



## Financial regulation: 2008 Q3

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### Introduction

In 2008 Q3 relatively few new financial provisions were enacted in comparison with previous periods.

In the securities market field, accounting regulations on financial and real-estate collective investment institutions (CIIs) were updated to bring them into line with the new accounting framework of the Spanish General Chart of Accounts (PGC), respecting the specific characteristics of these institutions.

In the private insurance area, the new chart of accounts for insurance companies, inspired by the PGC, was published and the regulations governing insurance companies were changed to adapt them to the new accounting framework and to include certain technical adjustments in the text.

A package of urgent measures to boost economic activity and combat the slowdown of the Spanish economy was approved. They include, most notably, action to facilitate the financing of small and medium-sized firms and programmes related to the housing market.

Lastly, two Community law provisions were passed. The first includes certain logistical improvements for the euro cash changeover in future participating Member States and the second modifies the statistics transmission system of the European Central Bank (ECB) in the field of quarterly financial accounts in the European Union.

### **Collective investment institutions: amendment of accounting rules, annual accounts and confidential returns**

CII Law 35/2003 of 4 November 2003<sup>1</sup> and its implementing regulations in Royal Decree 1309/2005 of 4 November 2005<sup>2</sup> empowered the Minister of the Economy and, with the latter's authorisation, the National Securities Market Commission (CNMV) to approve specific accounting rules for CIIs. Further to this, Order EHA/35/2008 of 14 January 2008 was published,<sup>3</sup> which empowered the CNMV to issue accounting rules for CIIs, their annual accounts, the determination of their total assets and results, and the frequency and detail with which their data must be reported to the CNMV.

Making use of this prerogative, CNMV *Circular 3/2008 of 11 September 2008* (BOE of 2 October 2008) was published on accounting rules, annual accounts and confidential returns of CIIs, repealing the previous accounting framework.<sup>4</sup>

The Circular's basic objective is to adapt the financial and real-estate CIIs' accounting regime to the new accounting framework established in the PGC, which was approved by Royal Decree 1514/2007 of 16 November 2007. The Circular establishes accounting rules and criteria

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1. See "Financial regulation: 2003 Q4" in *Economic Bulletin*, Banco de España, January 2004, pp. 84-87. 2. See "Financial regulation: 2005 Q4" in *Economic Bulletin*, Banco de España, January 2006, pp. 112-116. 3. See "Financial regulation: 2008 Q1" in *Economic Bulletin*, Banco de España, April 2008, pp. 176 and 177. 4. The Circular repeals CNMV Circular 7/1990 of 27 December 1990 on accounting rules and confidential returns of CIIs, which was partially amended by CNMV Circulars 4/1993 of 29 December 1993, 3/1998 of 22 September 1998 and 7/1998 of 16 December 1998, and certain sections of CNMV Circular 4/1994 of 14 December 1994 on accounting rules, reporting obligations, determination of net asset value and investment and operating ratios and operations in the appraisal of real estate held by real estate investment funds and companies.

for these two types of institutions which, although falling within the scope of the principles and guidelines of the new PGC, are required to apply the PGC in a form adapted to their characteristic and specific features.

#### SCOPE OF APPLICATION

The Circular regulates the specific accounting rules, the asset measurement and classification criteria, the determination of total assets and results, the annual accounts and supplementary confidential returns of both financial and real-estate CIIIs.

As to the form of submitting the information, unlike the previous regulations, the annual accounts and other confidential returns will be sent to the CNMV, within the deadlines set, electronically via the new CIFRADO/CNMV system approved by the CNMV board of directors on 15 September 2006, or by another similar means.

#### GENERAL ACCOUNTING CRITERIA

The Circular details the general accounting framework and, specifically, the basic principles, measurement criteria, accounting definitions, periodicity in accounting and specific accounting rules of these institutions.

The purpose of the basic accounting principles, which are similar to those of the previous regulations,<sup>5</sup> is clarity in the wording of the annual accounts and the confidential returns so that they can be understood by and are useful for users when taking their financial decisions, giving a true and fair view of the institutions' total assets, financial situation and results.

Noteworthy within the measurement criteria is the introduction of *fair value* as established by the PGC and other criteria, such as the amortised cost of a financial instrument, the effective interest rate, transaction costs attributable to a financial asset or liability, the book or carrying value of assets or liabilities, historic cost, active market and the residual value of an asset.

As for periodicity in accounting, the financial CIIIs will apply the Circular's criteria and will calculate the estimated realisation value of assets as frequently as they calculate the net asset value established in their prospectuses, unless there are other provisions whereby they must calculate these values more frequently. The real-estate CIIIs will calculate the estimated realisation value of their assets monthly, or in the case of real estate investment funds, as frequently as they calculate their net asset value as stipulated in their regulations, if this was less than one month.

