FINANCIAL REGULATION: 2012 Q3

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Introduction

In comparison with previous years, a large amount of new financial legislation was enacted in 2012 Q3.

The European Central Bank (ECB) adopted three guidelines: one to establish temporary measures relating to Eurosystem refinancing operations and the eligibility of new collateral in monetary policy operations; a second to update the TARGET2-Securities regulations; and a third to introduce an information exchange system for cash transactions in the Eurosystem.

In relation to credit institutions, four pieces of legislation of some significance were published: to regulate a new framework for the restructuring and resolution of institutions, and to attribute new powers to the Fund for the Orderly Restructuring of the Banking Sector (FROB); to implement regulations on the remuneration policy of institutions that receive public financial support for reorganisation or restructuring; to update the rules on transparency and protection of bank service customers; to modify certain financial provisions in order to grant new powers to the European Supervisory Authorities (ESA).

Regulations on State debt market-makers were updated.

Two pieces of legislation were enacted in relation to the securities market: to update the regulation of collective investment institutions (CIIs), in accordance with the latest amendments introduced in the law which regulates them, and to amend the law on the derivative instrument transactions of CIIs.

In relation to Union law, two regulations were published which implement certain aspects of the law on short positions. Also, a regulation was published relating to extra-stock market derivatives, central counterparty institutions (CCIs) and transaction registers.

Finally, the financial and fiscal changes introduced by two royal decree-laws are summarised: one on the approval of measures to ensure budgetary stability and foster competitiveness, and the other, relating to the adoption of liquidity measures for regional governments.

The contents of this article are set out in Table 1.

European Central Bank: refinancing operations and collateral in monetary policy operations

Guideline ECB/2012/18 of 2 August 2012 (OJ L, 15 August 2012) on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9 on monetary, financial institutions and markets statistics was published.

The measures established must be applied temporarily until the Governing Council of the ECB considers that they are no longer necessary, to ensure an appropriate monetary policy transmission mechanism.

OPTION TO TERMINATE OR MODIFY LONGER-TERM REFINANCING OPERATIONS

The Eurosystem may decide that counterparties may reduce the amount of, or terminate, certain longer-term refinancing operations before maturity. Such conditions will be published in the announcement of the relevant tender.

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TABLE 1

TABLE 1

COLLATERAL

The Guideline specifies additional assets that will be eligible as collateral for Eurosystem monetary policy operations, which are summarised as follows:

Admission of certain asset-backed securities

Asset-backed securities (ABS) that do not fulfil the credit assessment requirements laid down in Guideline ECB/2011/14 of 20 September 2011[1] will be eligible as collateral provided

1 For ABS issued from 1 March 2010, the Eurosystem requires at least two ratings of the issue from accepted external credit assessment institutions (ECAIs). In determining the eligibility of these ABS, the "second-best" rule is applied, whereby not only the best, but also the second-best available ECAI rating must comply with the minimum threshold applicable to ABS. Under this rule, the Eurosystem requires both ratings to be at the "AAA"/"Aaa" level at issuance and "A" over the lifetime of the security, for the securities to be eligible. From 1 March 2011, all ABS, regardless of their date of issue, must have at least two ratings from accepted ECAIs and must comply with the second-best rule to be eligible collateral. As for ABS issued before 1 March 2010 that only have one rating, a second must be obtained before 1 March 2011. For ABS issued before 1 March 2009, both ratings must be at the "A" level over the lifetime of the security.

that they have two ratings of at least triple B[2], at issuance and at any time subsequently, and that satisfy certain additional requirements.[3] Also, ABS backed by commercial mortgages will be subject to a valuation haircut of 32% and all other ABS to a valuation haircut of 26%.[4]

For their part, national central banks (NCBs) may accept as collateral for Eurosystem monetary policy operations ABS whose underlying assets include residential mortgages[5] or loans to SMEs[6] or both, so long as they have two ratings of at least triple B (there being no need to satisfy any other kind of requirement). These ABS will be limited to those issued before 20 June 2012 and will be subject to a valuation haircut of 32%.

As was already established, a counterparty may not submit as collateral any asset issued or guaranteed by itself or by any other entity with which it has close links.[7]

Admission of certain credit claims

Credit claims that do not satisfy the Eurosystem eligibility criteria specified in Guideline ECB/2011/14 will be admissible. In this case, national central banks (NCBs) that decide to accept such credit claims must establish the eligibility criteria and risk control measures in accordance with the laws of the Member State of the NCB concerned. Such criteria and control measures will be subject to the prior approval of the Governing Council of the ECB.

In exceptional circumstances NCBs may, with the approval of the Governing Council of the ECB, accept credit claims governed by the law of any Member State other than the Member State in which the accepting NCB is established.

Acceptance of certain government-guaranteed bank bonds

NCBs may accept bank bonds guaranteed by a Member State under a European Union/International Monetary Fund programme, or by a Member State whose credit assessment does not meet the Eurosystem's minimum requirement for issuers and guarantors of marketable assets laid down in Guideline ECB/2011/14.[8]

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2 A "triple B" credit rating is a rating of at least "Baa3" from Moody's, "BBB-" from Fitch or Standard & Poor's, or a rating of "BBB" from DBRS.

3 Inter alia, the following requirements: 1) the assets backing the ABS must belong to certain asset classes; 2) they may not include loans that are non-performing, structured, syndicated or leveraged, and 3) the ABS transaction documents must contain servicing continuity provisions.

4 Unless they have at least an "A" rating, in which case they will be subject to a 16% valuation haircut.

5 Residential mortgages include, apart from mortgage-secured loans for house purchase, loans for house purchase without mortgage security, as long as the guarantee is payable immediately upon default. Such guarantees may be provided in different contractual formats, including contracts of insurance, provided that they are granted by a public-sector entity or a financial institution subject to public supervision. The rating of the guarantor for the purposes of such guarantees must be equivalent to credit quality step 3 in the Eurosystem's harmonised rating scale over the life of the transaction.

6 SMEs are entities that, regardless of their legal form, perform economic activity with annual turnover, or where applicable, of the consolidated group, of less than €50 million.

7 "Close links" are deemed to exist between a counterparty and an issuer/debtor/guarantor of eligible assets when: 1) the counterparty owns directly, or indirectly, through one or more other undertakings, 20% or more of the capital of the issuer/debtor/guarantor; 2) the issuer/debtor/guarantor owns directly, or indirectly through one or more other undertakings, 20% or more of the capital of the counterparty; or 3) a third party owns more than 20% of the capital of the counterparty and more than 20% of the capital of the issuer/debtor/guarantor, either directly or indirectly, through one or more undertakings.

8 The requirement for marketable assets to be of high credit quality is established on the basis of certain criteria, such as the assessment of credit quality by accepted external credit assessment institutions (ECAIs), which should be equal to or exceed the credit quality threshold, which must be equivalent to credit quality step 3 in the Eurosystem's harmonised rating scale. In the event that no (acceptable) assessment of the credit quality of the issuer by an ECAI is available, the credit quality requirement may be met on the basis of guarantees provided by solvent guarantors, which must be adjusted to certain requirements. The financial solvency of a guarantor is determined on the basis of the credit assessments made by ECAI which meet the credit quality threshold.

Counterparties may not submit bank bonds issued by themselves and guaranteed by an EEA public-sector entity,[9] or bonds issued by closely linked entities as collateral for Eurosystem credit operations in excess of the nominal value of these bonds already submitted as collateral on 3 July 2012. In exceptional cases, the Governing Council may decide on derogations from this requirement if the counterparty makes a request accompanied by a funding plan.

The Guideline entered into force on 4 August and has applied since 14 September.

TARGET2-Securities: changes to its regulations

Guideline ECB/2012/13 of 18 July 2012 (OJ L, 11 August 2012), which updates and replaces Guideline ECB/2010/2 of 21 April 2010 on TARGET2-Securities (T2S), was published. In particular, it incorporates the provisions of Decision ECB/2012/6 of 29 March 2012 on the establishment of the T2S Board, while repealing Decision ECB/2009/6 of 19 March 2009.

T2S is a Eurosystem service, established by Guideline ECB/2010/2, for securities settlement in NCB money.[10] It is based on a single technical platform integrated with central bank real-time gross settlement systems, which allows for the core, neutral and borderless settlement of securities transactions by central securities depositories (CSDs).[11] In this way, CSDs can provide customers with harmonised and commoditised delivery-versus-payment settlement services in an integrated technical environment with cross-border capabilities.

Guideline ECB/2012/13 basically maintains the functions of internal governance of T2S, which is based on three levels: at level 1 is the Governing Council, which will be responsible for the direction, overall management and control of T2S. It will also be responsible for ultimate decision-making in relation to T2S and will decide on the allocation of tasks not specifically attributed to levels 2 and 3.

At level 2, the T2S Board (which replaces the former T2S Programme Board) is responsible for assisting the ECB's decision-making bodies in ensuring the successful and timely completion of the T2S Programme. It is a simplified Eurosystem management body which develops proposals for the T2S Governing Council on key strategic issues and executes tasks of a purely technical nature. The T2S Board has been entrusted with certain implementing tasks by the Eurosystem central banks so that it can be fully operational and act on behalf of the whole Eurosystem.

At level 3 are the 4CB, which will develop and operate T2S and provide information on their internal organisation and allocation of work to the T2S Board.

The functions of CSDs are specified. Apart from enabling securities to be established and settled in book-entry form, they provide a securities settlement service to entities in the

9 The EEA came into existence on 1 January 1994, as a result of an agreement between the countries belonging to the European Union (EU) and the European Free Trade Association (EFTA). Its creation enabled EFTA countries to participate in the EU's internal market without having to join the EU. It is made up of the 27 countries of the EU and the following members of EFTA: Iceland, Liechtenstein and Norway.

10 On the basis of an offer made by the Deutsche Bundesbank, the Banco de España, the Banque de France and the Banca d'Italia (hereinafter the "4CB"), the Governing Council also decided that T2S would be developed and operated by the 4CB.

11 A CSD is an entity that: 1) enables securities to be established and settled in book entry form, and/or maintains and administers securities on behalf of others through the provision or maintenance of securities accounts; 2) operates or provides for a securities settlement system or for entities not located in the EEA in accordance with the relevant national legislation and/or is regulated by a central bank, and 3) is recognised as a CSD by national regulations and/or is authorised or regulated as such by a competent authority.

European Union or for entities located outside the EEA, in accordance with the relevant national legislation.

Also, T2S services are extended to non-euro area NCBs on the basis of contractual arrangements, so that the relationship with the latter is structured throughout the development, migration and subsequent operation of T2S. To this end, a CSD Steering Group and a Non-euro Currencies Steering Group, which replace the former CSD Contact Group, have been set up.

The T2S Advisory Group is maintained, as a forum for communication and interaction between the Eurosystem and external T2S stakeholders, although it is given some new functions, since, apart from being an advisory body to the Eurosystem for all T2S-related issues, it may also advise the CSD Steering Group and the Non-euro Currencies Steering Group. Also, its working procedures and reporting are detailed.

Finally, the functions of national user groups,[12] such as contributing to the monitoring and implementation tasks associated with the T2S harmonisation activities supported by the Advisory Group, and adhering to the high standards of transparency of T2S, are extended, and certain aspects of their working procedures are clarified.

This Guideline entered into force on 20 July 2012.

European Central Bank: exchange of information on cash transactions in the Eurosystem

Guideline ECB/2012/16 of 20 July 2012 (OJ L, 11 September 2012) on the data exchange for cash services was published.

The Guideline introduces a system of Data Exchange for Cash Services (DECS)[13], with a view to further harmonising cash services in the Eurosystem. It maximises efficiency in the supply and withdrawal of cash and the functioning of the cash cycle in the euro area. It also ensures the interchangeability of data for cross-border cash transactions and bulk transfers of euro banknotes between NCBs that use different cash management systems.

NCBs must connect their cash management systems to DECS to: 1) enable clients[14] to exchange electronic data messages concerning cash transactions with a non-domestic NCB via the cash management system of their domestic NCB[15]; and 2) facilitate the exchange of electronic data messages concerning bulk transfers between NCBs or between a printing works[16] and a receiving NCB,[17] via the cash management system of the supplying NCB.

NCBs must establish a connection between their cash management system and DECS as soon as they are technically able to do so.

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12 National User Groups are a forum for communication and interaction with providers and users of securities settlement services within their national market, in order to support the development and implementation of T2S and assess the impact of T2S on the national markets. As a rule, the National User Groups will be chaired by the respective NCBs.

13 "DECS" is the common interface that communicates with an NCB's cash management system enabling the mapping, routing and transformation of electronic data messages between NCBs using different cash management systems or cash management specifications related to cash transactions and bulk transfers.

14 A client is a credit institution providing cash services incorporated in a Member State whose currency is the euro or, if applicable, a cash-in-transit company incorporated in a Member State whose currency is the euro that is registered in the database of a domestic NCB for the use of its cash management system and DECS.

15 A domestic NCB is responsible for providing the DECS system to NCBs in their cash management systems.

16 This printing works must have concluded contractual arrangements with an NCB for the production of euro banknotes.

17 A receiving NCB receives euro banknotes from a supplying NCB or a printing works for bulk transfers of euro banknotes.

Domestic NCBs will ensure that they meet the technical requirements for communication via DECS. Also they must put in place contractual arrangements with their clients stipulating that cash transactions will be processed through DECS. Finally, they must establish, maintain and regularly update a database of clients that agree to the use, conditions and technical requirements of DECS.

Domestic NCBs will not be parties to nor be held liable for cash transactions between clients and non-domestic NCBs.

Non-domestic NCBs must, as soon as feasible, enter into contractual arrangements with the clients of domestic NCBs that intend to enter into cash transactions with that non-domestic NCB via DECS.

