Management companies of collective investment institutions may also provide certain investment services.

The Law sets out exhaustively the internal organisation requirements to be met by investment firms. This is because Directive 2004/39/EC confers a Community passport on all Community investment firms, so the level of harmonisation must be sufficient to ensure they are all competing on an equal footing. For the same reason, it regulates in detail the cross-border operations of firms that provide investment services.

Additionally, the Law devotes space to fine-tuning and updating the regulations on the supervision of solvency of investment firms and their consolidated groups, which will continue to be the responsibility of the CNMV. The Law delimits the latter's powers over other natural and legal persons in its actions relating to the securities market, particularly its powers over: securities issuers; Spanish credit institutions (including their branches abroad and their agency network) and non-Community credit institutions; EU investment firms (including their branches in Spain and their tied agents); the branches in Spain of EU credit institutions; and any other natural and legal persons that may be affected by the Law.

INVESTOR PROTECTION

One of the basic principles of this Law is to ensure adequate investor protection, and an extensive list of rules of conduct is therefore laid down which must be observed by all entities providing investment services. Specifically, three possible categories of investors are distinguished: retail clients, professional clients and eligible counterparties. The highest level of protection is afforded to retail clients.

The Law specifies that professional clients shall be understood as those who possess the experience, knowledge and expertise to make their own investment decisions and properly assess the risks that they incur. By exclusion, all those that are not professionals shall be considered to be retail clients. Nevertheless, retail clients may, provided they fulfil certain conditions, request to be treated as professional clients.

The following professional clients are in turn considered to be eligible counterparties: investment firms, credit institutions, insurance companies, collective investment institutions and their management companies, pension funds and their management companies, other financial institutions authorised or regulated under Community legislation or the national law of a Member State, national governments and their services, regional (autonomous) communities and supranational organisations. Also classifiable as eligible counterparties shall be other professional clients that so request and the entities of third countries subject to equivalent requirements and conditions.

Entities providing investment services should act with diligence and transparency in the interests of their clients, caring for such interests as if they were their own. They must also keep their clients adequately informed at all times. The information, including that of an advertising nature, should be impartial, clear and not misleading. Clients or potential clients[25] shall be provided with appropriate comprehensible information about the investment firm and its services, financial instruments and investment strategies, execution venues, and costs and associated charges, so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. The information about financial instruments and investment strategies should include appropriate guidance on and warnings of the risks associated with investments in those instruments or strategies.

When providing investment advice or portfolio management the investment firm shall obtain the necessary information on the retail client's knowledge and experience[26], his financial situation and his investment objectives so as to enable the firm to recommend the investment services and financial instruments that are suitable for him. When the firm does not obtain this information, it shall not recommend investment services or financial instruments to the client or potential client. For other services, the investment firm must ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client. If it is not, the investment firm shall warn the client or potential client. In cases where the client or potential client does not provide the requested information, or the information provided is insufficient, the investment firm shall warn the client or potential client that such a decision will not allow the firm to determine whether the investment service or product envisaged is appropriate for him.

When the service provided is the execution or the reception and transmission of client orders, the foregoing procedure need not be followed, provided that, in the case of non-complex financial instruments, certain organisational and reporting conditions are met. In any event, reasonable measures should be taken to obtain the best possible result for the client.

The Law establishes certain obligations in respect of preventing conflicts of interest and registering contracts.

The Law sets out a number of transitional provisions to allow investment firms to adapt their articles of association, activity programmes and internal rules of conduct within a period of six months from the entry into force of the Law, which was on 21 December 2007. The same time

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25. A potential client is considered to be a person that has had direct contact with the entity for the provision of an investment service, at the initiative of either party. **26.** In the case of professional clients, the firm need not obtain information on the client's knowledge and experience.

period is set for the existing unofficial trading organised markets or systems to transform themselves into MTFs. Otherwise, they will have to cease operating.

Finally, the government is authorised to draft, within one year from the entry into force of this Law on 21 December 2007, a consolidated text to regularise and clarify the Law and harmonise it with other related legislation.

Amendment of the pension scheme and pension fund regulations

The Pension Scheme and Pension Fund Regulations enacted by Royal Decree 304/2004 of 20 February 2004[27] updated, systematised and completed the adaptation of the law governing pension schemes and funds, having regard to past experience in this area and taking as a reference the developments in the European Union.

