

Financial regulation: 2008 Q4

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Introduction

In 2008 Q4, numerous financial provisions were enacted. In the credit institutions area, accounting regulations were amended to adapt them to the changes in Spanish mercantile legislation and in international financial reporting standards (IFRSs). Further, the arrangements for payment of Banco de España profits into the Treasury were amended following the end of the transitional period in 2007.

In the field of government debt, the regulations governing market makers were updated to take into account new developments in the securities market. Also, the cooperation agreements regarding State debt investment funds were modified so as to make the investment criteria equal for all the Fondtesoro categories concerned.

The European Central Bank (ECB) promulgated four new legal provisions. First, the rules on eligibility of collateral were temporarily altered to improve the liquidity of credit institutions. Second, the criteria for exempting certain credit institutions from the obligation to hold minimum reserves were revised. Third, the reporting requirements in the field of government finance statistics were updated. And finally, certain quality criteria for the compilation of balance of payments statistics were established.

Some details entrusted to the Banco de España of the rules on the own funds of mutual guarantee companies, particularly in regard to credit and operational risk, were written into legal provisions.

In the securities markets, the accounting regulations governing investment firms, collective investment institution (CII) management companies and venture capital entity management companies were amended to adapt them to the Spanish general chart of accounts. Also, the formats which have to be followed in the announcements and applications for authorisation of takeover bids were approved.

Some changes were also made to the legislation governing collective investment institutions (CIIs). First, the rules for determining net asset value and for certain operational matters were updated. Second, the statistical asset and liability reporting requirements were broadened to encompass all EU CIIs, rather than just those of a monetary nature, as has been the case so far. Third, the format and content of the reports to be sent periodically to shareholders and unit-holders were approved. Lastly, the Spanish National Securities Market Commission (CNMV) has been empowered to issue rules on certain accounting matters relating to institutions of this type.

Private insurance legislation has been adapted to the new chart of accounts for insurance companies.

A number of urgent measures on economic, financial and fiscal matters designed to foster financing to households and firms and boost economic activity have been approved.

Finally, the new features (mainly of a monetary, financial and fiscal nature) in the State budget for 2009 are analysed.

**Credit institutions:
amendment of public and
confidential financial
reporting rules and
formats**

Banco de España Circular CBE 4/2004 of 22 December 2004¹ on public and confidential financial reporting rules and formats (hereafter, “the accounting circular”) amended the accounting regime of Spanish credit institutions to adapt it to the new accounting framework derived from the adoption of international financial reporting standards (IFRSs) by the European Union.

The recently released *Banco de España Circular CBE 6/2008 of 26 November 2008* (BOE of 10 December 2008) amends CBE 4/2004 to take account of the changes in Spanish and EU corporate legislation and in the IFRSs that affect accounting legislation,² basically in regard to the following: definition of a group of credit institutions; public financial statement formats; treatment of financial instruments (including guarantees), of pension commitments, of capital instrument-based payments and of income tax; and certain disclosures to be made in the notes to financial statements. Also introduced are minor modifications to take account of changes in the law regulating the determination and control of own funds, the reporting requirements of the European Central Bank, the mortgage market and the Spanish national classification of economic activities (*clasificación nacional de actividades económicas*).

The definition of a group of credit institutions, which was previously based on a decision-making unit existing among various entities, now hinges on an entity having control over one or more others. Thus an entity is deemed to control another if it has the power to govern its financial and operating policies so as to obtain economic benefits from its activities.³

Under the current accounting rules, the previous classification of groups of credit institutions⁴ no longer applies for the purpose of preparing public consolidated financial statements, having now been reduced to a single type of group formed by a parent and one or more subsidiaries.

In individual and consolidated annual accounts, the financial statement formats were adapted to reflect the changes in the Commercial Code, and, in addition, the statement of changes in equity was split into a statement of recognised income and expense and a statement of all changes in equity.

In regard to income tax and other related items, the references to the previous chart of accounts⁵ have been replaced by ones to the current chart of accounts approved by Royal Decree 1514/2007 of 16 November 2007.⁶

Other changes introduced by the new Circular include improvements in disclosures on capital management and on risk associated with financial instruments, as well as fuller treatment of the various types of credit derivatives and collateral or guarantees.

1. See “Financial Regulation: 2004 Q4”, *Economic Bulletin*, January 2005, Banco de España, pp. 127-131. 2. One of the purposes of these changes is to adapt the accounting circular to the EU legislation enacted since 2005 and to the new Spanish business and accounting framework resulting from amendments of the Commercial Code, the Public Limited Companies Law and the new general chart of accounts. 3. In particular, control shall be presumed to exist when an entity is in any of the following situations in relation to another entity: a) it holds the majority of the voting rights of the other entity; b) it has the power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the other entity; c) through agreements with other shareholders, it can exercise the majority of the voting rights of the other entity; and d) it has appointed with its votes the majority of the members of the board of directors or equivalent governing body of the other entity in office at the time the consolidated accounts have to be prepared and during the two immediately preceding accounting periods. 4. Previously, Circular CBE 4/2004 distinguished, for the purpose of public and confidential financial reporting, between subordination groups and coordination groups. This distinction currently applies only for the confidential returns of consolidable groups of credit institutions which serve as a basis for calculating own funds. 5. Approved by Royal Decree 1643/1990 of 20 December 1990. 6. See “Financial Regulation: 2007 Q4”, *Economic Bulletin*, January 2008, Banco de España, pp. 196-199.

Also, the general provisioning mechanism is changed to make it more flexible so that credit institutions can adapt the lower limit of this caption depending on their credit risk provisioning policy and on the characteristics of their credit portfolio.

Lastly, the information on mortgage lending activity that institutions must have in their accounting registers is systematised and a new confidential accounting return, to be submitted half-yearly and entitled "Information on the mortgage market", is introduced. Also, certain confidential accounting returns are modified to adjust them to the latest accounting developments and other new ones are added.⁷

The Circular came into force on 11 December 2008, except that the provisions for special accounting registers of mortgage activity came into force on 31 December 2008.

Amendment of the arrangements for payment of Banco de España profits into the Treasury

Royal Decree 2059/2008 of 12 December 2008 (BOE of 17 December 2008) on the arrangements for payment of Banco de España profits into the Treasury partially amended the arrangements established in the previous legislation,⁸ which was in force until 2007.

There are basically two new developments: first, for operational reasons, the date of the first payment of 70% of the profits accrued and recorded to 30 September of each year was changed. From now on, that payment will have to be made on the first working day of December, instead of the first working day of November.

Second, given that the transitional regime set in place by ECB legal provisions has ended,⁹ there is no longer any reason for limiting the period during which the arrangements will be in force. Hence, unlike in previous legislation, the arrangements are not limited as to the length of time they will be in force, as has been customary since 1999. This endows the payment arrangements with greater legal certainty and permanence.

Thus the percentages of and deadlines for payment into the Treasury of profits accrued and recorded by the Banco de España are as follows:

- a) On the first working day of December each year, 70% of the profits accrued and recorded to 30 September of such year. The payment resolution shall take into account profit forecasts to the end of the year.
- b) On the first working day of the following March, 90% of the profits accrued and recorded to 31 December of the previous year, having deducted the payment referred to above.

These payments shall be agreed by the Governing Council of the Banco de España after approval of the relevant income statements, taking into account the possible obligations of the Banco de España to the ESBC.

7. The new individual and consolidated confidential returns added are: "T.15/C.13 Financial asset transfers", "T.16/C.14 Fair value of financial instruments", "S.4/C.15 Financial assets. Transfers between portfolios" and "S.5/C.16 Fair value hierarchy. Transfers of level in the period". 8. Royal Decree 1198/2005 of 10 October 2005 established arrangements for payment of Banco de España profits into the Treasury which were in force from 2005 to 2007. See "Financial Regulation: 2005 Q4", *Economic Bulletin*, January 2006, Banco de España, pp. 109 and 110. 9. The Statute of the European System of Central Banks and of the ECB laid down the basic principles governing the system of allocation of monetary income earned by the national central banks. These principles have been successively adjusted by a series of decisions of the ECB Governing Council, the latest of which on 6 December 2001 established a transitional allocation period which lasted until 2007.

- c) Finally, when the annual accounts and proposed distribution of profits formulated by the Banco de España have been approved by the Council of Ministers, the Banco de España shall pay to the Treasury the rest of the profit for the year, except that part whose exclusion has been authorised by the Council of Ministers.¹⁰

The Royal Decree came into force on 18 December 2008.

New regulation of State debt market makers

Treasury Resolution of 18 November 2008 (BOE of 21 November 2008) adapts the operating conditions of market makers to the new legal framework and repeals the Treasury Resolution of 20 July 2005.¹¹ Its purpose is to adapt the regime governing market makers to Law 24/1988 of 28 July 1988¹² on the securities market, amended by Law 47/2007 of 19 December 2007,¹³ specifically in regard to multilateral trading facilities (MTFs),¹⁴ systematic internalisers and official secondary markets.

The main changes are briefly described below.