Transaction messages must be processed via DECS as set out in Annex I to the Guideline.

Finally, NCBs must duly cooperate in exchanging information about the operation of DECS, in particular, where an NCB is faced with potential or actual litigation initiated by a client stemming from a transaction processed through DECS.

The Guideline entered into force on 1 October 2012.

New framework for the restructuring and resolution of credit institutions

Royal Decree-Law 24/2012 of 31 August 2012 (BOE of 31 August 2012) on restructuring and resolution of credit institutions, which repeals Royal Decree-Law 9/2009 of 26 June 2009 on bank restructuring and strengthening of the capital of credit institutions, as well as certain sections of Royal Decree-Law 2/2011 of 18 February 2011 on the strengthening of the Spanish financial system, and of Royal Decree-Law 2/2012 of 3 February 2012 on restructuring of the financial sector. Also, it introduces various amendments to a large number of provisions with the status of Law.

The Royal Decree-Law includes the following measures: 1) a new enhanced framework for the management of credit institution crises, which will allow such institutions to be effectively restructured and, where necessary, resolved (wound up) in an orderly manner; 2) new regulation of the FROB, which delimits its powers and significantly enhances the tools for intervention in all phases of the management of credit institution crises; 3) a system of burden sharing to distribute the costs of credit institution restructuring and resolution between the public and private sectors; 4) the legal framework for the incorporation of an Asset Management Company (AMC); 5) greater protection for retail investors; 6) a new regime of "capital principal" requirements that must be complied with by institutions, which covers both the definition and level of such capital; 7) the transfer of certain powers to the Banco de España; 8) new functions of the Deposit Guarantee Fund for Credit Institutions, and 9) new limits on the remuneration of executives of credit institutions that receive financial support.

Table 2 shows the most important changes relative to the previous situation.

MANAGEMENT OF CREDIT INSTITUTION CRISIS SITUATIONS

The Royal Decree-Law establishes a new legal regime for addressing situations of institutions in difficulty. For this purpose, three levels of management are established:

Early action measures

These are envisaged for credit institutions that are viable, but which either fail or, owing to the existence of objective factors,[18] can be expected to fail to comply with solvency,

18 Regulations will specify the objective indicators that should be used to determine the situation of institutions in any possible phase of the crisis.

NEW FRAMEWORK FOR THE RESTRUCTURING AND RESOLUTION OF CREDIT INSTITUTIONS TABLE 2

ROYAL DECREE-LAW 9/2009 OF 26 JUNE 2009	ROYAL DECREE-LAW 24/2012 OF 31 AUGUST 2012
Management of credit institution crisis situations	
Not specifically envisaged.	Early action measures: provided for institutions that may be viable on the basis of their own funds, but which may require exceptional, temporary assistance, through contributions to share capital, purchase of ordinary shares or instruments convertible into shares, to be repaid within two years.
Restructuring processes: two phases are envisaged. The first, with the submission of the plan of action setting out the actions planned to overcome the situation of financial weakness. When the plan of action is insufficient, the restructuring process is initiated with the intervention of the FROB. Its objective is to support integration processes or the transfer of all or part of the banking business. The FROB can provide temporary financial support to the restructuring process.	Restructuring processes: envisaged for institutions displaying temporary weaknesses that may be overcome by means of public financial support, to be repaid within a five-year period, extendable by no more than two years. The restructuring instruments that the FROB may implement (individually or jointly) are two: 1) public financial support, and 2) the transfer of assets or liabilities to the Asset Management Company (AMC).
Not envisaged.	Orderly resolution of institutions: applied to unviable credit institutions. The resolution instruments that may be adopted by the FROB (individually or jointly) are: 1) sale of the business or the institution; 2) transfer of assets or liabilities to a bridge bank; 3) transfer of assets or liabilities to the AMC, and 4) financial support for acquirers of the business, the bridge bank or the AMC.
Composition and powers of the FROB	
The FROB is governed by a Governing Committee with eight members: five proposed by the Banco de España and three of which correspond to by each of the Deposit Guarantee Funds.	The Governing Committee is made up of representatives of the Ministry of Economic Affairs and Competitiveness, the Ministry of Finance and Public Administration (five members) and the Banco de España (four members). It will have a general manager with full executive powers.
It has a capital endowment financed out of the State budget and the contributions of the Deposit Guarantee Fund. In addition, it may raise funds on the securities markets by issuing fixed-income securities, taking out loans, requesting the opening of credit facilities and conducting any other debt operation, although such funds may not amount to more than three times the value of the capital endowment existing from time to time. However, as from 1 January 2010, funding beyond this limit may be authorised, although external funds may in no event amount to more than ten times the capital endowment.	It has the capital endowments that may be financed out of the State budget. In addition, to achieve its purposes, the FROB may raise funds by issuing fixed-income securities, taking out loans, requesting the opening of credit facilities and conducting any other debt operation. The external funds obtained must not exceed the limit established in the State budget.
The FROB basically has two functions: management of the restructuring processes (by means of financial support and management measures to improve the organisation and the procedural and internal control systems), and the strengthening of the capital of institutions with the exclusive purpose of carrying out integration processes.	The FROB manages credit institution restructuring and resolution processes with the instruments mentioned above.
Not envisaged.	In cases of restructuring or resolution of credit institutions that belong to international groups, the FROB will collaborate with the EU institutions, including the European Banking Authority, and with foreign authorities with the relevant responsibilities, and may conclude collaboration agreements and exchange information for the exercise of its powers.
System for distributing the costs of restructuring or resolving credit institutions	
Not envisaged.	The distribution of the costs of restructuring or resolution of institutions is addressed, and the mechanism established whereby the holders of hybrid capital instruments (preference shares, convertible bonds, subordinated bonds or any other subordinated financing obtained by the credit institution) may be obliged to assume part of the losses of an institution in crisis.
Asset management company	
Not envisaged.	Its sole object is to hold, manage and administer directly or indirectly, acquire and dispose of the assets transferred to it by credit institutions, as well as any that it may acquire in future. The transfer of assets will be subject to certain special conditions.

SOURCES: BOE and Banco de España.

liquidity, organisational structure or internal control requirements, although they have the capacity to return to compliance using their own resources. Institutions in such a situation must report the fact immediately to the Banco de España, submitting a "plan of action" setting out the actions planned to ensure the institution's long-term viability. This plan must be approved by the Banco de España, and a favourable report by the FROB will also be required if the institution needs public financial support.

Simultaneously, the Banco de España, from the moment it is aware of the situation, may take certain early action measures. The Royal Decree mentions, inter alia, the following: 1) to require the replacement of members of the board, or of the equivalent body, or of general managers and the like; 2) to require the preparation of a programme to renegotiate or restructure the institution's debt with all or some of its creditors; 3) to adopt any of the measures in the current law on regulation and discipline, in accordance with the provisions of Law 26/1988 of 29 July 1988 on discipline and intervention of credit institutions, and 4) exceptionally, and complying with Spanish and EU law on competition and State aid, to require recapitalisation measures through contributions of share capital, purchase of ordinary shares or instruments convertible into shares (known colloquially as "cocos"), in which the repurchase or repayment period does not exceed two years.

Restructuring measures

These are envisaged for institutions with temporary weaknesses that, to ensure their viability, may be overcome through public financial support, there being objective factors that make it reasonably foreseeable that such support will be repaid within five years, with a maximum extension of two years. The institution can obtain guarantees, loans, or recapitalisation by means of ordinary shares, contributions to share capital, cocos, etc. These measures are also envisaged, in the absence of objective factors, when the orderly resolution or winding up of a credit institution have effects that are seriously prejudicial for the stability of the financial system as a whole.

The institution must submit a "restructuring plan" setting out the planned measures to ensure its long-term viability, which must be approved by the Banco de España. This plan will include, in addition to the elements envisaged for action plans (mentioned in the previous section), the restructuring tools that the FROB is going to apply, of which there are basically two: 1) public financial support, and 2) the transfer of assets and liabilities to the AMC. These tools can be applied individually or jointly.

Orderly resolution of institutions

This will be applied to credit institutions that are non-viable,[19] or when it is reasonably foreseeable that they will become non-viable in the near future. Following the opening of the resolution process, and provided that the FROB does not possess a holding that gives it control of the institution, the Banco de España will agree to replace the board or equivalent body of the institution, appointing the FROB as sole director. The latter will prepare a resolution plan for the institution or, where applicable, will determine whether it is appropriate to open insolvency proceedings, which must be approved by the Banco de España, within the framework of its powers.

19 A credit institution will be deemed non-viable when it is in one of the following situations: 1) the institution substantially fails, or it is reasonably foreseeable that it will in the near future fail, to comply with the solvency requirements; or 2) the debt of the institution is greater than its assets or it is reasonably foreseeable that it will be in the near future, or 3) the institution cannot, or it is reasonably foreseeable that in the near future it will not be able to, punctually comply with its enforceable obligations. It is also non-viable if it is not reasonably foreseeable that the institution can redress the situation within a reasonable period of time by using its own resources, tapping the markets or receiving public financial support.

The resolution tools are: 1) sale of the institution's business;[20] 2) transfer of assets or liabilities to a bridge bank;[21] 3) transfer of assets or liabilities to the AMC; and 4) the financial support to the acquirers of the business, the bridge bank or the AMC when it is necessary to facilitate implementation of the above-mentioned tools and to minimise the use of public financial support. The FROB may adopt these tools individually or jointly.

Bridge banks will be administered and managed with a view to their sale, or to the sale of their assets or liabilities, when the conditions are appropriate and, in any event, within five years from its incorporation or acquisition by the FROB. Such sale shall be carried out at arm's length by means of competitive, transparent and non-discriminatory procedures. In the event that the bridge bank is no longer operational, the FROB will proceed to wind it up, provided that it holds the majority of its share capital. The amount resulting from the winding-up will be paid to the institutions in resolution whose assets and liabilities have been transferred to the bridge bank.

Prior to the adoption of any restructuring or resolution measure, the FROB will determine the economic value of the institution or of the relevant assets and liabilities on the basis of the valuation reports commissioned from one or more independent experts. This valuation will be used whenever public financial support is granted to an institution.

STRENGTHENING OF THE POWERS OF THE FROB

The other major part of the Royal Decree-Law is the strengthening of the powers of the FROB, which is conceived, along with the Banco de España, as the public institution responsible for managing credit institution restructuring and resolution processes. It will have funds assigned to it out of the State budget. In addition, to achieve its purposes, the FROB may raise funds by issuing fixed-income securities, receiving loans, requesting the opening of credit facilities and through any other debt-incurrence transaction. The external funds obtained by the FROB, in whatever form, may not exceed the limit established in the State budget.[22]

The FROB will be governed by a Governing Committee, made up of representatives of the Ministry of Economic Affairs and Competitiveness, of the Ministry of Finance and Public Administration (five members) and of the Banco de España (four members). A director general will have full executive functions for the steering and ordinary management of the FROB, as well as those others that may be delegated to him/her by the Governing Committee. He/she will be appointed by the Council of Ministers, upon a proposal from the Minister of Economic Affairs and Competitiveness and after consulting the Governor of the Banco de España, among persons with the capability, technical training and sufficient experience to perform the functions of the post.

In the exercise of its powers, and in particular in the event of restructuring or resolution of credit institutions that belong to international groups, the FROB will collaborate with the

20 The sale of the institution's business involves transfer to an acquirer that is not a bridge bank of the shares, non-voting equity units or contributions to share capital or, generally, instruments representing or convertible into the capital, or equivalent, of the institution, whoever their holders may be, or all or some of the assets or liabilities of the institution.

21 A bridge bank will be considered to be a credit institution (including, where applicable, the very institution in resolution) in which the FROB has a holding, whose object is to carry on all or part of the activities of the institution in resolution and to manage all or part of its assets and liabilities. The total value of the liabilities transferred to the bridge bank may not exceed the value of the assets transferred from the institution or from any other source, including those relating to the public financial support.

22 Law 2/2012 of 29 June 2012 on the 2012 State budget has been amended, so that the limit on external funds obtained by the FROB in 2012 will be €120 billion.

institutions of the European Union, including the European Banking Authority, and with foreign authorities with functions relating to supervision, restructuring or resolution of financial institutions, and for this purpose may conclude with them the appropriate collaboration agreements, and exchange information for the exercise of their powers in relation to the planning and implementation of early action measures, restructuring or resolution. In addition, it may participate in the colleges of resolution authorities that may be established to ensure the necessary cooperation and coordination with foreign resolution authorities.

In the event that the competent foreign authorities do not belong to an EU Member State, the exchange of information will require reciprocity and that they are subject to a duty of secrecy on at least equivalent terms to those established by Spanish law.

BURDEN SHARING SYSTEM FOR THE COSTS OF CREDIT INSTITUTION RESTRUCTURING OR RESOLUTION

The Royal Decree-Law addresses the distribution of the costs of credit institution restructuring or resolution, establishing a mechanism to enable the holders of hybrid capital instruments (preference shares, convertible bonds, subordinated bonds or any other subordinated financing obtained by the credit institution) to be obliged to assume part of the losses of an institution in crisis. Burden sharing will be managed in accordance with the EU law on State aid and the objectives and principles established in this Royal Decree-Law: in particular, to protect financial stability and minimise the use of public funds.

Operations may consist of offers to exchange credit institutions' capital instruments; repurchase by means of direct cash payment or of payment that is conditional upon subscription for capital instruments or any other banking product; reduction in the face value of debt; and early redemption at other than face value. In all cases, market value must be taken into account, with discounts applied to face value in accordance with European law.

At the same time, the FROB may agree certain actions to manage hybrid capital and subordinated debt instruments, such as deferment, suspension, elimination or modification[23] of certain rights, obligations, terms and conditions of all or some of the issues of hybrid capital and subordinated debt instruments, or obliging the institution to repurchase the securities concerned at such price as the FROB itself may determine.