According to PGC terminology, in the rules referring to financial instruments, a distinction is drawn between financial assets, financial liabilities and equity instruments, detailing the measurement criteria for each one. Furthermore, specific rules on foreign currency transactions, income tax and general criteria for determining results are included.

The fair-value measurement criterion is used for all the financial assets of financial CIIIs, in the terms indicated by the Circular, and the changes in this measurement will be taken to the income statement. Thus, with the new regulations, the unrealised gains of such assets will be included directly in the income statement.<sup>6</sup>

Similarly, real-estate CIIIs' property investment portfolio will also be measured at fair value which, initially, bar evidence to the contrary, is the acquisition cost plus considerations com-

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<sup>5</sup> Principles of accrual, going-concern, uniformity, prudence, non-compensation and materiality. <sup>6</sup> In the previous regulations (Circular 7/1990), financial assets were recorded initially at cost and, subsequently, at market value. Unrealised gains were shown off-balance sheet in memorandum accounts and any unrealised losses were charged to the income statement.

mitted arising from the acquisition. Subsequently, it will generally coincide with the latest appraisal value. Possible gains will be taken to an adjustment account used to reflect changes in value, within the total assets of CII, and unrealised losses will be taken to the income statement, once the possible positive balance of the above-mentioned adjustment account has been used in full.<sup>7</sup>

The specific criteria and mechanisms for recording particular transactions undertaken by financial and real-estate CII are established. Noteworthy among the former are spot and forward purchases and sales of securities, repos, futures contracts, options and warrants, securities lending, and swaps, among others.

As for real-estate CII, specific accounting rules are established for certain transactions, among others, completed properties, commitments to purchase buildings by instalments and agreements for the sale of property (*contratos de arras*), the acquisition of property purchase options, properties at the pre-construction phase and those under construction, administrative licenses and other rights in rem, indemnity payments to be received and hybrid transactions.

#### FORMAT OF ANNUAL ACCOUNTS AND CONFIDENTIAL RETURNS

The Circular introduces the new public formats of annual accounts and confidential returns of financial and real-estate CII, which must be submitted by the latter to the CNMV and which are slightly different with respect to the previous regulations. Specifically, the statement of changes in equity will comply with the general provisions of the PGC, with the exception that the cash flow statement will not be required, because it provides little relevant information about CII.

Similarly, the balance sheet, income statement and statement of changes in equity must include, in addition to the figures for the year just ended, those for the previous year.

The notes, which are included in the annual accounts, will complete, enlarge upon and discuss the other documents which make up the annual accounts in accordance with the provisions of the PGC. It will not be necessary to include information by segment about turnover.

Lastly, the system for the transition from the previous accounting model to the model included in the Circular is regulated, establishing the allocation to reserves of the adjustments arising from changes in accounting rules. The annual accounts for 2008 will not include figures for comparison purposes, without prejudice to the inclusion, in the notes to these annual accounts, of the balance sheet and income statement included in the previous year's annual accounts.

The Circular will come into force on 31 December 2008.

#### **Amendment of the regulations for insurance companies**

*Royal Decree 1317/2008 of 24 July 2008* (BOE of 11 September 2008), approving the chart of accounts of insurance companies was published. Also enacted was *Royal Decree 1318/2008 of 24 July 2008* (BOE of 11 September 2008), amending the Regulation on the Ordering and Supervision of Private Insurance, approved by Royal Decree 2486/1998 of 20 November 1998<sup>8</sup> in order to bring it into line with the new above-mentioned chart of accounts and to include certain technical adjustments in the text to adapt to the characteristics of new insurance products.

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7. Under the previous regime (Circular 4/1994), it was also initially valued at acquisition price and subsequently, with the latest appraisal value, and gains and losses were taken to memorandum accounts, although the balance of these accounts was considered for calculating the institution's net asset value. 8. See "Regulación financiera: cuarto trimestre de 1998" in Boletín Económico, Banco de España, January 1999, pp. 90-93.

The purpose of the chart of accounts of insurance companies is to adapt the accounting framework of insurance companies to the International Financial Reporting Standards (IFRSs) applicable in the European Union,<sup>9</sup> and, consequently, it replaces the previous chart of accounts approved by Royal Decree 2014/1997 of 26 December 1997.

The chart of accounts consists of five parts: the conceptual accounting framework, the recognition and measurement rules, the annual accounts, the chart of accounts itself and the accounting definitions and relationships.