The eligibility requirements for market makers are updated. In addition to holding a securities account in their own name in the public debt book-entry market and meeting the technical and human resources requirements that may be established, they must meet certain financial and legal conditions that are necessary to be considered a member with full powers of at least one of the regulated markets or MTFs determined by the Treasury. Such eligibility shall be assessed by the Treasury on the following basis: a) the regulated markets or MTFs must be recognised as such by at least one EU country and b) a sufficient number of market makers must undertake to quote and trade State debt securities in these regulated markets or MTFs, so as to promote the liquidity of the debt.

For their part, regulated markets or MTFs have to provide the Treasury with any information needed to assess market makers. Otherwise, the Treasury may declare that such markets or facilities are unsuitable settings for market makers to fulfil their commitment to provide liquidity to State debt.

The rights and obligations of State bond market makers are similar to those stipulated in the previous Resolution, albeit with certain differences when it comes to the activity of regulated markets or MTFs. One change, regarding the obligation to ensure secondary market liquidity, is that minimum volumes and maximum bid-ask spreads are no longer expressly mentioned, and it is left to the Treasury, upon consultation with market makers, to set them as and when necessary to adapt them to prevailing market conditions.

Also, similar changes were made to the rights and obligations of Treasury bill market makers. Thus minimum volumes and maximum bid-ask spreads are no longer expressly mentioned, and the Treasury, upon consultation with market makers, will define the bills considered to be market benchmarks and will establish the maximum spreads and minimum trading volumes.

10. The Royal Decree empowers the Council of Ministers to authorise, at the proposal of the Banco de España, the exclusion of certain profits from payment into the Treasury. **11.** See "Financial Regulation: 2005 Q3", *Economic Bulletin*, October 2005, Banco de España, pp. 119-122. **12.** See "Regulación financiera: tercer trimestre de 1988", *Boletín Económico*, October 1988, Banco de España, pp. 61 and 62. **13.** See "Financial Regulation: 2007 Q4", *Economic Bulletin*, January 2008, Banco de España, pp. 182-189. **14.** MTFs were first regulated in Law 47/2007. They are defined as systems operated by an investment firm or by an operator of an official secondary market 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.

Lastly, the assessment of market makers and the grounds for loss of market-maker status remain much the same as before.

The Resolution will come into force on 1 February 2009.

Updating of legislation on cooperation agreements relating to State debt investment funds

Ministerial Order EHA/2688/2006 of 28 July 2006 on cooperation agreements relating to State debt investment funds established certain requirements to be met by the investment funds set up under the agreements that may be entered into by the Ministry of Economy and Finance through the Treasury and the collective investment institution (CII) management companies to foster the optimum placement of State debt. These included, for all the Fondtesoro categories referred to in the Ministerial Order, the requirement that 70% of the assets of the fund or, where applicable, the sub-fund must be invested in State debt in any of its forms, including, for the purpose of this Ministerial Order, bonds issued by FTPymes backed by State guarantee up to a limit of 20% of the assets of the fund or, where applicable, sub-fund.

The Instituto de Crédito Oficial (ICO) recently decided to foster the financing of government-subsidised housing through the grant of guarantees to securitisation special purpose entities (SSPEs) known as government-subsidised housing SSPEs (hereafter "FTVPO" by their Spanish abbreviation) whose underlying assets are mortgage loans at least 80% of which are to individuals for the purchase of government-subsidised housing and the rest has to be mortgage loans to individuals for the purchase of open-market housing.¹⁵

Given that the nature and credit quality of the asset-backed securities issued by FTVPO and by the FTPymes eligible to receive guarantees from the ICO and from the State, respectively, are similar, *Ministerial Order EHA/3465/2008 of 26 November 2008* (BOE of 3 December 2008) amended Ministerial Order EHA/2688/2006 of 28 July 2006 to put the two of them on an equal footing for the purpose of definition of the investment criteria of all the Fondtesoro categories concerned. This broadens the operational scope of the fund management companies and makes these products more readily available to investors, without detracting from their safety.

The agreements entered into by the Treasury and CII management companies prior to the entry into force of the Ministerial Order on 4 December 2008 have to be adapted to the new legal provisions by 31 March 2009. Otherwise, the Treasury will terminate the agreements in a written notification with immediate effect.

Subsequently the management companies must update the content of the prospectuses issued by the Fondtesoros under their management in the three months following signature of the agreement. In addition, they have to communicate this to the unit-holders in the investment fund's next regular report.

European Central Bank: temporary changes to the rules relating to eligibility of collateral

Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem established, inter alia, the eligibility criteria for collateral provided by a counterparty to obtain liquidity from the Eurosystem.

¹⁵ The ICO-FTVPO line of guarantees has been assigned €3 billion of funding. This initiative is managed by Spanish credit institutions and by the branches in Spain of foreign credit institutions. They have given an undertaking that all funds obtained through the sale of the guaranteed tranche in the financing of new government-subsidised housing, will be re-invested by them in the extension of new loans to individuals and to developers and construction companies. The securitisation SPEs holding government-subsidised housing loans (ICO-FTVPO) set up with backing from this line of guarantees must be closed-end funds and the guaranteed triple A tranche must amount to at least €100 million. Also, the guaranteed bonds must be traded on the organised secondary market. FTVPO must be set up entirely by the entities to which the ICO guarantee has previously been granted, which they must contribute to the securitisation SPE. The time period for setting them up will end on 30 June 2009.

In view of the international financial strain and to enhance on a temporary basis the provision of liquidity to counterparties in Eurosystem monetary policy operations, *Guideline ECB/2008/18 of the European Central Bank of 21 November 2008* (OJ of 25 November 2008) on temporary changes to the rules relating to eligibility of collateral¹⁶ was adopted.

Accordingly, in the period from 1 December 2008 to 31 December 2009, the following assets will also be accepted as collateral in Eurosystem monetary policy operations:

- a) Marketable debt instruments if denominated in US dollars, pounds sterling or Japanese yen, provided that they are issued and held/settled in the euro area and the issuer is established in the European Economic Area. An additional haircut of 8% shall be imposed by the Eurosystem on all such marketable debt instruments.
- b) Syndicated loans if they fulfil certain conditions established in Guideline ECB/2000/7.
- c) Debt instruments issued by credit institutions, which are traded on certain non-regulated markets as specified by the ECB, shall constitute eligible collateral for the purposes of Eurosystem monetary policy operations. An additional haircut of 5% shall be imposed by the Eurosystem on all such marketable debt instruments.
- d) Subordinated assets with acceptable guarantees will be accepted as collateral in Eurosystem monetary policy operations provided that a financially sound guarantor provides an unconditional and irrevocable guarantee payable on first demand on these assets. An additional haircut of 10% shall be imposed by the Eurosystem on all such assets, with a further 5% valuation markdown in the event of a theoretical valuation.
- e) Fixed-term remunerated deposits from eligible counterparties in the national central bank of the Member State in which the counterparty is established.

Also, the Eurosystem's new minimum requirement for the assessment of the credit standard of assets eligible as collateral shall be a "BBB-" equivalent credit assessment by a specialised credit rating agency. This change to the credit assessment requirement shall apply to both marketable and non-marketable assets, with the exception of asset-backed securities, for which the requirement for high credit standards (above "A-") shall remain unchanged. An additional haircut of 5% shall be imposed by the Eurosystem on all eligible assets with a credit assessment below "A-".

The Guideline came into force on 25 November 2008.

**European Central Bank:
amendment of rules on
minimum reserves**

Regulation 1052/2008 of the ECB of 22 October 2008 (OJ of 25 October 2008), amending Regulation 1745/2003 of the ECB of 12 September 2003, on the application of minimum reserves was adopted in order to revise the criteria for granting exemptions from reserve requirements and refine the definition of the components of the reserve base, among other things.

¹⁶. See Guideline ECB/2000/7 of 31 August 2000 (OJ of 11 December 2000) on monetary policy instruments and procedures of the Eurosystem, which established, inter alia, the eligibility criteria for collateral provided by a counterparty to obtain liquidity from the Eurosystem.

First, a new exemption criterion is added for those institutions subject to the freezing of funds and/or other measures imposed by the Community or a Member State restricting the use of their funds or a decision of the ECB's Governing Council suspending or excluding their access to open market operations or the Eurosystem's standing facilities.

Second, the definition of the components of the reserve base in respect of which minimum reserves are calculated is reworded. Also modified are the provisions on granting an exemption from the requirements of separate reporting for institutions holding minimum reserves through an intermediary.

Lastly, general criteria governing transitional maintenance periods are established for institutions which become subject to the ECB's reserve requirements on account of the adoption of the euro by the Member State in which they are located. The new provisions specify, inter alia, the dates of the transitional maintenance period, the manner of calculation of the reserve base and the time limit by which the calculation and verification of the minimum reserves is to be carried out by these institutions and their national central bank.

The Regulation came into force on 26 October 2008.