For this purpose, it must assess the suitability and content of the management action it intends to agree in accordance with the following criteria: 1) the proportion of all the assets of the institution that the hybrid capital and subordinated debt instruments represent; 2) the amount of public assistance that has been or that is going to be received by the institution and its form, and in particular whether the institution has received or is going to receive financial support in the form of share capital; 3) the proportion of the risk-weighted assets of the institution that the public assistance received or promised represents; 4) the viability of the credit institution without such assistance; 5) the current and future capacity of the credit institution to raise capital on the market; 6) the amount that the holders of the hybrid capital and subordinated debt instruments would receive if the institution were wound up or liquidated in the absence of public assistance; 7) the market value of the hybrid capital and subordinated debt instruments which will be affected by the action; 8) the effectiveness obtained or obtainable by an action of management of hybrid capital and subordinated debt instruments carried out by the institution, and 9) the probability that investors would voluntarily accept the measures planned, taking into account, moreover,

23 The modifications may affect, inter alia, the payment of interest, the repayment of principal, the maturity date, and the individual or collective rights of investors.

the profile of the majority of the investments in each of the issues that are going to be affected by such measures.

The holders of affected hybrid capital and subordinated debt instruments may not initiate any other action for payment based on breach of the terms and conditions of the issue in question, if such terms have been affected by an action of management of hybrid capital and subordinated debt instruments agreed by the FROB and the institution is complying with its content. Also, neither the institution nor the FROB may claim any type of financial compensation for losses that may have been caused to them by the execution of an action of management of hybrid capital and subordinated debt instruments.

ASSET MANAGEMENT COMPANY

The Royal Decree-Law first addresses a general framework for asset management companies that may be set up as instruments for restructuring credit institutions. Within this are established the powers of the FROB to oblige an institution receiving public assistance to transfer to the AMC certain categories of assets that have been particularly impaired or whose presence on the institution's balance sheet is considered prejudicial to its health and viability, in order to remove them from the balance sheet and enable them to be independently managed.

Also, the broad outline of the process to be followed for this purpose is established, including the determination of the categories of assets that should be transferred (at the responsibility of the FROB), the recording by the credit institution (prior to the transfer) of adjustments to the valuation of the assets to be transferred, and the determination, also beforehand, by the Banco de España, of the transfer value of such assets on the basis of reports commissioned from one or more independent experts. For all this the appropriate powers to determine implementing regulations are established.

Asset transfers will be subject to certain special conditions, such as the following: 1) in no event may they be reversed by the application of claw-back actions envisaged in insolvency legislation; 2) the acquiring company is not obliged to make a public offering, in accordance with the law on stock markets; and 3) the AMC will not be responsible, in the event that transfer takes place, for any tax obligations arising prior to transfer due to the ownership, operation or management of the assets by the transferring institution.

At the same time, the Royal Decree-Law envisages the creation, within three months from its entry into force of a specific AMC to acquire the assets of those institutions in which, as at that date, the FROB has a majority holding or that, in the opinion of the Banco de España, following an independent assessment of its capital needs and the quality of its assets (also under way at that date), are going to require a restructuring or resolution process to be initiated.

The AMC will be incorporated for a limited period, which will be determined in its articles of association. Its sole object will be to hold, manage and administer, directly or indirectly, to acquire and dispose of the assets that are transferred to it by credit institutions, as well as those that it may acquire in future.

Apart from the FROB the shareholders of the AMC may include the Credit Institution Deposit Guarantee Fund, credit institutions, other financial institutions (inter alia, venture capital institutions and their management companies), other institutional investors and those institutions that may be determined by regulations. The public holding[24] of the capital of the AMC must be below 50%.

24 Public holding is understood to include all the direct or indirect holdings of public institutional units, as defined in the European System of National Accounts.

If desirable for the appropriate management of the AMC, the FROB may incorporate a management company whose objects would be to manage and administer the assets and liabilities of the asset management company, which it will represent, where applicable, in the operations of its ordinary traffic, with a view to realising such assets on the best conditions possible.

Finally, the obligation to contribute foreclosed assets or assets received in payment of debts to asset management companies, in accordance with the provisions of Royal Decree-Law 18/2012 of 11 May 2012 on the writing down and sale of the real estate assets of the financial sector, will not be applicable to credit institutions in which the FROB has a majority holding or that are subject to a resolution process. Nor will this obligation be applicable to any credit institution belonging to the consolidable group or sub-group of these institutions.

STRENGTHENING THE PROTECTION OF RETAIL INVESTORS

A number of restrictions are introduced on the marketing of hybrid capital and subordinated debt instruments, in order to protect retail investors and increase transparency in the marketing of these products. Henceforth, there must be a tranche of at least 50% for professional investors and the minimum investment will be €100,000 in the case of unlisted companies and €25,000 in that of listed companies.

Information on these financial instruments must include appropriate guidance and warnings regarding the risks associated with such instruments or strategies. The CNMV may require such information to be delivered to investors before the acquisition of a product, with highlighting in particular of those products that are not appropriate for non-professional investors owing to their complexity. Also, it may require these warnings to be included in any advertising.

In the event that the service is provided, the contractual document must include, along with the signature of the client, a written statement by the investor, in such terms as the CNMV may determine, that he/she has been warned that the product is inappropriate for him/her or, where applicable, that the institution has not been able to assess his/her knowledge and experience in relation to the product or service offered or applied for, given the insufficiency of the information supplied by the client.

In the case of securities other than shares issued by a credit institution, the information delivered to investors must highlight, inter alia, the differences between these products and ordinary bank deposits, in terms of yield, risk and liquidity.

NEW "CAPITAL PRINCIPAL" REQUIREMENTS

The "capital principal" requirements established by Royal Decree-Law 2/2011 of 18 February on the strengthening of the financial system that institutions and consolidable groups must comply with will be modified from 1 January 2013. Specifically, the current requirements of 8% (general) and 10% (for institutions that have not sold at least 20% of the securities representing their capital to third parties, and that have a wholesale funding ratio of more than 20%) will be converted into a single 9% requirement.

Also, the definition of "capital principal" will be modified, to adapt it to the one used by the European Banking Authority, although this will not involve any significant change to the requirements currently imposed on credit institutions operating in Spain. Instruments convertible into ordinary shares, non-voting equity units and contributions to capital of credit cooperatives which the Banco de España classifies as qualifying as "capital principal" are included in the new definition. Accordingly, issuance contracts or prospectuses, and any

changes in their characteristics, should be sent to the Banco de España to enable it to classify them as qualifying as "capital principal". By contrast, revaluation surpluses on available-for-sale financial assets that form part of equity, net of tax effects, are left out of the new definition.

Among deductions, apart from losses from previous years and intangible assets, 50% of the amount of certain assets is deducted, including: 1) certain holdings in financial institutions which are consolidable, by reason of their activity, but not included in the consolidable group; 2) holdings in reinsurance undertakings; 3) subordinated financing or other securities qualifying as capital issued by investee institutions, and; 4) exposures to asset-backed securities that receive a risk weighting of 1,250% of capital requirements, except when this amount has been included in the calculation of weighted risks for the calculation of such requirements for securitised assets.

Institutions or consolidable groups of credit institutions that on 1 January 2013 do not have the correct amount of "capital principal" must submit to the Banco de España the strategy and timetable to achieve compliance by 30 June 2013. However, institutions or consolidable groups of credit institutions that expect to fail to comply should notify the Banco de España, which must approve the tentative strategy and timetable presented by the institution.

TRANSFER OF POWERS TO THE BANCO DE ESPAÑA

From 1 January 2013, the Banco de España is entrusted with powers in relation to the authorisation of the creation of credit institutions, the establishment in Spain of branches of credit institutions not authorised in an EU Member State, and the imposition of very serious sanctions.[25] Previously, the authorisation of credit institutions and the imposition of sanctions for very serious infringements were the competence of the Ministry of Economic Affairs and Competitiveness, upon a proposal from the Banco de España.

REMUNERATION OF MANAGERS

The cap on the total fixed remuneration of the executive chairmen, managing directors and managers of institutions which, although not majority-held by the FROB, receive financial support is lowered from €600,000 to €500,000.

NEW FUNCTIONS OF THE CREDIT INSTITUTION DEPOSIT GUARANTEE FUND

Royal Decree-Law 16/2011 of 14 October 2011, which created the Deposit Guarantee Fund (DGF), introduced measures to support the resolution of a credit institution. When adopting these measures, the DGF may not assume a financial cost higher than the payments it would have had to make had it opted, at the time the resolution process opened, to pay the amounts guaranteed in the event of the winding-up of the institution.

The financial support measures that the DGF may implement can take the form of one or more of the following: 1) the granting of guarantees; 2) the extension of loans or credits; 3) the acquisition of assets or liabilities, the management of which it may carry out itself or entrust to a third party; and 4) facilitate its participation in the resolution process.

OTHER CHANGES

Law 2/2012 of 29 June 2012 on the 2012 State Budget is amended to increase by €41,235 million (from €55,000 million to €96,235 million) the guarantees granted for the financial obligations deriving from bond issues of credit institutions resident in Spain

25 Sanctions for very serious infringements are as follows: 1) a fine of up to 1% of own funds or up to €1 million, whichever is the highest; 2) revocation of the authorisation of the institution. In the case of branches of credit institutions authorised in another EU Member State, the sanction of revocation of authorisation will be understood to be substituted by a prohibition on the undertaking of new business within Spanish territory, and 3) a public reprimand published in the BOE.

with significant activity in the national credit market. Of this amount, €55,000 million is reserved for guarantees granted up to 15 December 2012 for new bond issues of credit institutions that, in the opinion of the Banco de España, are solvent but need liquidity.

The Royal Decree-Law entered into force on 31 August 2012.

Remuneration policy of credit institutions receiving public financial support for reorganisation or restructuring

Order ECC/1762/2012 of 3 August 2012 (BOE of 8 August 2012), which implements Royal Decree-Law 2/2012 of 3 February 2012 on the restructuring of the financial sector as regards remuneration at credit institutions receiving public financial support for reorganisation or restructuring, was published.

SCOPE

The Order will apply to the remuneration of the directors and senior managers of credit institutions which, as a result of reorganisation or restructuring, are majority-held by the FROB,[26] have received support from the FROB[27] or are going to request its support.

The remuneration restrictions established will apply from 2012 and will be lifted following completion of the reorganisation or restructuring of the credit institution, as declared by the Banco de España, on the basis of an opinion from the FROB that the majority holding or financial support has ended.

UPPER LIMITS ON REMUNERATION AT INSTITUTIONS MAJORITY-HELD BY THE FROB

As provided by Royal Decree-Law 2/2012 of 3 February 2012, the non-executive members of the board or similar body of institutions majority-held by the FROB may not receive total annual gross fixed remuneration of more than €50,000. Executive chairmen, managing directors and similar officers may not receive a total annual gross fixed remuneration of more than €300,000. This Order now specifies that, as long as the FROB has a majority holding, such officers may not receive any variable remuneration.

UPPER LIMITS ON REMUNERATION AT INSTITUTIONS THAT RECEIVE FINANCIAL SUPPORT FROM THE FROB

Likewise, Royal Decree-Law 2/2012 of 3 February 2012 established that the total annual gross fixed remuneration of non-executive members of the board or similar body of institutions that receive financial assistance from the FROB could not exceed €100,000. While for executive chairmen, managing directors and similar officers it could not exceed €600,000 (now lowered to €500,000, in accordance with the amendment introduced by Royal Decree-Law 24/2012, which was discussed in the previous section of this article).

The Order provides that the annual variable remuneration of managers and directors may not exceed 60% of the annual gross fixed remuneration. The receipt of this remuneration, in line with the provisions of Royal Decree-Law 2/2012, must be deferred by three years from its accrual, and must be subject to the condition that the profits arising from compliance with the plan drawn up to obtain the financial support are obtained.

This remuneration may amount to as much as 100% of the annual gross fixed remuneration, with the prior approval of the Banco de España, in the case of managers hired after or at the same time as the financial support from the FROB is received.

26 For the purposes of this Order, institutions majority-held by the FROB are deemed to be those in which the majority holding is held directly, as well as those that have received public financial support and form part of the same group as the former.

27 Institutions that have received financial support are deemed to be those that, although not majority-held by the FROB, have received any form of financial support envisaged in Royal Decree-Law 9/2009 of 26 June 2009 on bank restructuring and strengthening of the capital of credit institutions.

RULES FOR CALCULATING REMUNERATION FOR THE PURPOSE OF THE LIMITS

To calculate remuneration for the purpose of the limits, all amounts received from the various institutions belonging to the same group as the institution majority-held or supported by the FROB must be taken into account. Also, any allowances, compensation or similar amounts that the managers and directors receive from institutions in which they hold any office for or on behalf of the institution held or supported by the FROB, will be understood to form part of such remuneration.

In particular, it should be noted that contributions to pension schemes or any other social welfare scheme under collective agreements will be considered to be fixed remuneration. Also, any type of remuneration in kind will be considered to be (fixed or variable) remuneration of the corresponding amount.

COMPENSATION

The contracts or agreements of the managers and directors may not provide for compensation for termination of contract[28] in excess of that provided for in additional provision seven of Royal Decree-Law 3/2012 of 10 February 2012 on urgent measures to reform the labour market.[29] Moreover, they must ensure that the payment of such compensation will be adjusted to the provisions of Royal Decree 216/2008 of 15 February 2008,[30] including clauses that qualify and, where applicable, extinguish the right to receive compensation in accordance with the solvency and results of the institution.