Law 35/2006 of 28 November 2006[28] on personal income tax and partially amending the corporate income tax, non-resident income tax and wealth tax laws, among others, introduced amendments to the consolidated text of the law regulating pension schemes and funds approved by Royal Legislative Decree 1/2002 of 29 November 2002[29]. In turn, Royal Decree 439/2007 of 30 March 2007[30], approving the personal income tax regulations and amending the pension scheme and pension fund regulations approved by Royal Decree 304/2004 of 20 February 2004, amended the latter to adapt it to changes in the law.

Recently, *Royal Decree 1684/2007 of 14 December 2007* (BOE of 15 December 2007) amended the pension scheme and pension fund regulations approved by Royal Decree 304/2004 of 20 February 2004 and the regulations on the implementation of firms' pension commitments to employees and beneficiaries enacted by Royal Decree 1588/1999 of 15 October 1999.

The Royal Decree makes changes in various areas of pension scheme law: actuarial aspects of pension schemes, obligations to provide information to participants and beneficiaries, regime governing pension funds, rules on internal control of management companies, rules of conduct and on separation of depositories, and rules on administrative registers, particularly those relating to cross-border activities.

As a result of the creation by Law 35/2006 of 28 November 2006 of occupational social insurance schemes as a new instrument for externalising firms' pension commitments to their workers, a number of adaptations to the law on pension schemes and on pension commitment implementation were made to regulate certain aspects of this new instrument of occupational supplementary welfare.

In particular, the changes focus on two basic matters: mobility between social insurance instruments with homogeneous tax treatment derived from Law 35/2006 of 28 November 2006 on personal income tax and partially amending the corporate income tax, non-resident income tax and wealth tax laws; and the adaptation of the principle of non-discrimination so as to prevent the simultaneous existence of both instruments in a firm.

The regulations on implementation of firms' pension commitments to workers and beneficiaries enacted by Royal Decree 1588/1999 of 15 October 1999 were amended to regulate certain essential aspects of occupational social insurance schemes, such as the regime governing the provi-

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27. See "Financial Regulation: 2004 Q1", *Economic Bulletin*, April 2004, Banco de España, pp. 97-98. **28.** See "Financial Regulation: 2006 Q4", *Economic Bulletin,* January 2007, Banco de España, pp. 111-114. **29.** See "Financial Regulation: 2002 Q4", *Economic Bulletin,* January 2003, Banco de España, pp. 113-114. **30.** See "Financial Regulation: 2007 Q1", *Economic Bulletin,* April 2007, Banco de España, pp. 142-143.

sion of information to insured workers and their representatives, and to delimit those aspects of the rules on externalisation via group insurance that apply to occupational social insurance schemes.

Regarding the regulation of actuarial aspects of pension schemes, the Royal Decree updates, systematises and delimits more clearly the professional activity of actuaries in the different areas in which they act and, in particular, insofar as actuarial reviews are concerned. Moreover, in view of the accumulated experience and of the level of acceptance and maturity currently offered by the system of pension schemes, the reserve requirements aimed at maintaining the solvency margin have been reduced in order to continue flexibilising the conditions imposed on pension schemes.

The amendments to the investment regime aim, on the one hand, to adapt the legal framework of the Pension Scheme and Pension Fund Regulations to the changes in pension funds in particular, and in the financial sector in general, owing to the appearance of new investment alternatives for pension funds, and, on the other, to adapt it to the existing trends in the rest of the financial sector in relation to internal control procedures.

In particular, regarding the investments eligible for pension funds, the list of the various assets and rights considered eligible is updated to include credit derivatives, non-financial derivatives and non-harmonised collective investment institutions, among others. The general regime governing derivative instruments is set out in greater depth, the eligibility criteria for venture capital firms are flexibilised and structured assets are subjected to more complete regulation.

Also, progress is made in the administrative organisation of management companies, internal control and risk management procedures, rules of conduct and rules to ensure that the management company is separate from the depository, all in clear harmony with the national and international regulatory trends in other financial system sectors and with the recommendations of international bodies.

In regard to legal aspects of information disclosures to participants, of special registers, of administrative procedures for authorisation and registration and of notification of registrable data and events, specific improvements are made, including most notably the registry references to pension funds derived from Law 11/2006 of 16 May 2006 adapting Spanish legislation to the regime of cross-border activities regulated in Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision. The aforementioned Law 11/2006 made it compulsory to keep a register of occupational pension funds of other Member States operating in Spain.

Except for the adaptation to Organic Law 3/2007 of 22 March 2007 for the effective equality of men and women, which came into force on 21 December 2007, the bulk of the Royal Decree came into force on 1 January 2008.