**European Central Bank:
amendment of statistical
reporting requirements in
the field of government
finance statistics**

Guideline ECB/2008/7 of The European Central Bank of 5 September 2008 (OJ of 17 October 2008), amending Guideline ECB/2005/5 of 17 February 2005, on the statistical reporting requirements of the ECB and the procedures for exchanging statistical information within the ESCB in the field of government finance statistics was adopted for the purpose of eliminating certain information on government debt held by non-residents of a Member State.¹⁷ This information is no longer needed as a result of the implementation in March 2008 of security-by-security data collection systems combined with the use of the Centralised Securities Database (CSDB).¹⁸ These systems provide information on the total euro area government debt held by non-euro area residents as part of the euro area international investment position. Moreover, their future development should in due time allow additional details to be compiled on the holdings of government securities by country and institutional sector.

The Guideline came into force on 1 October 2008.

**European Central Bank:
quality criteria for balance
of payments statistics**

Regulation 184/2005 of the European Parliament and of the Council of 12 January 2005 on Community statistics concerning balance of payments, international trade in services and foreign direct investment established a common framework for the systematic production of Community statistics in these fields. Among other things, it stipulated that Member States shall take all reasonable measures they consider necessary to ensure the quality of the data transmitted.

Recently, *Commission Regulation 1055/2008 of 27 October 2008* implementing Regulation 184/2005 as regards quality criteria and quality reporting for balance of payments statistics was adopted. Under the new Regulation, Member States shall send annually a quality report to the European Commission by 30 November of each year. This report shall be drawn up in accordance with the rules laid down in the Annex to the Regulation and subject to the follow-

¹⁷ Guideline ECB/2005/5 required data to be collected on the government debt held by non-residents of a Member State, broken down into debt held by non-residents within and outside the euro area. ¹⁸ Recommendation of the European Central Bank of 16 July 2004 on the statistical reporting requirements of the European Central Bank in the field of balance of payments and international investment position statistics, amended by the Recommendation of the European Central Bank of 31 May 2007.

ing quality criteria: timeliness and coverage of data, methodological soundness, stability, plausibility, consistency and accuracy.

The Regulation came into force on 17 November 2008.

**Mutual guarantee
companies: minimum own
funds and other obligatory
reporting**

Royal Decree 2345/1996 of 8 November 1996¹⁹ on the administrative authorisation rules and solvency requirements for mutual guarantee companies (MGCs), amended by Royal Decree 216/2008 of 15 February 2008²⁰ on the own funds of financial institutions, laid down, inter alia, the basic criteria on which MGCs' minimum capital requirements have to be based. However, the specific definition of these requirements, in particular those applying to the coverage of credit and operational risk deriving from non-habitual commitments or investments, was entrusted to the Banco de España.

For this purpose, *Banco de España Circular CBE 5/2008 of 31 October 2008* (BOE of 21 November 2008) on minimum own funds and other obligatory reporting of MGCs, which implements the aforementioned Royal Decree and repeals the previous legal provisions of the same rank still in force,²¹ was issued.

The Circular adopts a model of capital requirements for credit risk which is equivalent to those set for credit institutions in CBE 3/2008 of 22 May 2008, although, given the lesser complexity of MGCs, it is appreciably simpler. Moreover, it is acknowledged that, under certain conditions, reguarantees reduce credit risk and therefore help to reduce capital requirements for commitments to government agencies or corporations. The Banco de España will specify the extent of the reduction after individual analysis of the general reguarantee contracts.

MGCs must at all times hold regulatory capital²² amounting to not less than the sum of the following requirements:

- a) For credit risk on ordinary activities: 8% of the outstanding risk exposures of credit guarantees²³ and 4% of that of other commitments, guarantees or indemnities granted, without prejudice to possible reduction of the requirements if the transactions are reguaranteed.
- b) For operational risk on ordinary activities: 15% of their annual net interest income.
- c) That needed to cover credit or operational risk derived from commitments or investments not habitual in MGC's activities; for this purpose, the MGC shall apply the criteria set for credit institutions, albeit with certain differences.

Further, MGCs must establish internal procedures, proportionate to the nature, scale and complexity of their activities, to control and manage the risks in their activity, ensuring that the risks assumed, the nature of the transactions arranged and the sectoral or other type of

19. See "Regulación financiera: cuarto trimestre de 1996", *Boletín Económico*, January 1997, Banco de España, pp. 109 and 110. 20. See "Financial Regulation: 2008 Q1", *Economic Bulletin*, April 2008, Banco de España, pp. 159-163. 21. CBE 10/1998 of 27 November 1998 on minimum own funds reporting and other obligatory reporting of MGCs. 22. Regulatory capital consists of: subscribed, paid-up capital; effective, express reserves; reserves for the regularisation, update or revaluation of assets following verification by the Banco de España; and any technical provisions not used to cover specific credit risk exposures, at book value. From these, the following shall be deducted: negative results of prior periods and of the current period, intangible assets included in net worth, and other exposures and assets that the company may decide to deduct. 23. Those having the nature of financial guarantee contracts and those in which the MGCs indirectly assume a credit risk equivalent to that of the financial guarantees.

concentration will not detract from the adequate coverage of their risks. If the Banco de España perceives significant deficiencies, it may, after consulting the interested party, require a remediation plan to be set in place and, until that plan has been effectively implemented, require additional capital to be held, up to a maximum of 25% of the minimum capital requirement.

MGCs are obliged to notify to the Banco de España, as soon as they are incurred, gross losses under operational risk exceeding either €100,000 or, if less than this amount, 1% of own funds, and identify, inter alia, the type of event in question. They must keep an internal historical register of the events which have given rise to losses above these limits and of any other significant factors allowing the amount and seriousness of those events to be assessed. MGCs shall keep this register, along with the supporting documentation of the entries made in it, at the disposal of the Banco de España.

MGCs shall continue to comply with the limits on large exposures,²⁴ the limit on property, plant and equipment and on shares and other equity²⁵ and the limits on investment of own funds.²⁶

Lastly, MGCs must submit quarterly to the Banco de España the returns included in the annex to the Circular and they continue to be obliged to send their current articles of association to the Banco de España for registration.

The Circular came into force on 22 November 2008 and applies to returns relating to 31 December 2008.

Amendment of accounting rules for investment companies, management companies of collective investment institutions and management companies of venture capital entities

CNMV Circular CBE 7/2008 of 26 November 2008 (BOE of 29 December 2008) on accounting rules, annual accounts and confidential returns of investment firms, management companies of collective investment institutions and management companies of venture capital entities was issued in order to adapt their accounting regime to the new accounting framework established in the general chart of accounts approved by Royal Decree 1514/2007 of 16 November 2007, the previous legal framework being repealed.²⁷

The Circular establishes accounting rules and criteria which, although set in the framework of the principles and broad lines of the new general chart of accounts, adapt the latter to the specific characteristics of these entities.²⁸ In certain matters, material has been drawn from international financial reporting standards and from CBE 4/2004 of 22 December 2004, recently amended by CBE 6/2008 of 26 November 2008.²⁹

24. The value of the total exposures of an MGC to any one person or economic group may not exceed 20% of its own funds. **25.** The sum of the two may not exceed 25% of regulatory capital. **26.** At least 75% of regulatory capital shall be invested in government debt securities issued by the State or regional (autonomous) governments, in fixed-income securities quoted on organised secondary markets or in deposits with credit institutions. **27.** The Circular repeals the following CNMV circulars: Circular 5/1990 of 28 November 1990 on accounting rules of securities dealers and brokers; Circular 1/1993 of 3 March 1993 on consolidation accounting rules applicable to groups and sub-groups of securities dealers and brokers; Circular 5/1992 of 28 October 1992 on CII management companies and portfolio management companies; Circular 6/1990 of 28 November 1990 on solvency ratios and liquidity of securities dealers and brokers; Circular 1/1995 of 14 June 1995 on accounting rules and additional recording and reporting obligations for trading losses of certain securities brokers; and all provisions relating to venture capital management companies. **28.** In this respect, the basic pivot of the process of adaptation is the priority consideration of the specificity of these entities. The existence of special accounting rules for the financial sector is recognised in the introduction to the new general chart of accounts, in Law 24/1988 of 28 July 1988 on the securities market, in Law 35/2003 of 4 November 2003 on CIIs and in Law 25/2005 of 24 November 2005 on venture capital management companies, which provide for powers to approve special accounting rules for investment firms, CII management companies and venture capital management companies, developed as implementing provisions of general accounting legislation. **29.** See the second heading of this article.

One of the new developments in the Circular is the formulation of more exhaustive and comprehensive definitions, especially in regard to the accounting treatment of financial instruments. In particular, the definition of fair value³⁰ is extended to financial instruments which have no active market, in order to include the treatment of certain financial assets which are illiquid and have a very wide range of bid-ask spread quotations .

Specifically, fair value is used when it facilitates proper risk management by entities and its application is limited when a deep market is lacking and the estimate of fair value is not sufficiently reliable. Also, various considerations concerning fair value are set forth which depend on whether or not the assets are of a financial nature. Further, the definitions of other concepts such as effective interest rate³¹ and asset impairment are extended.

The Circular establishes strict conditions for the reclassification of assets among the various categories of instruments defined. Exhaustive definitions are given of the factors that determine whether a financial asset is classified as held-to-maturity,³² such as *intention* and *financial ability*. Also, the Circular incorporates the EU doctrine whereby, in exceptional circumstances, a non-derivative financial asset may be reclassified out of the trading book, provided that certain requirements are met and due disclosure is made in the notes to financial statements.