RULES APPLICABLE IN INTEGRATION PROCESSES

In the case of integration of institutions, the managers and directors who do not form part of the institution majority-held or supported by the FROB will not be affected by the above-mentioned limits, even when they subsequently hold office in the majority-held or supported institution following the integration. For this purpose, a list of managers and directors should be submitted to the Banco de España, specifying which are affected by the restrictions established in this Order and which are not.

As regards the managers and directors from the institution that has required public financial support or that gives rise to it, the Minister of Economic Affairs and Competitiveness, upon a reasoned proposal of the Banco de España, may modify the criteria and limits established in this Order. However, under no circumstances may the variable remuneration proposed for directors and managers exceed 100% of the fixed remuneration.

Finally, in the event that the financial support of the FROB is granted during a competitive procedure for divestment, the Minister of Economic Affairs and Competitiveness, on the basis of a reasoned proposal of the Banco de España, may also adjust the above-mentioned limits for managers and directors who are going to hold office in the institution allotted the business under the competitive procedure or exempt them from such limits.

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28 The term "compensation for termination of contract" includes any amount of a compensatory nature that the manager or director may receive as a consequence of termination of contract, whatever the reason, origin or purpose, so that the sum of all the amounts that may be received may not exceed the limits established in Royal Decree-Law 3/2012 of 10 February 2012.

29 Additional provision seven provides that credit institutions majority-held or financially supported by the FROB may not pay, under any circumstances, compensation for termination of contract in excess of the lower of the following amounts: a) twice the maximum levels laid down by Royal Decree-Law 2/2012 of 3 February 2012 on restructuring of the financial sector; or b) twice the stipulated fixed annual remuneration. Directors and managers who have joined the institution or its group after or at the same time as the holding was taken or financial support granted by the FROB are exceptions to this rule. The Banco de España may, in view of the contractually stipulated conditions and the results of the restructuring plan, authorise higher amounts for such persons than those laid down in Royal Decree-Law2/2012, but always subject to the limit of twice the originally stipulated fixed annual remuneration.

30 This provision stipulates that payments for early termination of a contract will be based on the results obtained over time and will be established in such a way as not to reward poor results.

The Order entered into force on 9 August 2012.

Transparency and protection of bank customers: updating of regulations

Banco de España Circular CBE 5/2012 of 27 June 2012 (BOE of 6 July 2012 and error correction in the BOE of 11 October 2012) to credit institutions and payment services providers on transparency of banking services and responsible lending implements Ministerial Order EHA/2899/2011 of 28 October 2011 under the mandate conferred by that Ministerial Order on the Banco de España. Also, it sets out the disclosure obligations of payments services providers which offer foreign exchange services.[31] It repeals CBE 8/1990 of 7 September 1990 to credit institutions on transaction transparency and customer protection, except for Rule 8, which will remain in force for the sole purpose of calculating the weighted average interest rates on the transactions in Spain with the resident private sector addressed in CBE 5/2012.

Table 3 sets out the main new developments with respect to the previous rules.

SCOPE

Its scope is limited to banking services provided in Spain by Spanish credit institutions and the branches in Spain of foreign credit institutions to customers, or potential customers, who are natural persons (hereafter "customers"),[32] without prejudice to certain provisions relating to payment services providers offering foreign exchange services.

If the customer is acting in pursuit of his professional or business activity, the parties may agree to waive totally or partially the provisions of the Circular, except in respect of calculation of the annual percentage rate (APR), the official interest rates and the reference indices or rates used to calculate market value in the compensation for interest rate risk on mortgage loans.

OBLIGATION TO PROVIDE MORE INFORMATION ON BANKING SERVICES

Fees and interest rates

As provided previously, the fees and, where applicable, interest rates charged by credit institutions to their customers for banking services will continue to be set freely. In addition, credit institutions will henceforth make available to customers the fees and interest rates that they normally receive for the services they most frequently provide, as well as the chargeable expenses in such services, presenting them in the standard format established in Annex 1 of the Circular. This system replaces the previous one, whereby the declarations of the prime rate and of indicative rates for other loans, and of brochures listing maximum fee and commission charges had to be registered at the Banco de España in order to be applicable.

Institutions tacitly allowing customers to run overdrafts in deposit accounts or exceed the credit limit in credit accounts must publish, in the format established in Annex 2 of the Circular, the interest rates (or overlimit charges in the case of an exceeded credit limit) applicable in these cases. Unlike at present, this information must also include the fees or commissions which will be applied for the granting of these transactions.

Annexes 1 and 2 have to be made public in the institutions' commercial establishments and on their website.

Greater diligence in information on banking services

As a general requirement, before providing any banking service, institutions have to indicate to customers the amount of all fees, commissions and expenses which they will be

31 In accordance with Article 3 of Ministerial Order EHA/1608/2010 of 14 June 2012 on transparency of conditions and information requirements applicable to payment services.

32 Customers are defined as including joint owners, owners' associations, associations of heirs, probate estates and the like, provided that they are composed mainly of individuals and are not acting in pursuit of their professional or business activity.

TRANSPARENCY AND PROTECTION OF BANK CUSTOMERS

TABLE 3

CBE 8/1990 OF 7 SEPTEMBER 1990	CBE 5/2012 OF 27 JUNE 2012
Obligation to provide more information on banking services	
The fees for banking services are set freely. They may only be received for services that have been requested and effectively provided.	No significant changes.
The interest rates applicable to banking services, whether in deposits or in loans, are also set freely by agreement between the parties, whatever the transaction type and term.	No significant changes.
Institutions must make public, after registering them at the Banco de España, fees and chargeable expenses which will constitute a maximum, and they may not charge higher rates or amounts or different items than those registered.	Credit institutions must make available to customers the fees and interest rates that they normally receive for the services they most frequently provide, as well as the chargeable expenses in such services, presenting them in a standard format.
Not envisaged.	Institutions have to be especially diligent in the explanations to be given to customers when they offer certain banking products or services, including those which carry special risks.
Not envisaged.	Credit institutions have to furnish customers, free of charge, with all the precontractual information needed to make an informed decision on a banking service and to compare similar offers.
The cases are specified in which customers have to be given a copy of the contractual document, provided they expressly request it.	The Circular extends to all banking services received the obligation for credit institutions to deliver free of charge to customers, regardless of whether or not they request it, a copy of the contractual document evidencing those services.
Customers must be given the transaction settlement documents.	No significant changes, although new settlement formats covering more transactions are established.
New notification requirements	
Not envisaged.	Institutions have to give full and detailed information on interest received and paid and on fees and expenses accrued for each banking service provided to customers in the previous year.
Improvements in bank lending practices	
Not specifically envisaged.	Credit institutions have to have internal procedures to assess customer creditworthiness.
Not envisaged.	The concept of "responsible loan" is introduced, whereby institutions have to act honestly, impartially and professionally, having regard to the personal and financial situation, and to the preferences and objectives, of their customers.
Information to the Banco de España	
Institutions must send, inter alia, fee rates, assessment rules and interest rate notifications and statements.	Institutions must send, inter alia, information on the most frequent transactions carried out in the previous quarter.

SOURCES: BOE and Banco de España.

charged and, after such indication, offer them the option of withdrawing from the transaction. When the contractual relationship concerns loan, deposit or service transactions listed in Annex 1, the explanations have to mention the existence of that annex, of its content and of where customers may consult it. In particular, in the case of loans or advances, these explanations must include data allowing customers to understand the method used to calculate charges and other possible costs or penalties, as well as a clear description of the obligations undertaken by the customer and of the consequences deriving from non-compliance.

Institutions have to be especially diligent in the explanations to be given to customers when they offer certain banking products or services: 1) which carry special risks, such as, for example, that of a zero return on structured deposits or on hybrids with guaranteed principal, or that of a potentially significant increase in the cost of a loan as a result

of its specific characteristics; 2) which, to be properly judged by customers, require the assessment of multiple factors, such as the (past or future) performance of benchmark indices or of the price of linked products necessarily included in the package; 3) which, as a result of their amount and duration, entail obligations for customers which may be particularly onerous; or 4) whose marketing is accompanied by a personalised recommendation, particularly in the case of large-scale campaigns to sell the aforementioned products or services.

Credit institutions and payment service providers which buy from or sell to their customers foreign currencies or banknotes against euro must make public their minimum buy rates and maximum sell rates or, where appropriate, the single rates, along with the commissions and other charges to be applied in spot transactions when the amount does not exceed €3,000.

Precontractual information

Credit institutions have to furnish customers, free of charge, with all the precontractual information needed to make an informed decision on a banking service and to compare similar offers. This information must be clear, sufficient and objective and has to be provided in good time and in any event before the consumer is bound by any contract or offer. If this information has the nature of a binding offer, such circumstance must be indicated, as well as its period of validity. Once this information has been provided, the customer will be offered, also free of charge, the opportunity to withdraw from the transaction. In the particular case of loans, if the analysis, processing or other similar fees or charges arising from loan extension are not combined in a single origination fee, accurate details must be given of the different services to which they relate and their amounts.

In certain products and services,[33] additional information listed in the Circular must be provided and certain information specified in Annex 3 of the Circular has to be highlighted. Also, institutions must decide, depending on the physical or virtual characteristics of each information item, the best way of attracting the customer's attention. The means used to highlight information, such as, for example, bold or capital letters, may not be used for any other information (including titles) in the document. The header of precontractual information documents must include a message advising customers that the highlighted information is particularly important.

Finally, the font size must allow the document to be easily read, for which purpose lower case letters may not be less than 1.5 millimetres high.

Contractual information

Pursuant to Ministerial Order EHA/2899/2011, the Circular extends to all banking services received the obligation for credit institutions to deliver free of charge to customers, regardless of whether or not they request it, a copy of the contractual document evidencing those services.

Such delivery may be made on a durable electronic medium which allows reading, printing, preservation and reproduction without changes, or on a paper copy delivered to the customer upon entry into the contract or subsequently sent by post. In the case of contracts entered into electronically through digitised hand-written signatures, the institution has to deliver to the contracting parties the contract on paper and/or on a durable electronic support

33 Including sight and savings deposits, principal-guaranteed time deposits, consumer loans, mortgage loans, cheque negotiation and remotely marketed banking services.

bearing the digitised signatures. If any of the parties has signed by means of an advanced electronic signature, the signature date, reference and certifying authority must be stated. In any event, if any of the parties to the contract so requests, the institution has to send the contract by e-mail to the address given to it.

The provisions on the content of contractual documents in Ministerial Order EHA/2899/2011 are implemented, and certain qualifications are made in some areas, such as in remuneration of products, contract term, notifications prior to changes in conditions that are non-beneficial for customers, etc.

Notifications to customers

Ministerial Order EHA/2899/2011 requires institutions to deliver to customers, upon each settlement of interest or fees for services, a settlement document with a specified minimum content, and empowers the Banco de España to establish standard settlement formats (the delivery of a settlement document was compulsory before the Ministerial Order came into force). In the exercise of these powers, the Circular sets out, in Annex 4, the most common formats, which follow the formats already in use but include some additional items in specific cases.

Further, in implementation of Ministerial Order EHA/2899/2011, the Banco de España establishes the notification format (Annex 5) to be used by credit institutions to send annually to customers, in January each year, full and detailed information on interest received and paid and on fees and expenses accrued for each banking service provided to customers in the previous year.

Also, they must send customers free of charge, at least monthly, a statement of all current account activity, including at least the information set out in Annex 4, unless there was no activity in the current account in the month in question.

IMPROVEMENTS IN BANK LENDING PRACTICES

The concept of "responsible loan", first presented in Law 2/2011 of 4 March 2011 on sustainable economy, and subsequently in Ministerial Order EHA/2899/2011 is regulated in detail. Thus institutions, when they offer and grant loans or advances to customers and, where appropriate, provide related ancillary services, must act honestly, impartially and professionally, having regard to the personal and financial situation, and to the preferences and objectives, of their customers, and highlighting any condition or characteristic of contracts which is not conducive to that objective.

Moreover, institutions, in a manner commensurate with the volume, characteristics and complexity of their transactions, must have in place specific policies, methods and procedures for analysing and originating customer loans or advances (including a loan marketing policy which also addresses the remuneration of the persons entrusted with the marketing tasks). Such policies, methods and procedures, duly updated, must at all times be available to the Banco de España. Annex 6 of the Circular sets out the principles to be observed by these policies, methods and procedures.

INFORMATION ON THE ANNUAL PERCENTAGE RATE (APR) AND THE FORMULA USED TO CALCULATE IT

The elements to be included in the calculation of the APR are stipulated, and the mathematical formula used to calculate it is set out in Annex 7 of the Circular.

The APR and the residual effective cost or return[34] are calculated on the assumption that the contract will be in force during the agreed period and that the institution will duly meet its obligations on the terms and conditions agreed in the contract.

34 The residual effective cost or return is calculated using the mathematical formula for APR, but applying it only to the period until maturity or repayment and to the cost or return still to be paid or collected if the transaction follows its normal course.

If a contract contains clauses allowing changes in the interest rate and/or the fees or charges included in the APR, but those changes cannot be quantified, they must be calculated on the assumption that interest, fees and charges will accrue at the rate set when the contract was entered into. In these cases, the term "APR" will be replaced by "variable APR" and it must be expressly stated that this calculation system has been used.

Also regulated are the particular means of calculating APR in certain lending transactions, specifically in consumer loans and advances and in mortgages, which are subject to Law 16/2011 of 24 June 2011 on consumer credit contracts and Ministerial Order EHA/2899/2011, respectively. Generally lending transactions must include interest, fees and other charges the customer has to pay the institution as consideration for the loan or advance received or the services inherent in it, as well as the premiums of insurance aimed at ensuring the loan is repaid to the institution in the event of death, disability or unemployment of the individual who received the loan, provided the institution requires such insurance to be taken out as a condition for granting the loan or advance. In binding offers of subrogation and amendment of mortgage loans, the amount of the loan settlement fee or of the compensation for withdrawal from the loan subject to subrogation must be included, and the customer informed of the remaining effective cost of the loan to be subrogated.