The first part (the conceptual accounting framework) includes the documents which comprise the annual accounts, defines the items which make them up and the requirements, principles and accounting criteria of recognition and measurement so that they give a true and fair view of the entity's equity, financial position and results.

The second part (recognition and measurement rules) sets out the accounting principles and details the recognition and measurement criteria of the various transactions, assets and liabilities of the insurance companies. It should be mentioned that the IFRSs on insurance contracts permits fees and acquisition costs to continue to be capitalised during a transitional period, although they do not comply with the definition of asset included in the conceptual framework, until an international accounting rule is issued and approved in this connection.

The third part, relating to the annual accounts, includes the rules on how they should be drawn up, the documents they must comprise and the requirements which must be observed in their preparation. Similarly, it includes the criteria for distributing revenue and expenses and the structure of the balance sheet, the income statement, the cash flow statement and the statement of changes in equity.

The fourth part (the chart of accounts itself) contains the groups, subgroups and accounts required, duly coded in decimal form and with a title stating their content.

The fifth part (accounting definitions and relationships) consists of the definitions of the various items which will be included in the balance sheet, income statement and statement of changes in equity and those of each of the accounts under those items in addition to the main factors giving rise to debits and credits.

The Royal Decree contains the transitional regime for the first-time application of the chart of accounts, which envisages: the information that must be included in the first year that it is applied, the possibility of entities valuing property at its fair value at the date of transition to the chart of accounts, the retrospective application of the criteria contained therein, with certain exceptions, and a series of specific features relating to business combinations.

Lastly, it includes an additional provision on the stabilisation reserve regime for the purpose of the distribution of interim dividends, which will be deemed a compulsory reserve established by Law.

The chart of accounts will come into force on 31 December 2008, without prejudice to the transition date chosen by each entity for the first-time application of the chart of accounts,

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<sup>9</sup> Included in Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and subsequently included in Spanish law through Law 16/2007 of 4 July 2007 on reform and adaptation of accounting-related corporate law for international harmonisation according to European Union law.

which will be the date of the opening balance sheet of the year in which the new regulations are applied, as established by the transitional regime of the Royal Decree.

AMENDMENT OF THE  
REGULATION ON THE ORDERING  
AND SUPERVISION OF PRIVATE  
INSURANCE

Certain specific technical amendments are introduced in the regulation, most of which are as a result of the application of the chart of accounts.

As for life insurance other than that in which the policyholder fully assumes the investment risk, the Ministry of the Economy and Finance is empowered to implement the system of provisions considered appropriate to reflect the risks arising from these operations.

The other amendments arise from the adaptation of its terminology to that of the chart of accounts and, especially, to the provisions of Law 16/2007 of 4 July 2007 on reform and adaptation of accounting-related corporate law for international harmonisation according to European Union law.

Thus, it is worth noting that, as regards uncommitted assets, its terminology and accounting treatment of certain items are adapted to the chart of accounts. Specifically, it should be noted that certain items are included in said assets, such as the property revaluation reserve arising from the first-time application of the chart of accounts, the goodwill reserve and adjustments due to changes in value which are part of equity.

Similarly, within the description of the grounds for the dissolution of insurance companies, the calculations referring to equity per books are adapted to the provisions of Law 16/2007 of 4 July 2007. Lastly, the references made to the market value of assets and liabilities will be understood as at their fair value and, those made to the acquisition cost of assets will be understood as at their initial book value in accordance with the new chart of accounts.

The Royal Decree will come into force on 31 December 2008.

**Structural reform  
measures and measures  
to boost the Spanish  
economy**

Royal Decree-Law 2/2008 of 21 April 2008<sup>10</sup> introduced a number of urgent measures to boost economic activity in order to combat the slowdown in the Spanish economy. In this connection, *Order Pre/2424/2008 of 14 August 2008* (BOE of 15 August 2008) has recently been published, which gives publicity to the Resolution of the Council of Ministers of 14 August 2008 on structural reform measures and measures to boost the financing of small and medium-sized businesses. This Resolution establishes a programme of actions in strategic sectors that involves all the economic ministries in order to accelerate its introduction, through a set of measures to be implemented in the short term (most of them before the end of the year).

First, to facilitate the financing of small and medium-sized businesses, the Ministry of Economy and Finance will present a proposal to grant government guarantees, for up to €3 billion in 2009 and 2010, of fixed-income securities issued by securitisation special purpose entities, whose assets are loans or credits granted to small or medium-sized businesses. Also, the Instituto de Crédito Oficial (ICO) will launch a line of credit to finance up to €2 billion of investment projects at medium-sized businesses in 2009 and 2010.