Highly rigorous criteria are established for the derecognition of financial assets, which generally arises when the financial claims associated with carried by the asset have been transferred or have expired. Hedge accounting is treated exhaustively and it is specified that, except in hedges of foreign currency risk, only derivatives can be used as hedging instruments. Also, certain criteria are set to determine when the gains derived from equity adjustments due to valuation of available-for-sale financial assets can be considered to be own funds.

Another new development regarding the general chart of accounts is the possibility of using methods based on default schedules when calculating losses in value due to financial asset impairment, provided that the amount of the impairment so calculated is consistent with the requirements set out in the Circular.

Also noteworthy is the reference to investments in group entities, jointly controlled entities and associates, which the Circular, in line with international accounting standards, does not consider to be financial instruments and to which it applies the rules for business combinations and consolidation in any valuations after the acquisition date.

In regard to intangible assets, the capitalisation of software developed in-house is only permitted when, in addition to compliance with certain requirements, the development phase has been reached and, therefore, the expenses incurred in the research phase are recognised directly in the income statement.

30. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction, without any deduction for transaction costs that may be incurred. Fair value is not, therefore, that resulting from a forced transaction, involuntary liquidation or distress sale. **31.** The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses. **32.** Held-to-maturity investments consist of debt securities with fixed maturity and fixed or determinable cash flows, which are quoted on an active market for which the entity has, from inception and at any subsequent date, both the positive intention and the demonstrated financial ability to hold to maturity.

The Circular regulates precisely the conditions for classifying certain instruments as non-current assets held for sale, since discontinuing their depreciation or amortisation has consequences for the determination of the own funds of supervised entities.

Property, plant and equipment is recorded at carrying amount or book value, following the provisions in the general chart of accounts. However, exceptionally, for the first-time application of the Circular, it has been envisaged that unrestricted tangible assets may be measured at fair value, recording any change in reserves.

Another notable feature of the Circular is the inclusion of a specific rule on revenue from the provision of services and, where applicable, on interest expenses and trading losses, which includes the criteria for taking them to the income statement. The fees and commissions collected or paid are recognised as income when the service is rendered or the cost incurred, while fees and commissions constituting additional remuneration to the interest rate on the transaction are apportioned over the life of the transaction.

In addition, the Circular sets out the obligation to submit individual and consolidated confidential information to the CNMV and stipulates the frequency and submission deadlines. It includes specific confidential returns for investment firms, which differ from those to be submitted by CII management companies and venture capital management companies on the basis of their operations. Financial advice firms are exempted from submitting the confidential returns required of investment firms and instead have to submit a confidential return on activity.

Lastly, the notes to financial statements and the management report have to include a description of the financial risks assumed and of the policies for managing and hedging them.

The Circular came into force on 31 December 2008.

**Takeover bids:
announcement and
application for
authorisation**

CNMV Circular 8/2008 of 10 December 2008 (BOE of 29 December 2008) approved the formats to be observed by announcements and applications for authorisation of takeover bids.³³

Both the application for authorisation and the announcement of a takeover bid must observe the formats specified in the Circular. The content of the announcement must be true, clear, complete and, when so required by the nature of the information, quantified, such that it does not confuse or mislead the reader, and shall be drafted so that it can be readily analysed and understood. Both shall include any other additional information which, in the judgement of the offeror, may be needed.

The application for authorisation must be accompanied by a prospectus containing the information that the people to whom the takeover bid is directed need to form a reasoned judgement on it, and by the documentation evidencing the resolution or decision to launch the takeover bid.

Lastly, the Circular deals with the cases in which the announcement and the application for authorisation of the takeover bid take place simultaneously or successively, and clarifies the particular features of each.

³³. In application of the powers granted by Royal Decree 1066/2007 of 27 July 2007 on the regime governing takeover bids. See "Financial Regulation: 2007 Q3", *Economic Bulletin*, October 2008, Banco de España, pp. 145-149.

Collective investment institutions: determination of net asset value and operational matters

CNMV Circular 6/2008 of 26 November 2008 (BOE of 2 December 2008) on the determination of net asset value and operational aspects of CILs, which simultaneously repeals the legal provisions of the same rank³⁴ and updates their content pursuant to the powers granted under current law.³⁵

The content of the Circular is as follows. First, it sets out the provisions for calculating the assets and liabilities and the net assets of CILs, in particular those of CILs with classes of units or series of shares hitherto unregulated.

Second, it contains the general criteria governing the systems by which unit-holders are individually charged the performance-based management fee, in those cases in which the management company has established this fee in the fund under management, subject always to the limits set in the CIL internal rules.

Third, the Circular details precisely the calculation of CIL operating ratios of a financial nature, including both risk diversification ratios and the ratio of obligations to third parties. In both cases, provision is made for the existence of sub-funds, in which case the ratios will be measured at sub-fund level.

Fourth, the provisions necessary to develop and control compliance with real estate CIL operating ratios and limits are set in place. The concept of real estate assets and the additional rules for the distribution of real estate assets in the appraisal schedule referred to in the CIL internal rules are set forth.

Lastly, for CILs which replicate or reproduce an index, a maximum deviation or tracking error with respect to the index is set, while for CILs whose investment policy takes a certain index as a benchmark, a maximum deviation with respect to that index is required which must be measured using a correlation coefficient.

The Circular came into force on 31 December 2008.

Collective investment institutions: statistical information on assets and liabilities

Regulation 958/2007 of the European Central Bank of 27 July 2007 concerning statistics on the assets and liabilities of investment funds broadened the statistical information required of CILs not classed as monetary financial institutions (MFIs) in order to provide the ECB with a comprehensive statistical picture of the CIL sector in the participating Member States, although it established certain exemptions for smaller CILs.

These requirements are incorporated into Spanish legislation by *CNMV Circular 5/2008 of 5 November 2008* (BOE of 19 November 2008) on requirements concerning statistical information on assets and liabilities of European Union CILs, the scope of application of which covers all CILs and, where applicable, all CIL sub-funds, rather than just

³⁴. CNMV Circular 8/1990 of 27 November 1990 on determination of the net asset value of securities funds and CIL operating ratios and investment limits, and Section 4 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. ³⁵. See the implementing regulations of Law 35/2003 of 4 November 2003 on CILs approved by Royal Decree 1309/2005 of 4 November 2005, which empowered the CNMV to approve specific rules for calculating the net asset value of CILs. Also, they empowered the Minister of the Economy and Finance and, with the latter's express authorisation, the CNMV to formulate precise rules on the composition of CILs' assets and liabilities. This empowerment was set forth in Ministerial Order EHA/35/2008 of 14 January 2008, for securities CILs, and in the Order of the Ministry of Economy and Finance of 24 September 1993, amended by Ministerial Order EHA/3064/2008 of 28 October 2008, for real estate CILs.

those whose investment policy or vocation is monetary, as has previously been the case.³⁶

The Circular details the confidential returns which these institutions have to send to the CNMV, the formats of which are included in the annex to the Circular. It should be noted that the Circular distinguishes the information to be sent by CII or sub-funds exempted for size reasons, the authorisation of which is the responsibility of the Banco de España at the proposal of the CNMV.

Confidential returns shall be submitted by the CIFRADO/CNMV or by a similar system which may be set up in the future, in accordance with the technical requirements established by the CNMV.

The Circular came into force on 9 December 2008 and the first information to be submitted shall be that relating to the operations of December 2008 and balances as at 31 December 2008.

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

Collective Investment Institutions (CIIs) Law 35/2003 of 4 November 2003,³⁷ implemented by Royal Decree 1309/2005 of 4 November 2005,³⁸ laid down the reporting documents to be prepared by management companies of CIIs or, if appropriate, by investment firms, in relation to each CII that they administer. Further, it empowers the CNMV to approve standard formats of these documents.

Making use of this prerogative, CNMV *Circular 4/2008 of 11 September 2008* (BOE of 7 October 2005), was published on the content of quarterly, half-yearly and annual reports of CIIs, and of the statement of position. Similarly, in view of the dispersion of regulations relating to these reports, the choice was made to bring together all references to them under this Circular, with the necessary adaptations. The existing provisions of the same rank were repealed.³⁹

The Circular shortens the full quarterly report hitherto prescribed, and distinguishes it from the simplified report, because the full report will include the details of the investment portfolio, while the simplified report will offer this information at the level of subtotals or totals. Similarly, the Circular stipulates that the half-yearly report which must be provided prior to subscription will be the simplified report for the first half of the year or the first part of the annual report, as appropriate.

The structure of the annual report comprises two parts: the first part is the half-yearly report for the second half of the year and the second part contains the annual accounts, management report and audit report.