In borrowing transactions, certain characteristics of the calculation of the APR are established, particularly in tacit overdrafts in sight accounts and in remuneration in kind, and, for the first time, the principles and factors to be taken into account in hybrid instruments with guaranteed principal are defined. In this latter case, the APR has to reflect the effective interest rate corresponding to the host contract once the embedded derivative has been separated, as well as the value of that derivative at the contract date.

OFFICIAL INTEREST RATES

The Circular specifies how to calculate the official interest rates,[35] which are stated in Annex 8. Particularly noteworthy are the two new ones introduced by Ministerial Order EHA/2899/2011: that linked to one- to five-year mortgage loans for the purchase of houses in the euro area, which has to be taken directly from those published by the ECB;[36] and the five-year interest rate swap (IRS) rate, which will be taken from those published daily on the screens customarily used by financial operators.

Also, it defines the reference indices and rates used to determine the market value of mortgage loans repaid early, for the purpose of calculating compensation for interest rate risk. Valid reference indices or rates are two–, three–, four–, five–, seven–, ten–, fifteen–, twenty– and thirty–year IRSs, with that used being the one whose term is nearest to the time remaining from the loan early repayment date to the next interest rate reset date specified in the contract or, if no interest rate adjustment is scheduled, to the maturity date.

INFORMATION TO THE BANCO DE ESPAÑA

The Circular specifies the formal obligations of institutions regarding the information they have to send periodically to the Banco de España by electronic means. Thus each quarter they have to send information on the most frequent transactions carried out in the previous

35 The official interest rates stated in Ministerial Order EHA/2899/2011 are: 1) average rate on unsubsidised house-purchase mortgage loans with terms over three years granted by credit institutions in Spain; 2) average rate on unsubsidised one- to five-year house-purchase mortgage loans granted by credit institutions in the euro area; 3) internal rate of return in the secondary market for two- to six-year government debt; 4) one-year interbank reference (EURIBOR); 5) five-year interest rate swap (IRS) ; and 6) MIBOR, applicable only for mortgage loans taken out before 1 January 2000.

36 Pursuant to Regulation 63/2002 of the European Central Bank of 20 December 2001 concerning statistics on interest rates applied by monetary financial institutions to deposits and loans vis-à-vis households and non-financial corporations.

quarter in the format established in Annex 1. Every month they must report the weighted average interest rates of certain transactions with the resident private sector in Spain initiated or renewed in the previous month, using the format given in Annex 9, so that the Banco de España can continue compiling and publishing certain mortgage market reference indices or rates.

Finally, a transition period is declared until the indices or rates currently applied (average interest rate of mortgage loans granted by commercial or savings banks with maturities longer than three years, and the savings bank lending reference rate, also known as the "CECA indicator, lending rate") in the review of contracts entered into before the entry into force of the Circular, and certain minor adjustments are made.

The Circular came into force, with certain exceptions, on 6 October 2012.

New powers of the European Supervisory Authorities: amendment of certain financial legislation

Royal Decree 1336/2012 of 21 September 2012 amended certain royal decrees[37] relating to the powers of ESAs (BOE of 5 October 2012).

This Royal Decree, which completes the transposition of Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010, incorporates into Spanish law the obligation of the competent authorities (Banco de España and CNMV) to cooperate with, inform and communicate with their European counterparts (the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA)) on certain matters, some of which were initially regulated in Royal Decree-Law 10/2012 of 23 March 2012 amending certain financial legal provisions relating to the powers of the ESAs, and which are now addressed in their respective implementing provisions.

The main developments are as follows.

BANKING SYSTEM

Credit institution registrations and deregistrations, as well as being recorded in the Special Register of the Banco de España and published in the BOE, must be notified to the EBA.

As regards the supervisory colleges promoted by the Banco de España to facilitate the exercise of supervisory functions, the EBA may participate in them as it sees fit in order to foster and monitor their efficient, effective and consistent functioning.

SECURITIES MARKET

The CNMV's communication and notification obligations to the ESMA regarding the securities market are as follows:

1 The authorisation of investment firms in Spain. Also, it must inform the ESMA and the European Commission (previously only the latter) of any difficulties

37 The Royal Decree amends the following legislation: the Regulations implementing Law 13/1989 of 26 May 1989 on credit cooperatives, approved by Royal Decree 84/1993 of 22 January 1993; Royal Decree 1245/1995 of 14 July 1995 on the creation of banks, cross-border activity and other matters relating to the legal regime of credit institutions; Royal Decree 1310/2005 of 4 November 2005 partly implementing Securities Market Law 24/1988 of 28 July 1988 on admission of securities to trading on official secondary markets, public and subscription offerings and the prospectus required for such purposes; Royal Decree 1332/2005 of 11 November implementing Law 5/2005 of 22 April on supervision of financial conglomerates, which amends other financial sector laws; Royal Decree 1362/2007 of 19 October 2007 implementing Securities Market Law 24/1988 of 28 July 1988 in respect of transparency requirements relating to information about issuers whose securities are admitted to trading on an official secondary market or on another regulated market in the European Union; Royal Decree 216/2008 of 15 February 2008 on the own funds of financial institutions; and Royal Decree 217/2008 of 15 February 2008 on the legal regime of investment firms and of other investment services entities partially amending the Regulations of Collective Investment Institutions Law 35/2003 of 4 November 2003 approved by Royal Decree 1309/2005 of 4 November 2005.

encountered by Spanish investment firms in establishing themselves, providing services or pursuing investment activities in a non-EU country.

2 In relation to prospectuses for admission of securities to trading on official secondary markets or public or subscription offerings, the approval of the prospectus and any supplement thereto for the purpose of cross-border validity. The CNMV must at the same time provide the ESMA with a copy of the prospectus. The CNMV must also notify the ESMA if it decides to transfer the approval of a prospectus (because Spain is the home Member State) to the supervisor of another Member State, or vice versa, i.e. if it accepts the transfer of prospectuses from the supervisor of another Member State for approval.

3 The cases in which issuers with registered office in a non-EU country are exempted by the CNMV from reporting and transparency obligations when the law of the third country in question lays down requirements equivalent to those in Spain or such an issuer complies with requirements of the law of a third country that the CNMV considers as equivalent.

4 The content of coordination and cooperation agreements which the CNMV may decide to enter into with other competent authorities to facilitate and establish effective supervision of the groups subject to its supervision, as well as the additional tasks delegated in those agreements.

Also, provision is made for the ESMA to participate, together with the CNMV and any other competent authority of a Member State, in on-site inspections of those supervisory authorities on institutions subject to supervision.

Regarding the supervision of financial holding companies and mixed financial holding companies, a list of the financial holding companies which control investment firms must, from the date of entry into force of the Royal Decree, be sent by the CNMV to the competent authorities of the other Member States, to the ESMA and to the European Commission.

Just as the ESMA may participate in credit institutions, it may also participate in CNMV-sponsored colleges of supervisors as it deems appropriate in order to promote and monitor the efficient, effective and consistent functioning of those colleges.

Also, the CNMV must advise the ESMA and the European Systemic Risk Board (ERSB), as well as the Ministry of Economic Affairs and Competitiveness and any other Spanish or foreign supervisory authorities which may be affected, whenever an emergency situation arises. An emergency situation refers particularly to an adverse financial market trend which may compromise the market liquidity and financial system stability of any Member State.

Finally, all the references to the rules of the Committee of European Securities Regulators (CESR) are replaced by references to the ESMA (the successor of the CESR).

FINANCIAL CONGLOMERATES

The changes made to the coordinator's[38] reporting obligations upon identification of a financial conglomerate are set out in Royal Decree 1332/2005 of 11 November 2005. Thus,

38 The function of coordinator is usually exercised by the competent authority entrusted with the tasks of overseeing and supervising the consolidable group of which the controlling entity forms part. In other cases it may be exercised by the competent authority responsible for supervising the Spanish regulated entity with the largest balance sheet total in the most important financial sector.

as well as notifying their status to the subject entity[39] and to the competent authorities which authorised the regulated entities of the financial conglomerate, it must inform the Joint Committee of the ESAs[40] (previously only the European Commission was informed).

The Royal Decree came into force on 6 October 2012.

Government debt market makers: new regulations

The *Resolution of 20 July 2012* (BOE of 26 July 2012) of the General Secretariat of the Treasury and Financial Policy (hereafter "the Treasury")[41] sets the conditions under which Spanish government debt market-makers may act and repeals the previous regulations set out in the Resolution of 18 November 2008, subsequently amended by that of 29 November 2011.

The new developments include most notably increasing the bonus ratio in the second round of Treasury bill auctions to make it equal to that for bonds.

Also, the time period in which the second round has to be conducted is changed. The second round must now be carried out between the auction allotment and 12.00 hours of the working day before that on which the bills are put into circulation (previously it was the following working day).

Finally, to endow the Treasury with greater flexibility in evaluating market makers, allowance is made for the non-penalisation of market makers when appropriate.

The Resolution came into force on 1 August 2012.

Collective investment institutions: new regulations

Royal Decree 1082/2012 of 13 July 2012 (BOE of 20 July 2012) approved the implementing Regulations of Collective Investment Institutions (CIIs) Law 35/2003 of 4 November 2012, amended by Law 31/2011 of 4 October 2012. It also repealed the previous regulations in Royal Decree 1309/2005 of 4 November 2005.

Among other things, the Royal Decree includes the amendments recently made by Law 31/2011 to Law 35/2003 and advances in the transposition of EU legislation.[42]

NEW OWN FUNDS REGIME FOR CII MANAGEMENT COMPANIES

The calculation of the minimum own funds to be held by CII management companies for the exercise of their activity in accordance with EU legislation is harmonised. It is similar to that in the previous regulations, although the percentages are different and the cases are broadened to include more types of activity. Thus they must have minimum fully paid share capital of €300,000 plus 25% of overhead expenses charged to the previous year's income statement (these items are unchanged). These amounts are increased by certain

39 The subject entity is the one which must assume the duties deriving from the conglomerate's relationship with the coordinator. It is usually the controlling entity.

40 The Joint Committee will be formed by the ESAs and the European Systemic Risk Board (ESRB). The ESAs will cooperate regularly and closely with the ESRB so as to ensure the inter-sectoral consistency of activities and to reach common positions in the area of financial conglomerate supervision and in other cross-sectoral issues.

41 Under the new basic organisational structure of the ministerial departments, the competences of the Directorate General of the Treasury and Financial Policy have been taken on by the General Secretariat of the Treasury and Financial Policy.

42 Specifically, to transpose Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (recasting Directive 85/611/EEC in a single text) and Directive 2010/78/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

percentages based on the effective value of the CIIs' net worth or on the assets managed for third parties,[43] with certain variations relative to the previous regulations.

If CII management companies market shares or other equity of CIIs, the minimum own funds must be increased by €100,000 before that activity is commenced, plus 0.5‰ of the effective net worth of the unit-holders or shareholders to whom the sale was made directly by the CII management company. If certain CIIs or similar foreign institutions are administered and/or managed, to the foregoing proportion must be added 4% of the gross fee income obtained. Certain items specified in the Royal Decree are deducted from the total own funds.

CII management companies with own funds below the required minimum must immediately notify this shortfall to the CNMV and submit a programme setting out their plans for returning to compliance. The programme must refer to: the reasons for non-compliance; the action, if any, taken by the institution; the definition of a plan for returning to compliance and the envisaged time that will be taken to do so, which may not be more than three months.

The obligations relating to investment in own funds (at least 60% in securities admitted to trading on regulated markets and in sight accounts or deposits with credit institutions), the upper limit on indebtedness (20% of own funds) and the prohibition on granting loans are similar to those in the previous regulations.

HARMONISATION OF POLICIES ON RISKS AND ON CONFLICTS OF INTEREST

A regime similar to that in other EU countries is set in place. In the area of risk management, it is made compulsory to specify the criteria to be used by CI management companies to assess the suitability and proportionality of their risk management policy on the basis of the nature, scale and complexity of their activities and of the CIIs managed by them.

Similarly, improvements are made to the rules applicable to CII management companies for controlling and managing personal transactions in which conflicts of interest may arise because inside information is held by employees or persons related to them or to the CII management company. In the case of inevitable conflicts of interest, the Royal Decree requires CII management companies to have suitable mechanisms to ensure fair treatment for the CIIs managed by them. Specifically, CII management companies have to ensure that their senior managers or the members of any of their competent internal bodies are informed without delay so they can take the necessary decisions to deal with those conflicts.

ENHANCEMENT OF INVESTOR PROTECTION

As envisaged in Law 31/2001, the Regulations provide for a short new document referred to as *key investor information*,[44] which replaces the previous simplified prospectus. It has two new features: first, it is standardised so as to ensure the comparability of harmonised funds and management companies of any Member State; and second, it includes only essential CII information, presented in abbreviated, easily understandable

43 The CNMV may set the terms under which a CII management company may replace the provision of 50% of the increase by a guarantee provided by a credit institution or an insurance policy with an insurance company for the same amount.

44 The key investor information document has to provide, inter alia, the following information: identification of the CII; short description of its investment objectives and investment policy; past-performance presentation or, where relevant, performance scenarios; costs and associated charges; and the risk/reward profile of the investment, including appropriate guidance and warnings in relation to the risks associated with investments in the CII.

form for investors so they are reasonably able to understand the essential characteristics, nature and risks of the investment product that is being offered to them and to take investment decisions on an informed basis without need to refer to other documents.[45]

New cases are included relating to changes in the regulations governing investment fund management, such as: the setting or raising of fees, changes in the frequency of calculation of the net asset value, conversion into a compartmentalised CII or into compartments of other CIIs, replacement of the depositary, and other cases to be defined in the regulations. As in previous cases, they must be authorised by the CNMV and communicated by the CII management company to the unit-holders before they come into force.