Transparency requirements in relation to information about listed companies

Law 6/2007 of 12 April 2007[31] reforming Law 24/1988 of 28 July 1988 on the securities market, incorporated partially into Spanish law Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004[32] and Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004, known as the transparency

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31. See "Financial Regulation: 2007 Q2", *Economic Bulletin,* July 2007, Banco de España, pp. 114-118. **32.** Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (the takeover directive) established a common minimum framework in the Member States for regulating takeover bids for companies whose shares are at least partially admitted to trading on a regulated market, in order to protect the holders of securities admitted to trading on a regulated market in a Member State and, in particular, those with minority holdings, when they are the target of a takeover bid or of a change in control of their companies.

directive, subsequently implemented by Commission Directive 2007/14/EC of 8 March 2007.

Law 6/2007 adapted the regime governing the publication and dissemination of the key information referred to in the basic provisions of the transparency directive. Hence, among other things, it specified that securities issuers have to make public and disseminate immediately to the market and to the CNMV all information as soon as the underlying event becomes known. The Law recognises the CNMV's power to require the auditors of the issuer to provide any information it needs to carry out its supervisory tasks and introduces the regime of periodic information set out in the transparency directive, i.e. the annual, half-yearly and quarterly reports that the issuer has to draft, publish and disseminate. Finally, the Law incorporates the regime governing disclosure by the issuer to the CNMV of the acquisition or loss of significant shareholdings with voting rights or of financial instruments carrying the right to acquire such securities (for the exercise of which a transitional procedure was envisaged while the implementing regulations of the new regime were being set in place), which was completed with the issuer's obligation to notify to the CNMV, publish and disseminate the transactions carried out by it in its own shares.

Recently *Royal Decree 1362/2007 of 19 October 2007* (BOE of 20 October 2007) implementing Law 24/1988 of 28 July 1988 on the securities market addressed transparency requirements in relation to information about issuers whose securities are admitted to trading on an official secondary market or on another regulated market in the European Union. This legislation culminates the incorporation into Spanish law of the Community regime on the transparency of information about listed companies. Hence the main aim of this Royal Decree is to spell out the aforementioned requirements so as to incorporate into Spanish law that part of Directive 2004/109/EC not included in Law 6/2007 and Directive 2007/14/EC implementing the former.

Regarding the content of Law 6/2007, it specifies the items composing the regulated information about listed companies and establishes the obligation of the issuer to publish on its website and disseminate that information and to send it simultaneously to the CNMV. The issuer can opt to disseminate it directly or entrust the task to a third party, which can be the CNMV itself or others such as a stock exchange or the mass media.

Regulated information includes periodic information (annual, half-yearly and, in the case of listed issuers of shares, the quarterly interim management statement), that relating to significant holdings and to issuers' transactions in their own shares, that relating to the total number of voting rights and capital at the end of each calendar month in which an increase or decrease of such total number has occurred, and the significant events. Regarding preparation and dissemination of the periodic information, several matters are specified, such as the content, the remittance date, the accounting principles applicable and the liability derived from its preparation and publication, as well as the conditions under which the rules on the periodic public information of companies listed in Spain whose registered office is located in a non-EU third country shall be considered as equivalent to Spanish rules.

The annual report shall comprise the audited annual financial statements and management report of the entity, both individual and, where applicable, of its consolidated group, as well as the statements of responsibility for its content signed by the directors of the issuer. The half-yearly report shall comprise the condensed financial statements and interim management report of the entity, both individual and, where applicable, of its consolidated group, as well as the statements of responsibility for its content signed by the directors of the issuer. If the half-

yearly report has been audited voluntarily, the audit report shall be published in full. Otherwise, it shall contain a statement by the issuer that it has not been audited or reviewed by auditors. The interim management report shall include at least: an indication of important events that have occurred during the reporting period and their impact on the condensed financial statements; a description of the principal risks and uncertainties for the remaining six months of the financial year; and major related parties transactions, including particular information, although the Ministry of Economy and Finance and, if expressly empowered by it, the CNMV, may stipulate additional requirements for information on transactions with related parties.

The interim management statement shall provide an explanation of the events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer and its group, as well as a general description of the group and of the results of the issuer and its controlled undertakings in the period.