The reports must include, among other things, the total expenses of the CIIs stated as a percentage of their average assets, significant events regarding the institution which occurred

³⁶. Up until now, on instructions also from the ECB, CNMV Circular 2/1998 of 27 July 1998, amended by CNMV Circular 1/2002 of 16 September 2002 and by CNMV Circular 1/2007 of 11 July 2007, set forth statistical reporting requirements for CIIs classed as MFIs, i.e. those whose investment policy or vocation is monetary, which are those with an average portfolio duration of less than one year and assets meeting certain conditions. This information could be used by the ECB to monitor monetary policy in the EU. ³⁷. See "Financial regulation: 2003 Q4", in *Economic Bulletin*, January 2004, Banco de España, pp. 84-87. ³⁸. See "Financial regulation: 2005 Q4" in *Economic Bulletin*, Banco de España, January 2006, pp. 112-116. ³⁹. The Circular repeals CNMV Circular 1/1991 of 23 January 1991 on the content of quarterly reports of CIIs to their shareholders and unit-holders, and several paragraphs of CNMV Circulars 4/1993 of 29 December 1993, 4/1994 of 14 December 1994 and 3/1997 of 29 July 1997.

during the reporting period and transactions with related parties.⁴⁰ Furthermore, the CII or, where appropriate, sub-funds whose investment policy consists of investing more than 10% of their assets in other CII will also calculate an indirect expenses ratio⁴¹ and, should it be impossible to calculate this ratio, they will estimate it.

Also regulated by the Circular are: the means of evidencing fulfilment of the obligation to deliver periodic reports prior to the subscription of units or shares of CII; the way to accredit the express waiver (which will be revocable) by the unit-holder or shareholder of receipt of these reports (such waiver can only be made in a separate document once the first periodic information has been received); and the request to receive quarterly reports and, if appropriate, the sending thereof electronically.

Furthermore, the CNMV may require the inclusion in the above-mentioned documents of any general or specific information and warnings which it considers appropriate for investor protection and market transparency.

Also, the obligation is included for CII management companies and investment companies to send to the CNMV the quarterly and half-yearly reports and the first part of the annual report via the CIFRADO/CNMV system, approved by the CNMV board of directors on 15 September 2006, or by any other similar means. The second part of the annual report and the audit report will be submitted to the CNMV within the first four months of each year.

Lastly, the content of the new statements of position has been changed. These must be sent by the CII management company, or the CII custodian, when the latter is the marketer, to the address indicated by the unit-holders and shareholders, although this may also be done by any other electronic means. The content of these statements is detailed in the Annex to the Circular.

The Circular will come into force on 31 March 2009.

Collective investment institutions: update of the CNMV's powers

Order EHA/3064/2008 of 28 October 2008 (BOE of 30 October 2008) amended the Order of the Ministry of Economic Affairs and Finance of 26 July 1989 implementing Article 86 of the Securities Market Law, and the Order of the Ministry of Economic Affairs and Finance of 24 September 1993⁴² on real estate investment funds and companies, in order to update the CNMV's powers.

The purpose of the amendment to the Order of 26 July 1989 is to adapt these powers as a result of the change in the CNMV's area of action, as established by Law 47/2007 of 19 December 2007, which substantially amended Securities Market Law 24/1988 of 28 July 1988.

The amendment of the Order of 24 September 1993 extends the CNMV's powers to specify certain accounting matters relating to this type of institutions, in particular the value of real

⁴⁰. Transactions with related parties include, inter alia, transactions involving the acquisition or sale of securities or financial instruments in which the custodian acts as seller or buyer, respectively; the acquisition of securities or financial instruments issued or guaranteed by a group entity; the acquisition of securities or financial instruments, the counterparty of which is a group entity of the management company, custodian or open-end investment company; and the amounts received by group entities of the management company arising from commissions or expenses paid by the CII they manage. ⁴¹. This ratio will be calculated on the basis of the ratio of total expenses of the CII in which the investment is being made, weighted by the percentage of assets invested in each of these CII and including the subscription and redemption fees arising from said investment which have been borne by the CII making the investment. ⁴². See «Regulación financiera: tercer trimestre de 1993», *Boletín Económico*, October 1993, Banco de España, pp. 77-79.

estate, of other assets and the items which must be used to calculate the established ratios and limits, especially the conditions to be met by the limits on obligations to third parties.

Lastly, in addition to laying down the specific accounting rules of real estate CIIIs, the CNMV may determine the items in the accounting statements which will count for calculating net assets and establish the specific features required if there are sub-funds, classes of units or series of shares.

Amendment of the regulations for insurance companies

Order EHA/3598/2008 of 18 November 2008 (BOE of 12 December 2008) was published, amending *Order EHA/339/2007 of 16 February 2007*, which implements certain precepts of the regulations for private insurance in order to adapt them to the new chart of accounts of insurance companies, approved by Royal Decree 1317/2008 of 24 July 2008,⁴³ and to include amendments to the Regulation on the Ordering and Supervision of Private Insurance approved by Royal Decree 2486/1998 of 20 November 1998, which were introduced by Royal Decree 1318/2008 of 24 July 2008.⁴⁴

As for the new chart of accounts, the suitability of the investments assigned to certain insurance transactions is updated on the basis of the relationship between the present value of investments and the obligations arising from insurance contracts, and the treatment of the risks associated with transactions is revised. The Directorate General of Insurance and Pension Funds is empowered to establish the operational aspects and the disclosure obligations for transactions of this type.

The Order came into force on 31 December 2008.

Urgent economic, financial and fiscal measures

The euro area countries have adopted a set of exceptional measures to counter the effects of the international financial crisis. Specifically, the EU Council of Economic and Finance Ministers (the ECOFIN Council), at its meeting of 7 October 2008, undertook to take all such actions as may be necessary to preserve the stability of the financial system, and agreed general principles for coordinated action by the Member States, according to which intervention should be opportune and temporary, taxpayers' interests should be protected and the rules of the European internal market respected. Subsequently, the Heads of State and Government of the euro area decided, at their meeting of 12 October 2008, in line with the ECOFIN Council's conclusions, to take coordinated action to ensure that liquidity conditions are appropriate for the functioning of financial institutions. For this purpose, it has been agreed that governments should provide for a limited period of time (until 31 December 2009), on market conditions, bank guarantees, insurance and similar instruments to secure new issues of medium-term bank debt. They also agreed to guarantee the liquidity of financial institutions, to facilitate medium-term financing of the financial system and, if necessary, to strengthen its capital structure.

Against this background, Spain has implemented a number of measures to stimulate lending to households and firms by credit institutions and to enhance the protection of depositors and investors. These measures may be grouped into the following lines of action.

FUND FOR THE ACQUISITION OF FINANCIAL ASSETS

Royal Decree Law 6/2008 of 10 October 2008 (BOE of 14 October 2008) creates the Fund for the Acquisition of Financial Assets (FAAF), in order to support the supply of credit to households and firms through the acquisition of financial assets. This Royal Decree Law has been

⁴³. See "Financial Regulation: 2008 Q3", *Economic Bulletin*, October 2008, Banco de España, pp. 137 - 139. ⁴⁴. See footnote above.

implemented and developed by *Order EHA/3118/2008 of 31 October 2008* (BOE of 3 November 2008) and the *Resolution of 31 October 2008* of the Directorate General of the Treasury and Financial Policy (BOE of 3 November 2008).

The FAAF, assigned to the Ministry of Economy and Finance, through the State Secretariat for Economic Affairs, is financed out of the State Budget, with a provision of €30 billion, that may be increased up to a maximum amount of €50 billion. For 2008, it is envisaged that €10 billion of extraordinary credit will be granted, which may be increased up to a maximum amount of €30 billion, to be financed with public debt. For 2009, the credit required for the FAAF to reach its maximum amount has been approved in the State Budget Law.

Administration and organisation of the FAAF

The FAAF shall be administered, managed and steered by the Ministry of Economy and Finance through a *Steering Council* and an *Executive Committee*.

The Steering Council consists of the Minister for Economic Affairs and Finance as Chair, the State Secretary for Economic Affairs, the State Secretary for Finance and the Budget, the President of the Instituto de Crédito Oficial (ICO), the Attorney General and the Auditor General. The Director General of the Treasury and Financial Policy shall act as Secretary, with the right to speak but not to vote.

The Steering Council shall have, inter alia, the following functions: establishing the investment policy of the FAAF, deciding how to apply the returns on assets and the proceeds of their redemption or sale, and approving the four-monthly report on the management of the FAAF.

The Executive Committee, which shall report to the Steering Council, consists of the State Secretary for Economic Affairs as Chair, the Director General of the Treasury and Financial Policy, the Director General of Insurance and Pension Funds, a representative of the ICO and a representative of the National Audit Office, with the right to speak but not to vote. A Treasury sub-director general shall act as secretary of the Committee, with the right to speak but not to vote. Its functions are: to carry out operations for the acquisition, transfer, disposal and management of the financial assets of the FAAF, in accordance with the guidelines laid down by the Steering Council, to prepare the proposed operating and capital budgets and to prepare the four-monthly report on the management of the FAAF.

The Executive Committee shall be advised by a *technical committee* consisting of the Director General of the Treasury and Financial Policy as Chair; three representatives appointed by the Banco de España; two representatives appointed by the CNMV; two Treasury sub-directors general, one of whom shall act as secretary of the Committee, and a representative appointed by the ICO.