Second, in the housing and building market, the ICO will renew in 2009 and 2010, in the amount of €5 billion, the line of guarantees to securitisation special purpose entities whose underlying assets are loans to the public for the purchase of government-subsidised housing. For its part, the Ministry of Housing will design a new regulatory framework to boost the reno-

10. See "Financial regulation: 2008 Q2", *Economic Bulletin*, July 2008, Banco de España, pp. 155-156.

vation and refurbishment of buildings and dwellings. Together with the Ministry of Industry, Tourism and Trade, it will present a proposal for a building renovation plan to boost the refurbishment of housing and hotel infrastructure. Finally, in conjunction with the Ministry of Justice, it will sponsor a draft law of measures to promote the rental of housing and the energy efficiency of buildings. These will include studying the possibility of setting up a rapid, simple, and economic arbitration system for rental disputes.

In addition, a number of measures affecting other sectors are included, such as: actions to reduce costs, to improve competition in the provision of services and to strengthen the independence and supervisory capacity of the sector regulatory bodies; actions to boost and dynamise rail freight, and to improve competition and competitiveness conditions in the sector; actions aiming to foster energy efficiency and the use of renewable energy, and to boost the strategic lines of action to combat climate change; and finally, certain actions in the telecommunications and information society sector.

**European Central Bank:  
introduction and  
distribution of euro cash**

Guideline ECB/2006/9 of 14 July 2006 on certain preparations for the euro cash changeover and on frontloading and sub-frontloading<sup>11</sup> of euro banknotes and coins outside the euro area established the rules that enable the national central banks (NCBs) of future participating Member States to borrow euro banknotes and coins from the Eurosystem for the purpose of frontloading and sub-frontloading them prior to the cash changeover. It also established the obligations to be performed by eligible counterparties and professional third parties in order to be frontloaded and sub-frontloaded, respectively.

Following the introduction of the euro in Slovenia, Cyprus and Malta, the need to make various amendments aimed at improving the logistical aspects of the cash changeover in future participating Member States was identified, leading to publication of *Guideline ECB/2008/4 of the European Central Bank of 19 June 2008* (OJEU of 4 July 2008) amending Guideline ECB/2006/9.

Only credit institutions and national post offices that have an account with their future Eurosystem NCBs are currently entitled to sub-frontload. In future, national post offices and credit institutions may appoint cash in transit companies as agents acting on their behalf and at their risk for the purpose of storage and sub-frontloading of euro banknotes and coins to professional third parties.

In addition, to avoid the duplication of reporting obligations relating to the volume and denomination of frontloaded and sub-frontloaded euro banknotes and coins, the reporting procedure applicable to future Eurosystem NCBs and eligible counterparties is simplified.

At the same time, Eurosystem NCBs, which have until now been responsible for carrying out audits and inspections at the frontloaded and sub-frontloaded entity's premises, are allowed to entrust these tasks to other competent public authorities, in order to verify the presence of the sub-frontloaded euro banknotes and coins.

Finally, a simplified sub-frontloading procedure is established to be used when only small amounts of euro banknotes and coins are sub-frontloaded to certain types of retailer (i.e. firms with fewer than 10 employees and with an annual turnover and/or annual balance sheet total that does not exceed €2 million).

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<sup>11</sup> Frontloading means the physical delivery of euro banknotes and coins by a future Eurosystem NCB to eligible counterparties (i.e. credit institutions and national post offices) in the territory of a future participating Member State. Sub-frontloading means the delivery of frontloaded euro banknotes and coins by an eligible counterparty to professional third parties (i.e. certain commercial target groups, such as retailers, the cash-operated machine industry and cash in transit companies) in the territory of a future participating Member State.

***Amendment of the statistical reporting requirements of the European Central Bank in the field of quarterly financial accounts***

Guideline ECB/2002/7 of 21 November 2002 set out the statistical reporting requirements in the field of quarterly financial accounts that the NCBs had to provide to the European Central Bank. At the same time, the revised transmission programme under the European System of Accounts 1995 (ESA 95)<sup>12</sup> fostered the introduction of more effective statistical data coding standards.

*Guideline ECB/2008/6 of the European Central Bank of 26 August 2008* (OJEU of 27 September 2008) amending Guideline ECB/2002/7 has recently been published in order to align the coding standards established therein with those of the ESA 95 transmission programme. The harmonisation of the coding standards effected by this Guideline is a technical amendment that does not change the conceptual framework underlying the reporting requirements or affect the reporting burden.

The Guideline came into force on 1 October 2008.

6.10.2008.

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<sup>12</sup>. As laid down in Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community.