The Royal Decree also sets out implementing regulations for the information required about significant holdings and treasury shares under Law 24/1988 of 28 July 1988 on the securities market. This law required shareholders and holders of certain financial instruments to notify the issuer and the CNMV of the acquisition or loss of a significant holding in the voting rights of the company, and now the Royal Decree specifies various matters regarding that obligation. Hence a shareholder that acquires or transfers voting shares of an issuer for which Spain is the home Member State and whose shares are admitted to trading on an official secondary market or on another regulated market domiciled in the European Union must notify the issuer and the CNMV of the proportion of voting rights of the issuer held by the shareholder as a result of these transactions where that proportion reaches, exceeds or falls below the thresholds of 3%, 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 60%, 70%, 75%, 80% and 90%. For this purpose, the Royal Decree defines what is meant by a shareholder and how the percentage of voting rights is to be calculated.

It also extensively sets out which persons other than shareholders have to notify a significant holding, the exceptions to the notification requirement, the time limits for making that notification and the content thereof. Similarly, provision is made for notification of significant holdings under special circumstances, such as capital increases with a charge to reserves, transfer of securities due to death or liquidation of a company, corporate merger or spin-off, and during the course of a takeover bid.

Another new feature is that certain notification obligations of the issuers of shares admitted to trading on an official secondary market or on another regulated market of the European Union for which Spain is the home Member State are specified with regard to the own shares held by them (treasury stock), such as the proportion of voting rights that has to be notified and the content of the notification. In this respect, the issuer must, within a maximum of four trading days, notify the CNMV when it acquires own shares to which voting rights are attached, at one or several times, either itself or through a controlled entity or interposed person, and the acquisition equals or exceeds 1% of the voting rights.

The conditions are defined in which the transparency rules for significant holdings and treasury stock of companies listed in Spain whose registered office is located in a non-EU third country can be considered equivalent to the Spanish rules.

Lastly, other information requirements for issuers are established in order to provide shareholders and debt securities holders with all the information and all the mechanisms needed for them to exercise their rights. Also, the Royal Decree includes obligations already existing in

Spanish law, such as that of directors and managers of listed companies to notify the CNMV if they are granted any compensation involving the delivery of shares of the company in which they hold office or of options which are based on such shares or the settlement of which is linked to their price.

The Royal Decree, which repeals Royal Decree 377/1991 of 15 May 1991 on the notification of significant holdings in listed companies and on the acquisition by the latter of their own shares, and various ministerial orders, came into force on 20 December 2007. The provisions regarding the annual financial report will come into force with regard to the annual financial statements for reporting periods beginning from 1 January 2007. The provisions on half-yearly financial reports and interim statements will come into force with regard to information for reporting periods beginning from 1 January 2008.

Information brochure for customer complaints in the financial services area

Law 44/2002 of 22 November 2002[33] on reform of the financial system (the Financial Law) aimed, inter alia, to enhance the efficiency and competitiveness of the Spanish financial system, without reducing the protection of financial services users. Regarding the latter, it created certain administrative bodies to defend customers. Specifically, these were the commissioner for the defence of bank customers, the commissioner for the defence of investors and the commissioner for the defence of insurance policyholders and pension scheme participants, attached to their respective supervisory authorities, namely the Banco de España, the CNMV and the Directorate General for Insurance and Pension Funds (DGS)[34].

Subsequently Royal Decree 303/2004 of 20 February 2004[35] approving the regulations for the protection of financial services customers and, subsequently, Ministerial Order ECO/734/2004 of 11 March 2004 on the customer service department and ombudsman of financial institutions, were published.

Recently the supervisory authorities (Banco de España, CNMV and DGS) have issued an *information brochure* on how users should make complaints and claims.

The initiative, undertaken in concert with the National Consumer Affairs Institute, will familiarise users with how they should submit a complaint of this nature, the stages comprising the procedure and the effects of the decision issued at the end of the process.

Under the "one stop shop" system, the complaint may be submitted to any of the three bodies, although it will be processed more quickly if it is made directly to the body competent to deal with the case.

The brochure explains that the Banco de España responds to complaints about banking products or services, the CNMV deals with investment products and services, and the DGS looks after matters relating to insurance and pension schemes.

The brochure specifies the minimum content and documentation that has to accompany a complaint or claim, which shall consist, among other things, of: the specific reason for the complaint, the user's personal particulars, the institution against which the complaint is made

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33. See "Financial Regulation: 2002 Q4", *Economic Bulletin,* January 2003, Banco de España, pp. 101-113. **34.** The functions entrusted to the Commissioners were to attend to the complaints and claims presented by financial service users in relation to their legally recognised interests and rights (whether they derive from contracts, from the legislation on transparency or customer protection or from good financial practices and conduct) and remit to the supervision services those cases in which evidence of non-compliance with or infringement of transparency and customer protection law is observed. **35.** See "Financial Regulation: 2004 Q1", *Economic Bulletin,* April 2004, Banco de España, pp. 92-93.

and accreditation that the complaint was previously lodged with the institution's customer service department or ombudsman[36].