The Banco de España, as agent and depository of the FAAF, shall conduct the Fund's operations, and shall record, manage and hold the security for repurchase agreements. It shall also be responsible for the accounts of the FAAF and the preparation of annual accounts, which shall be approved by the Executive Committee and subsequently sent to the Steering Council.

Assets of the FAAF and asset selection procedures

The FAAF shall invest in financial instruments issued by credit institutions and by securitisation special purpose entities, backed by loans granted to individuals, companies and non-financial institutions. To carry out its operations, the FAAF shall announce auctions, in which credit institutions domiciled in Spain and the Spanish branches of foreign credit institutions who have previously expressed an interest in participating may participate.

Prior to the announcement of each auction, the Steering Council shall determine the assets and the maximum volume that may be acquired at the auction, and the characteristics of the purchase transactions. In accordance with these criteria, the Executive Committee shall specify other aspects such as the maximum number of bids per institution and their minimum value. In this respect, Order EHA/3118/2008 of 31 October 2008 has set the minimum amount of bids at €3 million and requires higher bids to be for whole multiples of €1 million, although these amounts may be modified in the announcements if the maturity of the asset or any other circumstance makes this desirable.

Competitive⁴⁵ and non-competitive bids⁴⁶ may be auctioned. In order to promote the granting of new credit, up to 25% of the amount of each auction may be reserved for non-competitive bids. This amount shall be divided among the institutions in proportion to their contribution to credit growth after 15 October, the date of entry into force of Royal Decree Law 6/2008. In no event may auctions be held after 31 December 2009.

The financial instruments in which the FAAF invests shall be of the highest quality (as detailed below), and shall be determined in accordance with the criteria set by the Steering Council, which shall in any event reflect principles of objectivity, security, transparency, efficiency, profitability and diversification. Specifically, at the meeting of 27 October, the Steering Council decided which assets were eligible for FAAF investment and the acquisition procedure, which may be as follows:

- a) By means of outright purchase of covered bonds and securities backed by covered bonds, provided that they comply with certain requirements, including, that they have been issued after 15 October and that they have a triple-A or similar rating. Their maturity, or estimated average life, in the case of asset backed securities, shall be no longer than that determined in each auction announcement.
- b) By means of repurchase agreements in covered bonds, asset-backed securities and mortgage-backed securities, backed by loans granted to individuals, companies or non-financial institutions, provided that certain requirements are met, such as, that they have been issued since 1 August 2007, that they have at least a double-A or similar rating, and that the maturity does not exceed that specified in the announcement for each auction or, in any event, 12 months.

The FAAF's investments shall comply with certain diversification criteria. Two portfolios shall be maintained: one with assets acquired outright, and the other with securities acquired under repurchase agreements. To ensure adequate diversification of the assets acquired outright, the securities of any one issuer shall not exceed 10% of the portfolio. Likewise, no more than 10% of the portfolio of securities acquired under repurchase agreements may be acquired from any one institution.

For each homogeneous group of assets in each auction, the maximum effective amount that may be allotted to a single entity shall be the minimum of the following two amounts: 10% of the maximum volume that is to be acquired by the FAAF in the auction and the percentage resulting from multiplying by 2.5 the entity's share under the heading "Loans. Other resident

⁴⁵. Those which indicate the volume and the interest rate at which the bidder is prepared to offer the assets to the Fund, in the manner specified in each announcement. Those that fail to specify the interest rate shall not be taken into consideration. ⁴⁶. Those that do not indicate the interest rate.

Characteristics	1st AUCTION	2nd AUCTION
Auction date	20-nov-08	11-dic-08
Amount	Maximum effective amount: €5 billion. However, if the whole of the maximum amount is not allotted, the unallotted amount shall be added to the amount of the second auction.	Maximum effective amount: €5 billion. To this shall be added that part of the maximum amount not allotted in the first auction.
Procedure	FAAF acquisitions shall be made by means of repurchase agreements, with a maturity of two years and annual interest payments.	FAAF acquisitions shall be made by means of outright purchases, with a maturity or estimated average life of three years.
Assets	Covered bonds, securities backed by covered bonds, asset-backed securities and mortgage backed securities, backed by loans to individuals, companies and non-financial institutions, issued after 1 August 2007, shall be acquired.	Newly issued covered bonds and securities backed by assets backed by covered bonds may be acquired. The issues shall have a nominal value of €100,000, with a fixed 4% annual coupon.
Asset requirement	1) Assets must be admitted to listing on a regulated market or the issuer shall apply for listing within three business days of the auction allotment date, and 2) They shall comply with the conditions for being on the ECB's list of eligible assets.	1) The assets must have been issued after 15 October 2008, and 2) They must be listed on a regulated market or the issuer shall, at least, request listing within three business days of the auction allotment date.
Rating	The assets shall have at least a double A or similar rating.	The assets shall have at least a triple A or similar rating.
Formulation of bids	Each credit institution may present a maximum of three bids, the minimum amount of each being €3 million. Bids for larger amounts shall be whole multiples of €1 million. Apart from the amount, they shall specify the interest rate.	The same as in the first auction.
Asset purchase price	The effective amount of the assets to be delivered by the institutions shall be calculated using the prices published by the ECB and the valuation haircuts in force on 20 November 2008.	The purchase price shall be calculated using the return on each bid accepted.
Auction allotment conditions	The effectiveness of the allotments resulting from the auction is conditional upon the admission to listing of the instruments acquired on a regulated market. Otherwise, they shall be replaced by other equivalent instruments that are listed.	The effectiveness of the allotments resulting from the auction is conditional upon the admission to listing of the instruments on a regulated market before 11 March 2009. Otherwise the instruments shall be returned to the institution, which shall repay the cash obtained from the auction plus interest at the rate specified in its bid plus 200 basis points for the period from the payment date until 11 March 2009.
Auction results	Amount requested: €4,562 million. Amount allotted: €2,115 million. Marginal rate of 3.15%.	Amount requested: €9,479 million. Amount allotted: €7,224 million. Marginal rate of 3.75%.

SOURCE: BOE and Banco de España

sectors" (in which households and companies are included) corresponding to the latest balance sheet available before the announcement of the auction, for the maximum volume that the FAAF may acquire at the auction.

The *Resolution of 7 November 2008* (BOE of 8 November 2008) of the Directorate General of the Treasury and Financial Policy published the decisions adopted by the Executive Committee of the FAAF regarding the announcement of the first two auctions, for a maximum amount of €5 billion in each case, to be held on 20 November and 11 December 2008, respectively.

The *Resolution of 20 November 2008* (BOE of 22 November 2008) of the Directorate General of the Treasury and Financial Policy publishes the results of the first of the Fund's auctions and the *Resolution of 11 December 2008* (BOE of 13 December 2008) publishes those of the second one.

The characteristics, conditions and results of the auctions are summarised in Table 1.

Finally, the *Resolution of 23 December 2008* (BOE of 27 December 2008) of the Directorate General of the Treasury and Financial Policy published the decisions adopted by the Executive Committee of the FAAF regarding the announcement of the third and fourth auctions of the Fund. The characteristics and conditions of these are summarised in Table 2.

Characteristics	3rd AUCTION	4th AUCTION
Auction date	No later than 21 January 2009.	No later than 30 January 2009
Amount	Maximum effective amount: €5 billion. However, if the whole of the maximum amount is not allotted, the unallotted amount shall be added to the amount of the fourth auction.	Maximum effective amount: €5 billion. To this shall be added that part of the maximum amount not allotted in the second auction.
Procedure	Fund acquisitions shall be made by means of repurchase agreements, with a maturity of two years and annual interest payments.	FAAF acquisitions shall be made by means of outright purchases.
Assets	Covered bonds, securities backed by covered bonds, asset-backed securities and mortgage backed securities, backed by loans to individuals, companies and non-financial institutions, issued after 1 August 2007, shall be acquired.	Newly issued covered bonds and securities backed by assets backed by covered bonds, with a maturity or estimated average life of three years may be acquired. The issues shall have a nominal value of €100,000, with a fixed 3.5% annual coupon. All issues shall have a standard structure and shall only contain the usual market clauses.
Asset requirement	1) Assets must be admitted to listing on a regulated market or the issuer shall apply for listing within three business days of the auction allotment date, and 2) They shall comply with the conditions for being on the ECB's list of eligible assets.	1) The assets must have been issued after 15 October 2008, and 2) They must be listed on a regulated market or the issuer shall, at least, request listing within three business days of the auction allotment date.
Rating	The assets shall have at least a double A or similar rating.	The assets shall have at least a triple A or similar rating.
Formulation of bids	Each institution may present a maximum of three competitive and one non-competitive bids, the minimum amount of each being €3 million. Bids for larger amounts shall be whole multiples of €1 million. Each bid shall specify the amount and, if it is a competitive bid, the interest rate also.	The same as in the first auction.
Asset purchase price	The effective amount of the assets to be delivered shall be calculated using the prices published by the ECB and the valuation haircuts in force on 21 January 2008.	The purchase price shall be calculated using the return on each bid accepted.
Auction allotment conditions	The effectiveness of the allotments resulting from the auction is conditional upon the admission to listing of the instruments acquired on a regulated market. Otherwise, they shall be replaced by other equivalent instruments that are listed.	The effectiveness of the allotments resulting from the auction is conditional upon the admission to listing of the instruments on a regulated market before 30 April 2009. Otherwise the instruments shall be returned to the institution, which shall pay the amount specified in the cell immediately above plus interest at the rate specified in its bid plus 200 basis points for the period from the payment date until 30 April 2009.