Communications to be made to unit-holders or shareholders must be by electronic means whenever so decided expressly by the investor.[46]

CII management companies which manage funds and investment firms established in another EU Member State must attend to and resolve complaints or claims in the language or in one of the official languages of the home Member State of the fund or investment firm.

Another aspect of investor protection derives from the strengthening of the mechanisms of cooperation, consultation, information exchange and professional secrecy between the competent supervisory authorities, similar to those in place for credit institutions. Thus the CNMV has to cooperate with the competent authorities of the Member States and with the ESMA to carry out the functions established in these Regulations.

It also has to assist the competent authorities of other Member States by providing the information needed for them to perform their functions and must cooperate in investigation or supervision activities. Similarly, it may request the cooperation of the competent authorities of another Member State in a supervisory activity or for an on-the-spot verification or in an investigation on the territory of the latter within the framework of their powers pursuant to the Royal Decree or its implementing regulations.

Finally, the CNMV may require the temporary suspension of the issuance, redemption or repurchase of units or shares of CIIs authorised in Spain when their price cannot be determined or for other reasons of force majeure.

CHANGES IN CROSS-BORDER ACTIVITY

Cross-border management

In accordance with Law 31/2011, the new development consists of the introduction of the European passport to operate throughout the EU for the cross-border management of investment funds,[47] as envisaged in Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009. Thus CII management companies may manage investment funds in other Member States either by establishing branches or under the freedom to provide services.

45 The prospectus and key investor information may be provided in a durable medium or via the investment company's or management company's website. A paper copy of these documents will be delivered free of charge to investors on request.

46 Previously, there were legal provisions only for sending the annual, six-monthly and, where applicable, quarterly reports free of charge by electronic means when so requested by unit-holders or shareholders.

47 Harmonised management companies and investment funds and investment firms already had a European "passport" to operate throughout the EU for the cross-border marketing of their shares and units. The main change consists of introducing a passport for the cross-border management of investment funds across EU Member States.

Cross-border management is of two types: activity abroad by Spanish CIIs and activity in Spain by foreign CII management companies. The regulations set different requirements for EU and non-EU CII management companies. Also, different procedures are laid down for the opening of branches and for the cross-border provision of services, and certain additional requirements are specified for CII management in the host country.

In any event, under the new regulations the provision of services in another Member State by an EU CII management company does not require authorisation by the supervisory authorities in the host country. All that is required is the submission of certain information by the supervisory authorities of the home country.

Cross-border marketing

The regime governing cross-border marketing in the EU is simplified. Previously, entities wishing to engage in cross-border marketing had to inform the competent authorities of the home Member State and submit certain documentation to the competent authorities of the host Member State, which considerably lengthened these formalities. Now, as well as less documentation being required,[48] the procedure is that the competent authorities notify their counterparts of the CII management company's application and that only the competent authorities of the home Member State check compliance with the requirements for the sale of CII shares or units to investors in Member States other than that in which the CII is domiciled. Also, the time periods required for being able to market CII shares and units are shortened,[49] and the CII no longer has to notify the competent authorities of the host Member State.

In consonance with the preceding section (enhancement of investor protection), CIIs domiciled in Member States have to provide investors based in another Member State, other than the home Member State, all the information and documentation in the manner stipulated in the Royal Decree and in these Regulations, including the investment fund rules or investment firm deed of incorporation, the key investor information, prospectus and yearly and six-monthly reports, along with any modifications thereof.

Finally, a supervision and cooperation framework is defined for the competent authorities of Member States which oversee CIIs engaging in cross-border marketing.

ADVANCES IN EU HARMONISATION

The provisions of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 in respect of the harmonised regulation of master-feeder structures have been transposed. A feeder CII invests at least 85% of its assets in another CII, called the master CII. Feeder CIIs may not invest in more than one CII (the master). A master CII may not also be a feeder CII, so as to prevent the cascade phenomenon. The harmonisation allows the master and feeder CIIs to be domiciled in different Member States, ensuring that investors better understand structures of this type and that the authorities can supervise them more easily, particular in a cross-border situation.

Also provided for is a harmonised regime for cross-border CII mergers which allows CIIs to merge regardless of their legal form upon prior authorisation by the competent authorities.

48 Apart from the notification letter, a CII only has to submit its fund rules or instruments of incorporation, its prospectus, its latest annual report and, where appropriate, any subsequent half-yearly report, its key investor information and an attestation that its fulfils the conditions imposed by Directive 2009/65/EC.

49 Previously the CII had to wait at least two months from the date when the documentation was submitted, except in the event of a reasoned denial, whereas the new Royal Decree allows marketing to commence when the competent authority of the home Member State notifies the CII that it has transmitted to the competent authority of the host Member State the notification letter along with the required documentation.

To provide greater assurance to investors, provision is also made for control by depositaries of the CIIs involved in the proposed merger and for examination by an independent auditor. Within the framework of this objective, the obligation to appoint an external expert to issue a report on the proposed merger if the resulting CII will be an investment fund is removed.[50]

OTHER REGULATORY CHANGES

Additions have been made to the list of cases in which the authorisation of CII management companies has to be suspended or revoked. If a CII management company administers, represents, manages investments and manages subscriptions and redemptions of CIIs authorised in another EU Member State, the competent authority of the host Member State (the CNMV in Spain) has to consult the competent authorities of the CII management company's home Member State before withdrawing the authorisation. The revocation of authorisation of a CII management company domiciled in a non-EU country also entails the revocation of authorisation of any branch operating in Spain. In this case, the CNMV also has to take the pertinent measures to prevent the institution from initiating new activities in Spain and safeguard investors' interests.

The penalty regime for CII management companies is updated by the addition of new serious and very serious infringements and the related penalties.

Also, the corporate income tax regulations approved by Royal Decree 1777/2004 of 30 July 2004 are amended to adapt the minimum percentage of investment required of CIIs investing in a single fund (currently 80%) to the new minimum percentage (85%) set by Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004.

Finally, the Royal Decree broadens the powers conferred on the CNMV by Royal Decree 217/2008 of 15 February 2008 on the legal regime governing investment firms and of other investment institutions, partially amending the implementing regulations of CII Law 35/2003 of 4 November 2003 enacted by Royal Decree 1309/2005 of 4 November 2005. Accordingly, as from the entry into force of the Royal Decree, the CNMV is empowered to define and implement: 1) the organisational structure requirements, and establish the minimum requirements for the organisation and internal control of investment and ancillary services provided by investment firms, as well as for specifying the tasks to be entrusted to the risk management functions; and 2) the communication regime, the content of reporting obligations, the manner in which disclosures are to be remitted, which may be electronically, and the reporting deadlines in relation to any changes made to investment firm authorisation conditions.

The Royal Decree came into force on 21 July 2012.

Collective investment institutions: amendment of the regulations on derivative instrument transactions and other operational aspects

CNMV Circular 1/2012 of 26 July 2012 (BOE of 4 August 2012) amending CNMV Circular 6/2010 of 21 December 2010 on transactions with derivative instruments and other operational aspects of CIIs; CNMV Circular 4/2008 of 11 September 2008 on the content of quarterly, half-yearly and annual reports of CIIs and of the statement of position; and CNMV Circular 3/2006 of 26 October 2006 on the prospectuses of CIIs, was published.

50 Previously a report by an independent expert had to be requested whenever any of the parties to the merger was a public limited company.

CHANGES TO CIRCULAR 6/2010

The criteria and requirements developed in the "Guidelines on risk measurement and the calculation of global exposure for certain types of structured UCITS" published by the ESMA on 28 March 2012, and applicable to CIIs with the specific objective of yield, are incorporated.

The counterparties of derivative financial instruments in which CIIs invest with sufficient solvency in the opinion of the management company to fulfil their obligations[51] are permitted as valid. To this end, the management company must perform a credit risk analysis of the counterparty, using the appropriate methodologies and considering various commonly used market indicators or parameters.[52]

Amendments are introduced in respect of the guarantees or collateral received by the CII to reduce counterparty risk in order to fulfil requirements for the eligibility, calculation and reinvestment of guarantees or collateral received in the CIIs' operations (both with derivatives and reverse repos, sell/buy-back agreements, securities lending, etc.) that are required at European level. Thus, the list of assets which can be used as guarantees[53] is extended, as is that of the assets in which the CII may reinvest the cash obtained as a guarantee; including, among others, reverse repos entered into with credit institutions that have their headquarters in a Member State of the European Union or in any other Member State of the OECD subject to prudential supervision.

In relation to the CIIs with the specific objective of yield,[54] an itemisation is given of non-compliances the resolution of which jeopardises achievement of the yield target set in the CIIs' prospectuses, specifying certain action for investor protection. Thus, in addition to informing the CNMV of this immediately, they must provide the measures which might be adopted in order to avoid conflicts of interest and the protection of unit-holders' interests.

Finally, the regime is relaxed for CIIs with a specific objective of guaranteed yield (commonly known as "internal guarantee" funds), with the result that it is not necessary to have a favourable credit rating for guarantors in cases where the limits established in the Regulation will not foreseeably be exceeded. Thus, the entity guaranteeing a specific objective of yield to the CII may, under no circumstances, have a solvency rating granted by a specialised agency which is lower than that of Spain at any given time. Furthermore, the aforementioned guarantors are required to have sufficient solvency in the management company's opinion to fulfil their obligations.

CHANGES TO CIRCULAR 4/2008

The online submission of certain documents to the CNMV is updated. Specifically CIIs' and CII management companies' annual reports, comprising the annual accounts, management report and auditor's report, must be submitted electronically using the "IPE"

51 Previously, a counterparty had sufficient solvency when its long-term credit rating showed the entity's strong capacity to meet payment of its obligations on time (rated at least "A-" by Standard & Poor's, "A3" by Moody's, "A-" by Fitch or similarly by other ECAIs), and in the short term, at least, a satisfactory capacity to meet the payment of its obligations on time (rated at least "A-2" by Standard & Poor's, "P-2" by Moody's, "F2" by Fitch or similarly by other ECAIs. For these purposes, the "short term" will be deemed a period of 13 months or less).

52 These solvency requirements are not enforced in relation to the counterparties of financial instruments not traded on organised derivatives markets provided that they are settled through a central counterparty clearing house which demands margins based on trading price, records the operations performed and is interposed between the contracting parties, acting as a buyer to the seller and as a seller to the buyer.

53 Including, *inter alia*, private non-subordinated debt traded on a regulated market which currently only needs to have a favourable credit rating in the management company's opinion.

54 These CIIs have an investment policy of attaining a specific yield target which may comprise obtaining a predefined fixed or variable pay-off tied to the performance of any of the suitable underlyings established in CNMV Circular 6/2010 of 21 December 2010.

procedure for regular reports of CIIs in the CIFRADOC/CNMV electronic service, in accordance with the provisions of the Resolution of the Chairman of the CNMV of 16 November 2011, whereby the CNMV's[55] Electronic Register is created and regulated. It will begin to be applicable to documents referring to 2012.

CHANGES TO CIRCULAR 3/2006

It is specified that changes to the credit rating of fixed-income assets are not considered essential items of CIIs' prospectuses provided that, at least: the credit rating of Spain is maintained, the other selection criteria of the assets remain the same, and the investment fund's purpose and policy are not distorted. In such cases, it will only be necessary to publish a significant event including the aforementioned change prior to it becoming effective, without prejudice to the obligation to include this information in the following update of the prospectus.

Furthermore, it is clarified that only essential changes[56] to the brochure are those which grant the right to withdraw.[57]

OTHER CHANGES

Like the CIIs, investment firms and their consolidable groups are required to send to the CNMV compulsory financial information and reports on internal control and capital adequacy assessment through the CIFRADOC/CNMV service, by the submission thereof to the CNMV's Electronic Register as standardised electronic documents, in accordance with the provisions in the Resolution of the Chairman of the CNMV of 16 November of 2011, whereby said register is created and regulated.

The Circular came into force on 5 August 2012.

Net short positions on shares, sovereign debt and uncovered sovereign credit default swaps: regulatory implementation of European law

Commission Delegated Regulation 826/2012 of 29 June 2012 (OJ L of 18 September 2012), supplementing Regulation 236/2012 of 14 March 2012 of the European Parliament and of the Council, on short selling and certain aspects of credit default swaps with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to the European Securities and Markets Authority (ESMA) in relation to net short positions and the method for calculating turnover to determine exempted shares was published.

The Regulation aims to establish, on one hand, a uniform regime for the submission of notifications and information by investors to national competent authorities or by the latter to the ESMA and, on the other, to establish the method to calculate turnover to determine the principal trading venue of a share.

Investors must notify the competent authorities of net short positions on shares, sovereign debt and uncovered sovereign credit defaults swaps using a form provided by the competent authority which shall take the formats set out in Annexes I and II to the Regulation.

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55 Previously, the above-mentioned documents were sent online using the CIFRADOC/CNMV service approved by the CNMV Board of Directors on 15 September 2006.

56 The following are considered changes to essential items in investment funds' prospectuses: the replacement of the management company; the replacement of the custodian; the engagement of asset management functions; the transformation of the fund or the sub-fund; the modification of the investment policy; changes in the income distribution policy; the setting or raising of the management fee and of the custodian's fee; the setting or raising of the management company's fees or of discounts in favour of the fund to be made in subscriptions and redemptions; for funds whose investment policy is based on investing in only one investment fund, the change of the fund subject to investment; and the cases envisaged here which affect the information included in their prospectus on said fund.

57 In this case, the communication sent to unit-holders must mention, their right to opt, during a period of 30 calendar days, to redeem or transfer their units, in full or in part, without the deduction of any redemption or transfer fee being payable, at the unit redemption price corresponding to the last day of the 30 calendar days of the notification period.