The brochure also explains the stages in the procedure, the maximum duration of which shall generally be four months from submission of the written complaint, except in the case of circumstances which must be duly explained in the final report.

Lastly, it is pointed out that the final report at the end of the complaint procedure is of an informational nature and not binding on the parties. It therefore is not considered to be an administrative action and an appeal against it cannot be lodged with administrative or judicial bodies. Nor does it provide economic assessments of the possible damages to financial service users, since only the courts can do this.

Directive on payment services in the internal market

At present, payment services markets in the European Union are organised separately according to the dictates of each Member State, and thus their legal framework is fragmented into different national regimes, since the various Community legal provisions adopted so far in this area[37] have not sufficiently resolved this situation.

In order to establish a coherent legal framework at Community level, the EU has published *Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007* (OJ of 5 December 2007) on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC, which establishes a legal framework ensuring the co-ordination of national provisions on prudential requirements, the access of new payment service providers to the market, information requirements, and the respective rights and obligations of payment services users and providers.

The Directive will apply to payment services within the European Union, although it establishes certain exemptions[38]. These services, which are listed in the annex to the Directive, include most notably the following: services enabling cash to be placed on or withdrawn from a payment account as well as all the operations required for operating a payment account; execution of payment transactions, including transfers of funds on a payment account with the user's payment service provider or with another payment service provider; issuing and/or acquiring of payment instruments; money remittance; and execution of payment transactions where the consent of the payer to execute a payment transaction is given by means of any telecommunication, digital or IT device and the payment is made to the telecommunication, IT system or network operator, acting only as an intermediary between the payment service user and the supplier of the goods and services.

The Directive lays down the rules in accordance with which Member States shall distinguish the six categories of payment service provider: credit institutions; electronic money institutions; post office giro institutions which are entitled under national law to provide payment services; payment institutions within the meaning of this Directive; the ECB and NCBs, when not acting in their capacity as monetary authority or other public authorities; and the Member States or their regional or local authorities when not acting in their capacity as public authori-

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36. Financial intermediaries are obliged to make available to the public the information on the existence and functioning of these services. **37.** Including Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers and Regulation 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro. **38.** The exemptions include, among others, payment transactions made exclusively in cash directly from the payer to the payee, without any intermediary intervention; payment transactions from the payer to the payee through a commercial agent authorised to negotiate or conclude the sale or purchase of goods or services on behalf of the payer or the payee; and professional physical transport of banknotes and coins, including their collection, processing and delivery.

ties. No other professional payment service providers shall be permitted. Furthermore, the Directive lays down rules concerning transparency of conditions and information requirements for payment services, and the respective rights and obligations of payment service users and payment service providers in relation to the provision of payment services as a regular occupation or business activity.

The requirements for authorisation as a payment institution under the Directive (a programme of operations; initial capital; description of the business management methods and of the internal control mechanisms, etc.) are set out, as are the cases in which the competent authorities may revoke that authorisation. Also established is the requirement to hold, at all times, own funds calculated in accordance with one of the three methods described in the Directive.

Member States shall establish a public register of authorised payment institutions, their agents and branches. This register shall identify, inter alia, the payment services for which the payment institution is authorised. The register shall be publicly available for consultation, accessible online, and updated on a regular basis. Also, payment institutions may provide services through agents, branches or entities to which activities are outsourced, of which it shall notify the competent authorities in its home Member State.

The Directive stipulates that Member States shall designate public authorities as the competent authorities responsible for the authorisation and prudential supervision of payment institutions. Member States shall ensure that the controls exercised by the competent authorities for checking continued compliance are proportionate, adequate and responsive to the risks to which payment institutions are exposed.

The competent authorities of the different Member States shall co-operate with each other and, where appropriate, with the ECB, NCBs and other competent authorities designated under Community or national legislation applicable to payment service providers.

The so-called *Community passport*, i.e. the right of establishment and freedom to provide services throughout the whole of the EU shall apply to payment institutions. Hence any authorised payment institution can provide payment services in another Member State, it sufficing to inform the competent authorities in its home Member State. Within one month of receiving that information, the competent authorities of the home Member State shall inform the competent authorities of the host Member State of the name and address of the payment institution, the names of those responsible for the management of the branch, its organisational structure and the kind of payment services it intends to provide in the territory of the host Member State.