SOURCES: BOE and Banco de España

Control of the FAAF

The FAAF shall be subject to supervision by the National Audit Office, by means of public auditing, in the terms provided in the General Budget Law. It shall also be subject to parliamentary supervision, through the relevant four-monthly reports on the management of the FAAF, which shall be sent by the Ministry of Economy and Finance to the Parliamentary Committee on Economic Affairs.

For its part, the Banco de España shall submit to the Executive Committee, every two months, detailed information on the FAAF's operations, and every fourth months, an analysis of the general financial conditions in which the FAAF's activity is taking place, as well as developments in bank lending. Both documents shall be sent to Parliament along with the four-monthly report.

GRANTING OF GUARANTEES FOR FINANCING OPERATIONS

Royal Decree Law 7/2008 of 10 October 2008 (BOE of 14 October 2008) on urgent economic and financial measures in relation to the concerted European action plan of the euro area countries,⁴⁷ implemented by *Order EHA/3364/2008 of 21 November 2008* (BOE of 24 November 2008), amended, in turn, by *Order EHA/3748/2008 of 23 December 2008* (BOE of

⁴⁷ The Parliamentary Resolution of 20 October 2008 (BOE of 25 October 2008) orders publication of the decision to validate Royal Decree Law 6/2008 of 10 October 2008, and Royal Decree Law 7/2008 of 10 October 2008.

24 December 2008), authorises State guarantees of new financing operations⁴⁸ by credit institutions resident in Spain. Also, the *Resolution of 24 November 2008* (BOE of 25 November 2008) of the Directorate General of the Treasury and Financial Policy publishes the standard form for applying for a State guarantee. The time limit for the granting of such guarantees is 31 December 2009.

Characteristics of the guarantees

State guarantees shall be granted on an irrevocable and unconditional basis, with waiver of the benefit of discussion.⁴⁹ Likewise, they shall only guarantee the principal of the loan and the ordinary interest. In the case of issues denominated in foreign currencies, guarantee mechanisms shall be established to minimise the exchange rate risk assumed by the State.

Guarantees may be applied for by credit institutions, consolidable groups of credit institutions or groupings of credit institutions, provided that they have a significant level of activity, meaning that they must account for a significant share of lending to firms and consumers in Spain.⁵⁰

Requirements for guaranteed operations

The operations that may be guaranteed comprise issues in Spain of commercial paper and bonds that fulfil the following requirements:

- a) They may be individual operations or issuance facilities.
- b) The securities issued shall be unsubordinated and shall not have any other type of guarantee. Interbank deposits shall not be guaranteed.
- c) The maturity shall be three months to three years from issuance. Exceptionally, the Ministry for Economic Affairs and Finance may guarantee operations with maturity of up to five years, following a report from the Banco de España.
- d) The interest rate may be fixed or variable. The effective interest rate shall be within the range of market returns on issues of issuers with similar characteristics and consistent with previous operations of the same issuer. Moreover, in the case of a variable interest rate, the reference rate shall be widely disseminated and used on the financial markets.
- e) Repayment shall be made by a single payment. Also, guaranteed issues shall not incorporate options, or any other derivative financial instruments, or any other element that makes it difficult to assess the risk assumed by the guarantor.
- f) The face value of each issue may not be less than €10 million and the securities shall be admitted to listing on official Spanish secondary markets.

48. These are deemed to be the issuance of commercial paper and bonds listed on official Spanish secondary markets, although they may also include other banking instruments, such as interbank deposits, within the framework of concerted and coordinated arrangements between the euro area governments. **49.** The benefit of discussion is the right of a surety (in this case the guarantor) not to pay the guarantee until the creditor has exhausted all the property of the debtor, i.e. the creditor must first proceed against the property of the principal debtor before having recourse to the guarantor. **50.** Specifically, they must account for at least 1% of total "Loans. Other residents" in Spain, as per the *Boletín Estadístico* of the Banco de España, and they must have issued during the immediately preceding five years securities similar to those that may now be subject to this guarantee.

- g) A commission, calculated in accordance with the annex to Order EHA/3364/2008, shall be payable to the State on each operation at the time of issuance.

Applications for guarantees and the criteria for granting them

In accordance with Order EHA/3364/2008, applications for guarantees under the 2008 State budget had to be submitted before 3 December 2008, although Order EHA/3748/2008 extended the deadline to 29 December 2008 for institutions interested in obtaining a State guarantee, the provisions of this second Order being applicable to the initial applications.⁵¹

The application shall specify the exact amount of the guarantee applied for. Those whose total amount by institution, consolidable group of credit institutions or groupings of credit institutions is less than €100 million shall not be considered. The guarantee shall be granted to each institution, group or grouping in direct proportion to its market share in total "Loans. Other residents" in Spain, as per the *Boletín Estadístico* of the Banco de España, and its amount shall be at most the result of applying such share to the maximum amount of the guarantees granted each year.

The guarantee may cover one or more issues, and shall be conditional upon the performance of certain formalities. The issues guaranteed in 2008 shall be made before 15 December 2009.⁵²

Finally, in the event of execution of the guarantee, the Treasury is obliged to notify the Banco de España of such circumstance, in case it is appropriate to adopt any of the measures contained in, among other provisions, Law 26/1988 of 29 July 1988 on discipline and intervention of credit institutions.

PURCHASE OF SECURITIES TO STRENGTHEN OWN FUNDS

The aforementioned Royal Decree-Law 7/2008 of 10 October 2008 authorises the Minister for Economic Affairs and Finance, on an exceptional basis until 31 December 2009, to purchase securities issued by credit institutions resident in Spain that need to bolster their own funds, including preference shares and non-voting equity units (*cuotas participativas*). The purchase decisions will be taken following a report from the Banco de España.

The securities which are purchased by the State will not be subject to the limitations imposed by law on the eligibility of own funds for capital adequacy purposes.⁵³

NEW AMOUNTS GUARANTEED BY DEPOSITOR AND INVESTOR GUARANTEE SYSTEMS

Royal Decree 1642/2008 of 10 October 2008 (BOE of 11 October 2008) increased the guaranteed amounts of depositors and investors, previously set by Royal Decree 2606/1996 of 20 December 1996 for the credit institution deposit guarantee fund and by Royal Decree 948/2001 of 3 August 2001 for investor compensation schemes.

The amount of deposits guaranteed by the deposit guarantee fund will have an upper limit of €100,000 (previously €20,000). The amount guaranteed to investors who have entrusted securities or financial instruments to a credit institution will be independent of the foregoing amount and have a ceiling of €100,000 (previously €20,000). It should be noted that these guarantees will apply per depositor or investor, whether a natural or legal person, and whatever the number and type of deposits of cash or of securities and financial instruments held by

⁵¹. The deadline for the submission of applications for guarantees under the 2009 State budget shall be established in due course by a Treasury resolution. ⁵². The deadline for making issues guaranteed under the 2009 State budget shall be established in due course by a Treasury resolution. ⁵³. See Law 13/1985 of 25 May 1985 on the investment ratios, own funds and reporting obligations of financial intermediaries and other financial system rules, amended by Law 36/2007 of 16 November 2007, Royal Decree 216/2008 of 15 February 2008 on the own funds of financial institutions and CBE 3/2008 of 22 May 2008.

the customer with the same institution. This limit will also apply to depositors or investors holding deposits or securities or financial instruments whose amount exceeds the guaranteed maximum.

As to investor compensation schemes, the guaranteed amount for investors that entrust holdings to investment firms will be subject to a quantitative limit of €100,000 (previously €20,000).

STATE FUND FOR LOCAL
INVESTMENT AND SPECIAL STATE
FUND TO INVIGORATE THE
ECONOMY AND EMPLOYMENT

Royal Decree-Law 9/2008 of 28 November 2008 (BOE of 2 December 2008) approved the creation of the State Fund for Local Investment and the Special State Fund to Invigorate the Economy and Employment, which entailed the approval of extraordinary loans totalling €11 billion out of the 2008 budget, of which €8 billion were earmarked for the first fund and the other €3 billion for the second. Both funds will be financed with public debt.

The State Fund for Local Investment aims to increase government investment in the municipal area through the financing of newly planned construction works⁵⁴ for immediate execution⁵⁵ from 2009. Responsibility for these works lies with the local municipalities. Specifically, the financing will be directed towards projects to improve municipal infrastructure, whether it be of a productive or social nature.

The amount that municipal governments can draw from the Fund is subject to a maximum determined objectively on the basis of the population registered in municipal censuses.⁵⁶ The application period runs from 10 December 2008 to 24 January 2009.

The Fund will be subject to strict control by both the Directorate General for Local Cooperation and the National Audit Office. The Fund will be administered, operated and managed by the Ministry of Public Administration, acting through its Directorate General for Local Cooperation.