The competent authorities shall provide ESMA with the following information: 1) the daily aggregated net short position on each individual share in the main national equity index as identified by the relevant competent authority; 2) on a quarterly basis, the aggregated net short position for each individual share which is not included in the previous point; 3) the daily aggregated net short position on each sovereign issuer, and 4) where applicable, daily aggregated uncovered positions on credit default swaps of a sovereign issuer.

As for the method for calculating turnover to determine the principal trading venue of a share, the competent authority shall use the best available information which may include, inter alia, the following: 1) publicly available information; 2) information from trading venues where the relevant share is traded; 3) information provided by another competent authority, including the competent authority of a third country; and 4) information provided by the issuer of the relevant share.

In accordance with Regulation 236/2012, *Commission Implementing Regulation 827/2012 of 29 June 2012* (OJ L of 18 September 2012) was published which lays down technical standards with regard to the means for public disclosure of net positions in shares, the format of the information to be provided to the ESMA, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and periods for the determination of the principal trading venue for a share.

Net short positions in shares shall be disclosed through central websites operated or supervised by the competent authorities. Said authorities shall notify the ESMA of this, which in turn, shall insert on its own website a hyperlink to all those central websites. Presentation shall be in the format specified in the Annexes to this Regulation so that all the relevant data on positions in respect of each share issuer shall appear. It will also permit users to check whether, at the time of accessing the website, the net short positions in a specific share issuer have reached or exceeded the publication threshold which is set at 0.5% of the issued share capital.

The competent authorities shall provide the ESMA on a quarterly basis with information on net short positions in shares electronically in the format specified in the Annexes to this Regulation.

Another block of this Regulation details the types of agreements, arrangements with third parties and other measures to ensure the settlement of uncovered short sales of shares or sovereign debt instruments when due.[58]

The agreements to borrow and other enforceable claims may consist of the following (provided that they are legally binding for the duration of the short sale): 1) futures and swaps; 2) options; 3) repurchase agreements; 4) standing agreements or rolling facilities; 5) agreements relating to subscription rights, and 6) other claims or agreements leading to delivery of the shares or sovereign debt.

58 Regulation 236/2012 established a series of restrictions on uncovered short sales in shares or in sovereign debt. Thus, one of the following conditions had to be fulfilled: 1) that they have been borrowed or alternative provisions resulting in a similar legal effect have been made; 2) that agreements have been entered into to borrow the share or, if applicable, the sovereign debt instrument, or there is an absolutely enforceable claim under contract or property law for the transfer of ownership of a corresponding number of securities of the same class so that settlement can be effected when it is due, or 3) there is an arrangement with a third party that has confirmed that the share or, if appropriate, the sovereign debt instrument has been located or there is a reasonable expectation that settlement can be effected when it is due.

In relation to arrangements with third parties for short sales of shares, a distinction is drawn between "standard locate arrangements and measures",[59] "standard same day locate arrangements and measures",[60] and "easy to borrow or purchase arrangements and measures"[61]. The arrangements to be made with third parties in relation to sovereign debt include: the "standard sovereign debt locate arrangement",[62] the "time limited confirmation arrangement",[63] the "unconditional repo confirmation"[64] and the "easy to purchase sovereign debt confirmation[65]. All of these arrangements shall comply with a series of conditions which are detailed in the Regulation.

Finally, the Regulation determines the dates and reference period for the principal trading venue calculation of a share and the obligations of the competent authorities to notify the ESMA of shares whose principal trading venue is located outside the European Union.

Both regulations came into force on 19 September 2012, and except for any derogations, will be applicable from 1 November 2012.

EU regulation on OTC derivatives, central counterparties and trade repositories

Regulation 648/2012 of the European Parliament and of the Council of 4 July 2012 (OJ L of 27 July 2012) on OTC derivatives, central counterparties (CCPs) and trade repositories was published.

Generally, the Regulation sets out clearing[66] and bilateral risk management requirements for OTC derivative contracts[67] ("OTC derivatives"), and requirements for the performance of activities of CCPs[68] and trade repositories.[69]

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59 The third party confirms, prior to the short sale being entered into, the availability of the shares for settlement in due time taking into account the amount of the possible sale and market conditions and the period for which the share is located.

60 The third party confirms, prior to the short sale being entered into, that it will be covered by purchases during the day on which the short sale takes place. In the event of the sale not being covered, the natural or legal person will promptly send an instruction to the third party to procure the shares to cover the short sale **and ensure settlement in due time.**

61 The third party confirms, prior to the short sale being entered into, that the share is easy to borrow or purchase in the relevant quantity, taking into account market conditions and indicating the period in which the share is located. If the sale could not be covered through purchasing or borrowing it, the natural or legal person will promptly send an instruction to the third party to procure the shares to cover the short sale and to ensure settlement in due time.

62 It is the confirmation given by a third party, prior to the short sale being entered into, that it considers that it may have available for settlement in due time the amount of the sovereign debt requested by the natural or legal person, taking into account market conditions and indicating the period for which the sovereign debt is located.

63 It is the arrangement whereby the natural or legal person indicates to a third party that the short sale will be covered by purchases during the same day of the short sale and the third party confirms, prior to the short sale being entered into, that it has a reasonable expectation that the sovereign debt can be purchased in the relevant quantity taking into account the market conditions and other information available to that third party on the supply of sovereign debt instruments on the day of entering into the short sale.

64 It shall mean the confirmation given by a third party, prior to the short sale being entered into, that it has reasonable expectation that settlement can be effected when due as a result of its participation in a structural based arrangement, organised or managed by a central bank, a debt management office or a securities settlement system that provides unconditional access to the sovereign debt in question for the amount corresponding to the short sale.

65 It shall mean a confirmation by the third party, provided prior to the short sale being entered into, that it has a reasonable expectation that settlement can be effected when due on the basis that the sovereign debt in question is easy to borrow or purchase in the relevant quantity taking into account the market conditions and any other information available to that third party on the supply of the sovereign debt.

66 Clearing is a process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash or both, are available to secure the exposures arising from those positions.

67 An OTC derivative is a derivative contract the execution of which does not take place on a regulated market or on a third-country market considered as equivalent to a regulated market.

68 A CCP is a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, acting as the buyer to every seller and the seller to every buyer.

69 Trade repositories shall be legal persons established in the European Union which centrally collect and maintain the records of derivatives.

The most important changes are as follows:

OTC DERIVATIVES

OTC derivatives subject to the clearing obligation shall be cleared through a CCP and the trade repositories shall be notified. For these purposes, ESMA shall establish, maintain and keep up to date a public register to correctly and unequivocally identify the classes of OTC derivatives subject to the clearing obligation. This register shall be available on ESMA's website.

The counterparties shall clear the OTC derivatives belonging to a class of OTC derivatives[70] declared subject to the clearing obligation[71]. Those which constitute intragroup transactions[72] shall not be subject to the clearing obligation provided that they fulfil certain requirements detailed in the Regulation.

The CCPs authorised to clear OTC derivatives shall accept clearing such contracts on a non-discriminatory and transparent basis, regardless of the trading venue[73]. Nevertheless, they may require that a trading venue comply with the operational and technical requirements established in the Regulation, including the risk-management requirements.

The counterparties and the CCPs shall report to the trade repository (on the working day following conclusion of the contracts) the data on the derivatives contracts concluded and any modification or termination thereof.

Finally, the Regulation sets forth a series of risk mitigation techniques applicable to OTC derivative contracts not cleared by a CCP, and the introduction of procedures and arrangements to measure, monitor and mitigate operational risk and counterparty credit risk.

AUTHORISATION AND SUPERVISION OF CCPS

The community passport of CCPs is regulated,[74] which shall be granted solely for activities related to clearing and shall specify the services or activities that the CCP may provide or undertake, including the classes of financial instruments covered by such authorisation. Similarly, the cases in which it can be refused or, if applicable, revoked are detailed.

The CCPs shall have a permanent and available initial capital of at least €7.5 million. The CCPs' capital, including retained earnings and reserves, shall be proportionate to the risk stemming from its activities and, especially, sufficient to ensure an orderly winding-down or restructuring of their activities over an appropriate time span and an adequate protection against credit, counterparty, market, operational, legal and business risks.

Likewise, they will have robust governance arrangements, including a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective

70 The class of derivatives is a subset of derivatives sharing common and essential characteristics including at least the relationship with the underlying asset, the type of underlying asset, and currency of notional amount. Derivatives belonging to the same class may have different maturities.

71 ESMA shall, on its own initiative, after having conducted a public consultation and after having consulted the ESRB and, where appropriate, the competent authorities of third countries, notify the Commission of the classes of derivatives that should be subject to the clearing obligation provided in Article 4, but for which no CCP has yet received authorisation.

72 An intragroup transaction is an OTC derivatives contract entered into with a counterparty belonging to the same group, provided that both counterparties are included in the same consolidation of a full basis and are subject to appropriate centralised risk evaluation, measurement and control procedures.

73 A trading venue is a system operated by an investment firm or a market operator, other than a systematic internaliser which bring together buying and selling interests in financial instruments that result in contracts.

74 The community passport means that once the authorisation has been given, it will be valid throughout the territory of the European Union.

processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate internal control mechanisms, including sound administrative and accounting procedures. The senior management shall be of sufficiently good repute and shall have sufficient experience so as to ensure the sound and prudent management of the CCP.

They shall inform the competent authority of the identities of the shareholders or members, whether direct or indirect, natural or legal persons that have qualifying holdings,[75] and of the amounts of those holdings. The competent authority shall refuse to authorise a CCP where it is not satisfied as to the suitability of the shareholders or members that have qualifying holdings in the CCP.

Where close links exist between the CCP and other natural or legal persons, the competent authority shall grant authorisation only where those links do not prevent the effective exercise of the supervisory functions of the competent authority.

Each Member State shall designate the competent authority responsible for carrying out the duties resulting from this Regulation for the authorisation and supervision of CCPs established in its territory and shall inform the Commission and ESMA thereof.

Competent authorities shall cooperate closely with each other, with ESMA and, if necessary, with the European System of Central Banks (ESCB). The CCPs established in a third country may provide clearing services to clearing members or trading venues established in the European Union only where the CCPs are recognised by ESMA. The latter may establish cooperation arrangements with the relevant competent authorities of third countries whose legal and supervisory frameworks have been recognised as equivalent.

CCPs shall establish a risk committee, which shall be composed of representatives of its clearing members, independent members of the board and representatives of its clients. The risk committee shall advise the board on any arrangements that may impact the risk management of the CCP, such as a significant change in its risk model, the default procedures, the criteria for accepting clearing members, the clearing of new classes of instruments, or the outsourcing of functions.

Where a natural or legal person or such persons acting in concert have taken a decision either to acquire or sell, directly or indirectly, a qualifying holding in a CCP or to further increase, directly or indirectly, such a qualifying holding in a CCP as a result of which the proportion of the voting rights or of the capital held would reach or exceed 10%, 20%, 30% or 50% or so that the CCP would become its subsidiary, they shall first notify in writing the competent authority, indicating the size of the intended holding. The competent authority shall appraise the suitability of the proposed acquirer and the financial soundness in order to ensure the sound and prudent management of the CCP, in which an acquisition is proposed, and having regard to the likely influence of the potential acquirer on the CCP.

The CCPs shall maintain and operate effective written organisational and administrative arrangements to identify and manage any potential conflicts of interest between themselves, including their managers, employees, or any person with direct or indirect control or close links, and their clearing members or their clients known to the CCP.

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75 A qualifying holding is a direct or indirect holding in a CCP or trade repository which represents at least 10% of the capital or of the voting rights.

Where the CCPs outsource operational functions, services or activities, they shall remain fully responsible for discharging all of their obligations. The CCPs shall not outsource major activities linked to risk management unless such outsourcing is approved by the competent authority.

When providing services to their clearing members, and where relevant, to their clients, CCPs shall act fairly and professionally in accordance with the best interests of such clearing members and clients and sound risk management. The CCPs shall have accessible, transparent and fair rules for the prompt handling of complaints.

The CCPs shall invest their financial resources only in cash or in highly liquid financial instruments with minimal market and credit risk that are capable of being liquidated rapidly with minimal adverse price effect.

The CCPs may enter into an interoperability arrangement[76] with other CCPs where the requirements laid down in this Regulation are fulfilled. Specifically, they shall: 1) put in place adequate policies, procedures and systems to effectively identify, monitor and manage the risks arising from the arrangement so that they can meet their obligations in a timely manner; 2) agree on their respective rights and obligations, including the applicable law governing their relationships; 3) identify, monitor and effectively manage credit and liquidity risks so that a default of a clearing member of one CCP does not affect the interoperable CCPs, and 4) identify, monitor and address potential interdependences and correlations that arise from an interoperability arrangement that may affect credit and liquidity risks relating to clearing member concentrations, and pooled financial resources. In any event, interoperability arrangements shall be subject to the prior approval of the competent authorities of the CCPs involved.

TRADE REPOSITORIES

As with CCPs, the Community passport for trade repositories has been regulated, specifying the instances in which authorisation may be refused or, where appropriate, revoked. The ESMA and the related competent authority will exchange all the information needed for oversight of the fulfilment of the requirements for inscription or authorisation in the Member State in which it is established.

Generally, and similarly to CCPs, trade repositories should have sound governance mechanisms, including a clear organisational structure, with well-defined, transparent and consistent reporting lines, along with suitable internal control mechanisms, including appropriate administrative and accounting procedures that prevent any revelation of confidential information. Senior management and board members should have sufficient integrity and experience to ensure appropriate and prudent management.

They shall maintain and apply effective measures for detecting and managing conflicts of interest that might arise in relation to their managers, employees or any person that directly or indirectly maintains close links with them.