Another section of the Directive refers to transparency of conditions and information requirements for payment services. In this respect, the payment service provider is obliged to furnish the information and conditions to the user in an easily accessible manner, subject to the specificities of each particular transaction. Here the Directive distinguishes single payment transactions from those covered by a framework contract. The information and conditions shall be given in easily understandable words and in a clear and comprehensible form, in an official language of the Member State where the payment service is offered or in any other language agreed between the parties.

Single payment transactions shall specify the information that has to be provided by the payment service user in order for a payment order to be properly executed; the maximum execution time for the payment service to be provided; all charges payable by the payment service

user to his payment service provider and, where applicable, the breakdown of the amounts of any charges; and, where applicable, the actual or reference exchange rate to be applied to the payment transaction. In transactions governed by framework contracts, information shall be provided, inter alia, on the payment service provider, on use of the payment service, on charges, interest and exchange rates, on means of communication between the provider and the user, and on safeguards and corrective measures.

In transactions covered by a framework contract, the payment service user may terminate the framework contract at any time, unless the parties have agreed on a period of notice. Such a period may not exceed one month. Termination of a framework contract concluded for a fixed period exceeding 12 months or for an indefinite period shall be free of charge for the payment service user after the expiry of 12 months. In all other cases charges for the termination shall be appropriate and in line with costs. The payment service provider may terminate a framework contract concluded for an indefinite period by giving at least two months' notice. However, Member States may provide more favourable provisions for payment service users.

Another significant facet of the Directive relates to rights and obligations in relation to the provision and use of payment services. In this respect, Member States may provide that they apply to microenterprises in the same way as to consumers.

No later than 1 November 2012, the Commission shall present to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank a report on the implementation and impact of this Directive, in particular on the possible need to extend the scope of the Directive to payment transactions in all currencies and to payment transactions where only one of the payment service providers is located in the Community.

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive before 1 November 2009.

NEW GENERAL CHART OF ACCOUNTS

Law 16/2007 of 4 July 2007[39] on reform and adaptation of accounting-related corporate law for international harmonisation according to European Union law aimed, among other things, to bring Spanish corporate law into line with international financial reporting standards (IFRSs).

The first final provision of Law 16/2007 authorised the government to approve a new Spanish general chart of accounts, hereafter referred to by its Spanish acronym PGC (*Plan General de Contabilidad*), as well as amendments to it and supplementary provisions, with a view to implementing the instructions contained in the law. It also authorised the approval of a general chart of accounts for small and medium-sized enterprises (hereafter "PGC for SMEs") to that the special characteristics of these companies would be taken into consideration.

In exercise of these two prerogatives, the government enacted *Royal Decree 1514/2007 of 16 November 1007* (BOE of 20 November 2007) approving the PGC, and *Royal Decree 1515/2007 of 16 November 1007* (BOE of 20 November 2007) approving the PGC for SMEs and specific accounting criteria for microenterprises.

GENERAL CHART OF ACCOUNTS (PGC)

The PGC consists of five parts preceded by an introduction explaining the basic features of the PGC and the main differences from the 1990 chart of accounts approved by Royal Decree 1643/1990 of 20 December 1990, now repealed. Nevertheless, in drafting the current Royal

39. See "Financial Regulation: 2007 Q3", *Economic Bulletin,* October 2007, Banco de España, pp. 92-93.

Decree, the legislators followed the same technique used in the previous one, giving emphasis to its explanatory component in order to make it easier to apply, given the number of new transactions, balance sheet elements and accounting criteria included in it.

Part One, entitled *conceptual accounting framework*, sets out the documents composing the annual accounts, as well as the information requirements, accounting principles and recognition and measurement criteria which, if properly applied, enable the annual accounts to present fairly the net worth, financial position and financial performance of the company. It also defines the elements of the annual accounts.

Part Two, *recognition and measurement rules*, develops in greater depth the accounting principles and other provisions contained in Part One. It sets out the recognition and measurement criteria for the transactions and balance sheet elements of companies from a general perspective, i.e. considering the transactions usually carried out by companies without going into specific cases. The appropriate accounting treatment of particular cases will, as in the past, be determined by the successive rulings issued by the *Instituto de Contabilidad y Auditoría de Cuentas* (Accounting and Audit Institute) in exercise of the powers conferred on it by the first final provision of Law 16/2007.