The objective of the Special State Fund to Invigorate the Economy and Employment is to finance works intended for immediate execution in certain strategic productive sectors, as a way of undertaking projects with a high impact on job preservation and creation. To this end, *Ministerial Order EHA/3566/2008 of 9 December 2008* (BOE of 10 December 2008) made public the resolution of the Council of Ministers of 5 December 2008 approving the stated purpose of the Fund and its distribution to ministerial departments. In particular, it was earmarked for such uses as: R+D+I; automobile sector activities; environmental activities; the construction, conditioning, refurbishing and improvement of public-sector buildings; and the refurbishment of housing and of urban spaces.

Lastly, the *Resolution of 9 December 2008* (BOE of 10 December 2008) of the State Secretariat for Regional Cooperation approving the application form to be submitted, the conditions applying to the process and the supporting documentation for financing via the State Fund for Local Investment was issued, and extraordinary loans for financing were approved.

OTHER COMPLEMENTARY
ECONOMIC AND FINANCIAL
MEASURES

The slowdown in economic activity and the rise in unemployment in recent months have seen the enactment of *Royal Decree 1975/2008 of 28 November 2008* (BOE of 10 December 2008), addressing the urgent adoption of economic, fiscal, employment and housing-access

⁵⁴. Newly planned works are defined as those whose execution is not envisaged in the municipal budget for 2009. ⁵⁵. Works for immediate execution are defined as those for which tendering begins less than one month from the date on which the resolution to authorise their financing via the Fund is published on the Ministry for Public Administration's website. ⁵⁶. The Ministry for Public Administration will immediately make public the list of municipalities, stating their respective numbers of inhabitants and the maximum investment to be made with a charge to the Fund.

measures, and Royal Decree 10/2008 of 12 December 2008 (BOE of 13 December 2008), whereunder financial measures to improve the liquidity of small and medium-sized companies and other additional measures have been adopted.

From the economic and financial standpoint, the most relevant measures are categorised below.

Moratorium on the payment of mortgage loans

Royal Decree 1975/2008 regulates the conditions under which certain groups may qualify for a temporary and partial moratorium on their mortgage payments. Specifically, this regulation is applicable to mortgage loan debtors purchasing their habitual residence who took out a mortgage prior to 1 September 2008, for an amount less than €170,000, and who are, prior to 1 January 2010, in one of the following situations, inter alia:

- a) Dependent employees who are unemployed and have been so for at least three months immediately prior to the application, while having entitlement to unemployment benefits.
- b) The self-employed who have been obliged to discontinue their business activity, and have been in this situation for a minimum period of three months.

The mortgage payment moratorium will cover a maximum of 50% of the monthly instalments accruing in relation to the mortgage loan between 1 January 2009 and 31 December 2010, with a ceiling of €500 per month. The deferred amounts will be made up for from 1 January 2011 by means of their distribution on a pro-rata basis over the monthly instalments remaining until the mortgage loan is fully repaid, with a maximum limit of ten years. The application of this measure will require prior agreement between the borrower and the creditor bank.

Fiscal measures

The above-mentioned Royal Decree 1975/2008 contains a package of tax measures designed to improve, exceptionally and temporarily, the tax benefits enjoyed by holders of home-purchase savings accounts and home-owners with mortgage loans or who have decided to sell their house to purchase a new habitual residence.

Firstly, the term for selling the habitual residence for the purposes of exemption due to reinvestment is extended, in those cases in which a new dwelling has been purchased in the 2006-2008 period, prior to the sale of the habitual residence, so that the formerly established period of two years is extended to 31 December 2010.

Secondly, home-purchase savings accounts which have been held as at 2008 for a period of four years and which, therefore, should be used to purchase or renovate the habitual residence so as not to forgo the tax benefits, may now be used to this end until 31 December 2010, without this entailing forfeiture of the entitlement to the tax deduction for investment in the habitual residence.

However, the new amounts deposited in the home-purchase savings account, once the four years since the account was opened have elapsed, will not qualify for a tax deduction for investment in the habitual residence.

Financing facilities for the working capital of small and medium-sized enterprises

Royal Decree Law 10/2008 approves the granting of a State credit to the ICO (Official Credit Institute) for a maximum amount of €5 billion, whose aim will be the creation and setting up of a new mediation facility to meet the working capital financing needs of small and medium-sized enterprises which, while solvent and viable, are subject to a temporary situation of credit constraints. These funds will be funded by public debt.

To cover the envisaged new financing facilities, the debt ceiling foreseen for the ICO in the State budget legislation for 2009 shall be raised by an additional €15 billion.

Further, the Royal Decree addresses other complementary measures affecting Spanish mercantile regulations. For a period of two years from 13 December 2008 (the date it came into force), the Royal Decree Law suspends the current corporate regime applicable for mandatory capital reductions of public limited companies, and for the winding up of public limited and of limited liability companies⁵⁷ arising as a result of losses derived solely from tangible fixed assets, from real estate investment and from inventories.

A further amendment under mercantile regulations relates to the consideration of net worth for the purposes of profit distribution, of the mandatory reduction in capital stock and of obligatory winding up owing to losses. In this respect, excluded from among the net worth items shall be adjustments for changes in value arising from cash flow hedging operations still to be charged to the profit and loss account.

State budget for 2009

Following the usual practice in December, Law 2/2008 of 23 December 2008 on the State budget for 2009 (BOE of 24 December 2008) was published.

From the standpoint of financial regulation, the following monetary, financial and fiscal sections call for comment.

As regards State debt, the government is authorised to increase the outstanding State debt in 2009, subject to the condition that it shall not exceed the level at the beginning of the year by more than €29,930 million (the limit for last year's budget was €7,924 million). This limit may be exceeded during the course of the year with prior authorisation of the Ministry of Economy and Finance, and those cases in which it shall be automatically revised are laid down.

In relation to State guarantees, mention should be made of the authorisation of public guarantees to back fixed-income securities issued by securitisation special purpose vehicles, aimed at improving the financing of corporate productive activity, for which an amount of €3 billion (€800 million in the previous budget) has been established.

Turning to personal income tax, an adjustment for inflation of the tax schedule, as in previous years, is not envisaged. The rules applicable to joint tax returns have been amended so that the minimum taxable income amount (set at €5,151 per annum per taxpayer) is the same for individual and joint returns, effective 1 January 2008.

The obligatory reporting ceiling applicable to gross earned income is raised from €10,000 to €11,200 when such income is received from several payers. This is as a result of the inclusion of the new rebate on income from work or from business activities.⁵⁸

⁵⁷. Under mercantile doctrine, the reduction in capital is mandatory for public limited companies if losses have reduced their net worth to below two-thirds of capital stock, and if a financial year has elapsed without net worth having been restored. A further cause for the winding up of public limited and limited liability companies is the existence of losses that leave the net worth at an amount below half the capital stock. See the Consolidated Text of the Law on Public Limited Companies, approved by Royal Legislative Decree 1564/1989 of 22 December 1989, and Law 2/1995 of 23 March 1995 on Limited Liability Companies. ⁵⁸. Regulated in article 80 bis of the Law on Personal Income Tax and which was incorporated by Royal Decree Law 2/2008 of 21 April 2008, which stated that taxpayers obtaining income from work or from business activities shall qualify for an annual rebate of €400.

The provisions to compensate for the loss of tax benefits affecting certain taxpayers have been maintained in the current personal income tax legislation, regulated by Law 35/2006 of 28 November 2006. The first provision establishes for 2008 a tax deduction for purchase of principal residence for taxpayers who purchased their principal residence before 20 January 2006. The amount is equal to the difference between the deduction resulting from the application of the previous personal income tax legislation (in Royal Legislative Decree 3/2004 of 5 March 2004⁵⁹), in force until end-2006, and that obtained under the new law.⁶⁰

The second provision for tax compensation will affect those receiving certain income from capital with a generation period exceeding two years in 2008. On one hand, income from capital obtained in relation to the transfer of capital to third persons from financial instruments taken out prior to 20 January 2006 shall qualify for a reduction of 40%, as was the case under the previous personal income tax law. On the other, income received in the form of deferred capital arising from life and invalidity insurance policies taken out prior to 20 January 2006 shall qualify for a 40% or 75% reduction, as envisaged under the previous personal income tax law.

For transfers of real estate not used in business activities, a rise of 2% in the acquisition cost adjustment coefficient is included.

Concerning corporate income tax, 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 2009 is laid down.

In relation to local taxes, the rateable values of properties are updated by 2%.

Other financial measures relate to the legal interest rate and the default interest rate, which are respectively held at 5.5% and 7%.

⁵⁹. See "Financial regulation: 2004 Q1", *Economic Bulletin*, April 2004, pp.99-100. ⁶⁰. During 2008 a deduction may be taken, in general, for 15% of the amounts paid for the purchase or renovation of the habitual residence, with a maximum of €9,015.18 per annum. In 2006, meanwhile, although the same deduction was available, in general, when the purchase was made using borrowed funds, in the two years following the purchase the deduction was for 25% of the first €4,507.59 and for 15% of the remainder up to €9,015.18. Subsequently, the foregoing percentages were 20% and 15%, respectively.