Part Three, *annual accounts*, includes rules for preparing annual accounts, along with definitions and clarifying explanations of the content of the documents forming part of them. Next come complete and condensed formats of the documents composing the annual accounts.

Part Four, *chart of accounts*, contains the groups, sub-groups and the accounts, duly numbered in decimal form, with a descriptive title indicating their content. The chart of accounts will, for the sake of flexibility, continue to be non-obligatory insofar as account numbers and titles are concerned, although it is compulsory in respect of the items of the annual accounts.

Part Five, *accounting definitions and relationships*, includes definitions of the various items in the balance sheet, income statement and statement of changes in equity, and of each account in these items, as well as the main reasons for charges and credits to accounts. The part on accounting definitions and relationships is not compulsorily applicable, except insofar as it refers to or contains recognition or measurement criteria enlarging on the provisions in Part Two on recognition and measurement rules or serves to interpret them more clearly.

A number of transitional provisions are laid down for first-time application of the PGC and for the transition to the new accounting legislation, which came into force on 1 January 2008. Hence the rules and criteria contained in the PGC must be applied retrospectively in the first accounting period beginning on or after 1 January 2008, with the exceptions indicated in the Royal Decree.

The notes to the first annual accounts prepared under the PGC shall include a section entitled *matters arising from the transition to the new accounting rules*. This section will explain the main differences between the accounting criteria applied in the previous year and in the current one, along with a quantification of the impact that this change in accounting criteria has had on the company's net worth. In particular, a reconciliation as at the opening balance sheet date shall be included.

Companies may voluntarily submit comparative information on the previous year adapted to the current PGC. For this purpose, they shall prepare an opening balance sheet for the previous year according to the new criteria and to the provisions of this Royal Decree. In this case,

apart from including in the notes to financial statements an explanation of the main differences between the accounting criteria applied in the previous and current periods, the impact of this change in accounting criteria on the company's net worth and profit shall be quantified.

The Ministry of Economy and Finance is empowered to approve the sectoral adaptations of the PGC. Until it does so, the existing sectoral adaptations will remain in force transitionally so long as they do not conflict with current legislation. Also remaining in force are the transitional regime applicable for accounting purposes to the externalisation of pension commitments and the accounting regulations for co-operatives regarding the delimitation between own funds and borrowed funds, which will continue to apply until 31 December 2009.

When companies have, prior to their first-time application of the PGC, prepared consolidated annual accounts in accordance with the Community regulations adopting international financial reporting standards, the valuations included in those accounts shall generally be accepted, provided that the criteria used are equivalent to those of the PGC.

Lastly, the final provisions specify the powers conferred under current legislation for the adaptation and implementation of the PGC.

PGC FOR SMES

The PGC for SMEs may be applied by all enterprises, whether their legal form be sole trader or corporate, which in two successive accounting periods meet, as at the closing date of each of them, at least two of the following conditions: a) total assets do not exceed €2,850,000; b) annual turnover does not exceed €5,700,000; and c) the average number of employees during the accounting period is no more than 50.

Enterprises shall forfeit the right to apply it if they cease to meet, for two consecutive accounting periods, as at the closing date of each of them, two of the above conditions. If so, they must apply the PGC.

The Royal Decree permits SMEs to use either the PGC or the PGC for SMEs, although, whichever they choose, they must use it continuously for a minimum of three accounting periods, unless, as a consequence of having ceased to fall within the scope of application of the latter, they are obliged to apply the PGC.

The structure of the PGC for SMEs is the same as that of the PGC. It consists of five parts preceded by an introduction explaining the basic features of this text and its main differences from the PGC.

Part One, which contains the *conceptual accounting framework*, shows no major differences from Part One of the PGC, except in regard to the cash flow statement, the preparation of which is voluntary.

Part Two, *recognition and measurement rules*, omits the rules on certain transactions considered to be little used by these enterprises. It also simplifies certain recognition and measurement criteria contained in the PGC, basically relating to financial instruments.

Part Three contains, in addition to rules for preparing annual accounts, the financial statement formats for SMEs, which are the same as the condensed formats in Part Three of the PGC, albeit dispensing with the sub-groupings, captions, items and explanatory footnotes relating to transactions not detailed in the PGC for SMEs. The statement of changes in equity of SMEs is simplified. It will consist of one document including all the changes in equity

carried out in transactions with equityholders or with third parties or simply due to reclassification of items.

Parts Four and Five include the groups, sub-groups and accounts needed to record the transactions addressed in Part Two of the PGC for SMEs, along with definitions, accounting relationships and movements giving rise to charges and credits in the accounts.

The transitional provisions regulate the first-time application of the PGC for SMEs following its entry into force, which was on 1 January 2008, similarly to the regulation of the first-time application of the PGC, albeit simplifying the rules for the transactions not broken down in this text.

Further, Royal Decree 1515/2007 includes regulations implementing the first final provision of Law 16/2007, which called for certain simplified and specific criteria applicable to microenterprises (SMEs of very small size). For this purpose, the PGC for SMEs includes the special conditions to be met by SMEs for them to be able to apply these accounting criteria. These conditions relate to total assets, which may not exceed €1 million, net turnover, which may not exceed €2 million, and the average number of workers, which may not exceed ten. These same conditions shall apply to non-commercial entities, particularly foundations. In general, although most of the general criteria are maintained for SMEs, there are some differences in the accounting treatment of finance leases and other similar agreements and in accounting for income tax.

The PGC and, where appropriate, the PGC for SMEs shall be obligatory for all enterprises, whether their legal form be sole trader or corporate, without prejudice to the special characteristics for financial institutions that may be established in their specific accounting regulations. Under the new framework, the regulatory powers in accounting matters conferred on the financial system's supervisory centres, bodies and institutions shall remain in place.

Lastly, both royal decrees address situations of transition from one chart of accounts to another. Thus, Royal Decree 1514/2007 (PGC) specifies the criteria to be followed by SMEs whose business growth leads them at a later stage to apply the standard criteria included in the PGC. Similarly, Royal Decree 1515/2007 (PGC for SMEs) sets out the criteria to be followed under the PGC for SMEs if the specific accounting criteria for microenterprises are no longer applicable or if it is decided to move from the PGC to the PGC for SMEs. In all cases, at the beginning of the first accounting period in which the enterprise applies the new chart of accounts, it shall be applied retrospectively and all the assets and liabilities that have to be recognised under the new chart of accounts shall be recorded. The balancing entry of the adjustments that have to be made shall be a reserves item or, if applicable, other equity items. Also, the notes to the first-time annual accounts shall include a specific section named accordingly, which shall explain the main differences between the accounting criteria applied in the previous period and in the current one, along with a quantification of the impact that this change in accounting criteria has had on the enterprise's net worth.

State Budget for 2008

Following the usual practice in December, Law 51/2007 of 26 December 2007 on the State budget for 2008 (BOE of 27 December 2007) was published.

From the standpoint of financial regulation, the following monetary, financial and fiscal sections call for comment. In relation to State debt, the government is authorised to increase the outstanding State debt in 2008, subject to the condition that it shall not exceed the level at the beginning of the year by more than €7,924 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

Most notable with regard to personal income tax is that the two components of the tax rate, namely the State one and the regional or supplementary one, are updated so that an increase in income derived from the mere adjustment to inflation does not increase the tax burden and so as to protect low-income earners in particular. For this purpose, adjustments of 2% were also made to the personal and family allowances of the taxpayer for descendents, ascendents and disability.

Also raised by the same percentage are the amounts applicable as a reduction of net earned income and of net income from business activities applicable to self-employed persons whose income depends on a single firm. For transfers of real estate not used in business activities, a rise of 2% in the acquisition cost adjustment coefficient is included.

The tax rebates granted in previous budget laws for principal residences were abolished in 2007 both for tenants whose rental contract dates from prior to 20 April 1998 and for purchasers of houses prior to 4 May 1998. However, a tax deduction for purchase of principal residence is granted to taxpayers who purchased their principal residence before 20 January 2006. The amount is equal to the difference between that established in the personal income tax law enacted by Royal Legislative Decree 3/2004 of 5 March 2004 and that established recently by Law 35/2006 of 28 November on personal income tax.

A tax rebate is granted on certain income from capital with a generation period exceeding two years in 2007, with respect to that established in the personal income tax legislation (the personal income tax law enacted by Royal Legislative Decree 3/2004 of 5 March 2004) in force up to 31 December 2006.

In relation to corporate income tax, the measures are 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 2008 is determined. Finally, in relation to local taxes, the rateable values of properties are raised by 2%.

Other measures of a financial nature relate to the legal interest rate, which is raised from 5% to 5.5% and to default interest, up from 6.2% to 7%.

9.1.2008.