If a trade repository offers ancillary services (e.g. trade confirmation services, trade matching, credit event servicing, portfolio reconciliation or portfolio compression), it will keep them operationally separate from the trade repository's function consisting of centrally collecting and maintaining records of derivatives.

76 An interoperability arrangement means an arrangement between two or more CCPs that involves a cross-system execution of transactions.

Further, they shall identify sources of operational risk and minimise them through the development of appropriate systems, controls and procedures. Such systems shall be reliable and secure and have adequate capacity to handle the information received. Also, they shall regularly, and in an easily accessible way, publish aggregate positions by class of derivatives on the contracts reported to them.

The Regulation details the procedural rules for the adoption of supervisory measures and the imposing of fines on trade repositories.

Relevant authorities of third countries that do not have any trade repository established in their jurisdiction may contact ESMA with a view to establishing cooperation arrangements to access information on derivatives contracts held in Union trade repositories, provided that guarantees of professional secrecy exist, including the protection of business secrets shared by the authorities with third parties.

Competent authorities, ESMA and other relevant authorities shall provide one another with the information required for the purposes of carrying out their duties. If they receive confidential information, they will use it exclusively in the exercise of their duties, duly informing the relevant members of the ESCB.

The Regulation came into force on 16 August 2012.

Measures to ensure budgetary stability and the promotion of competitiveness

Royal Decree-Law 20/2012 of 13 July 2012 (BOE of 14 July 2012) on measures to ensure budgetary stability and the promotion of competitiveness.

From the financial regulation and fiscal standpoint, the following aspects are notable.

FINANCIAL MEASURES

Law 24/1988 of 28 July 1988 on the Securities Market and Law 44/2002 of 22 November 2002 on financial system reform measures have been amended to include a new financial instrument in the Spanish legal system: the so-called *internationalisation covered bonds*, which are similar to territorial covered bonds[77], introduced by Law 44/2002.

They are fixed-income securities that may be issued by credit institutions, whose capital and interest are especially secured, inter alia, by the following assets:

1 Loans and credits tied to the financing of Spanish goods and services export agreements or to the internationalisation of companies resident in Spain, granted or guaranteed by general government, central banks or multilateral development banks, and international organisations, and which are of high credit quality. These loans and credits may also secure territorial covered bonds, whereby, at the time of issue of internationalisation covered bonds, it must be decided which of these loans or credits are to secure this issue, since they cannot simultaneously secure both types of bonds.

2 Loans and credits tied to the financing of Spanish goods and services export agreements or to the internationalisation of companies resident in Spain, granted to debtors that are non-financial corporations or financial institutions, and are of high credit quality, or that benefit from the protection from credit

77 They are similar to covered bonds and enjoy the same tax arrangements.

risk by means of an insurance policy or a guarantee by the State, issued by CESCE (the Spanish export credit insurance and reinsurance company).

3 The loans and credits tied to the financing of goods and services export agreements of whatever nationality that benefit from protection from credit risk by means of an insurance policy or a guarantee by States of high credit quality, issued by their respective export credit agencies or bodies of a similar nature.

The internationalisation covered bonds may be secured up to a limit of 5% of the principal issued by specific replacement assets,[78] provided they are not secured by any loan or credit granted by the issuing institution itself, or by other institutions in its group (with the exception of those issued by the State, by other European Union Member States or by the OCI).

The total amount of internationalisation covered bonds issued by a credit institution may not exceed 70% of the amount of the unrepaid loans and credits mentioned in item 1) above. However, if the amount exceeded this limit, it would have to be restored within a period no longer than three months, increasing its portfolio of the aforementioned loans or credits, acquiring its own covered bonds on the markets or through the redemption of covered bonds for the amount necessary to restore the balance. Meanwhile, it must cover the difference by means of a deposit of cash or public funds at the Banco de España, or by assigning to the payment of the covered bonds new replacement assets of the type envisaged in item 2), provided that the limit set hereunder is met.

Finally, the instruments may be admitted to trading on securities markets, in conformity with the provisions of Law 24/1988 of 28 July 1988 on the Securities Market, and may be acquired by the institutions, in which case they will be in the form of book entries.

FISCAL MEASURES

In the case of personal income tax, the withholding rate on fee-earning activities and on the prepayment of tax on earned income[79] rises from 15% to 19%. Temporarily, however, from September 2012 to 31 December 2013, this rate will be 21%.

Further, the tax offset applicable to the deduction for purchase of the principal residence for taxpayers who bought their house prior to 20 January 2006 has been eliminated for fiscal year 2012.

Under corporate income tax, the measures essentially affect large companies. In 2012 and 2013 the offsetting of negative tax bases generated in previous years will be restricted to 50% for those entities whose turnover during the previous year was between €20 million and €60 million (the figure was previously 75%) and to 25% if the turnover exceeds €60 million (previously 50%).

Over this same period, the deduction for goodwill arising from acquisitions of businesses will be subject to the maximum annual limit of 1% of the related amount (5% previously). Likewise, for fiscal years 2012 and 2013, the ceiling on the tax deduction for intangible fixed assets with an indefinite useful life is reduced from 10% to 2%.

78 These include the following: a) fixed-income securities represented by book entries issued by the State, other Member States of the European Union or the Official Credit Institute; b) mortgage covered bonds or mortgage bonds listed on an official secondary market or on a regulated market; c) securities issued by mortgage or asset securitisation special purpose entities listed on an official secondary market, or on a regulated market, with a high credit rating; d) territorial covered bonds and internationalisation covered bonds listed on an official secondary market or on a regulated market.

79 Specifically, imparting courses, conferences, colloquiums, seminars and the like, or arising from the production of literary, artistic or scientific work, provided that the right to use such work is conceded.

There is also a temporary increase in partial payments that will affect the two remaining such payments for 2012 and the three partial payments for 2013. The tax base of the partial payment thus increases on including the 25% of the amount of dividends and the income accrued thereon, to which the exemption for avoiding international economic double taxation is applicable. There is also an increase in the percentage applicable to the base for the calculation of this partial payment on the basis of the volume of operations for the previous year, establishing several tranches, between €6 million and €20 million. If this amount is exceeded, the percentage of the minimum amount of the partial payment increases from 8% to 12%.

Finally, the restriction on the deduction for financial costs is widened, making it extensive to all companies in general, without it being confined to their being part of a mercantile group. The limit on this deductibility was set at 30% of the operating profit for the year, but it allowed, in any event, costs for the year up to €1 million to be deducted. The Royal Decree-Law specifies that, if the tax period for the entity is less than one year, the limit of €1 million will be applied in proportion to its duration. Further, the instances in which this limit will not be applicable are amended. These cases are:

1 Credit institutions[80] and insurance companies (previously only credit institutions). However, in the case of credit institutions or insurance companies that are taxable under the fiscal consolidation regime jointly with other institutions that do not have this consideration, the 30% ceiling will be calculated taking into account the net operating profit and financial costs of these latter institutions.

2 When during the tax period the entity is wound up, unless this is as a result of a restructuring operation or takes place within a fiscal group, and the wound-up institution has deductible financial costs as at the time of its integration into the group.

Lastly, a new 10% charge is established on dividends and income of foreign origin arising on the transfer of equity securities of companies not resident in Spain, exclusively to 30 November 2012, in a similar fashion to that envisaged in Royal Decree-Law 12/2012. Thus, fulfilling certain requirements set out in the regulations, it may not be necessary to integrate the returns generated to that date into the corporate income tax base and they will have the option of availing themselves of new special charge.

Regarding indirect taxation, as from 1 September the standard rate of VAT increases from 18% to 21%, the reduced rate from 8% to 10%, and the super-reduced rate is held at 4%, which is applicable to staple goods and services. Certain goods and services hitherto taxed at the reduced rate (8%) will now be taxed at the standard rate (21%). Finally, the tax rate applicable to the delivery of housing units, including garage parking spaces (with a maximum of two units) transferred jointly therewith, is maintained at 4% until 31 December 2012.

The Royal Decree-Law came into force on 15 July.

Liquidity measures for the regional governments and in the financial field

Royal Decree-Law 21/2012 of 13 July 2012 (BOE of 14 July 2012) on liquidity measures for general government and in the financial field has been published.

From the financial regulation standpoint, the following paragraphs are notable.

80 To this end, those entities whose voting rights relate in full, directly or indirectly, to credit institutions, and whose sole activity consists of the issue and placement on the market of financial instruments to reinforce regulatory capital and the financing of such entities, shall receive the treatment of credit institutions.

EUROPEAN FINANCIAL ASSISTANCE FOR THE RECAPITALISATION OF SPANISH FINANCIAL INSTITUTIONS

The Banco de España shall be exempt from the duty of professional secrecy[81] so it may provide the European Commission, the ECB, the European Banking Authority, the IMF, the European Financial Stability Facility and, where appropriate, the European Stability Mechanism with the information needed for the proper performance of their functions in respect of financial assistance for the recapitalisation of Spanish financial institutions.

Along the same lines, the FROB is authorised to subscribe to the agreements and contracts necessary to formalise and place at the disposal of the State and the FROB itself the financial assistance that it may receive, directly or indirectly through the State, in cash or in debt securities. This assistance will not be subject to the limits envisaged in Article 2.5 of Royal Decree-Law 9/2009 of 26 June 2009 on bank restructuring and the strengthening of credit institutions' own funds.[82]

As part of the recapitalisation processes envisaged in Royal Decree-Law 9/2009 of 26 June 2009, the FROB may advance in the form of a loan, in cash, or in debt securities the amount of the financial support that the institutions participating in these processes had requested. The decision to grant these advances will be conditional upon a series of circumstances which, in the opinion of the Banco de España, may determine that the institution in question is subject to liquidity tensions that may affect its stability during the period needed for the effective subscription and disbursement of the support from the FROB.

The advances will be compensated as credit vis-à-vis the institution at the time at which the subscription and disbursement of the corresponding capital instruments take place. If the subscription and the disbursement do not ultimately take place due to not meeting one of the requirements in the recapitalisation process or for any other cause, the institution will be obliged immediately to reimburse the FROB in full for the cash or for the securities delivered on loan. Likewise, if the amount of the financial support formalised is less than the advance, the institution will be obliged to reimburse the related surplus.

In terms of its functions to reinforce the solvency of credit institutions, and bearing in mind the profit of the system of affiliated institutions as a whole, the DGF may adopt measures aimed at facilitating European financial assistance for the recapitalisation of Spanish credit institutions. The cost of these measures shall be lower than the disbursements the DGF may have had to make under its governing regulations, in the context of the processes of orderly restructuring and reinforcement of the capital of credit institutions envisaged in Royal Decree-Law 9/2009 of 26 June 2009.

To this end, it may commit its assets for the providing of the collateral that may be required in respect of the financial assistance referred to. These commitments and collateral may be assumed by credit institutions under the recapitalisation plans approved by the Banco de España.

GUARANTEES TO BACK CREDIT INSTITUTIONS' BOND AND NOTE ISSUES

Law 2/2012 of 29 June 2012 on the State Budget for 2012 has been amended to authorise the State, up to 15 December 2012, to grant guarantees for a maximum amount of €55 billion for the economic obligations arising from new bond and notes issues by credit institutions with a registered office in Spain which, in the opinion of the Banco de España, are solvent but have temporary liquidity needs.

81 The duty of secrecy is stipulated in article 6 of Royal Legislative Decree 1298/1986 of 28 June 1986 on the adaptation of prevailing law on credit institutions to that of the European Communities.

82 Under this article, borrowings by the FROB, however instrumented, shall not exceed an amount threefold the endowment capital existing at each moment in time. However, the Minister of Finance and General Government may authorise the breaching of this ceiling, without borrowings by the FROB being allowed, in any circumstances, to be more than sixfold the endowment capital.

To obtain the guarantee, the applicant institution must, among other aspects, prove it meets, individually or jointly with the other institutions in its consolidable group, a share of at least 1‰ of the total for the item "loans and credits, other sectors" relating to residents in Spain from the latest EMU1 return (summary balance sheet, business in Spain) published in the Banco de España *Boletín Estadístico*. In the case of credit institutions that have transferred their liquidity management in the interbank market systematically to another institution with which they have a contractual clearing agreement, the institution to which such management is assigned may request the guarantee. Within each consolidable group, the State guarantee will be granted, if appropriate, on the operations entered into by the applicant institutions.

The guarantee will be granted irrevocably and unconditionally with a waiver of the "benefit of discussion"[83], under the terms set in the granting orders. The guarantee will back the principal of the issue and the ordinary interest.

In the event of execution of the guarantee, provided this is initiated within the five calendar days following the bond maturity date, the State shall pay compensation to the legitimate holders of the secured instruments, without prejudice to the amounts it must satisfy in respect of the guarantee. The amount of this compensation will be that resulting from applying, to the payment comprised of the execution of the guarantee, the EONIA rate published by the Banco de España or that which, if appropriate, is determined by the Minister of Economy and Competitiveness, on the maturity date of the guaranteed bond, taking the number of days that elapse between the latter date and the date of actual payment by the guarantor using the day-count convention actual/360.

The guarantees granted will accrue, in favour of the State, the following commissions:

a guarantee-granting commission of 0.5% of the total, to be settled by the Treasury, the payment of which will be credited by the institution prior to the formalisation of the guarantee by the Minister of Economy and Competitiveness.

b An issuance commission whose payment will be credited by the issuing institution before launching the issue. The amounts paid as a guarantee-granting commission will be deducted in full from this issuance commission.

The criteria for the calculation of the issuance commissions have been laid down in the Treasury *Resolution of 18 July 2012* (BOE of 20 July 2012), approving the guarantee application format for credit institutions' bond and note issues to be guaranteed by the State and establishing the criteria for the calculation of issuance commissions.

Specifically, issuance commissions shall be applied to the face value of each issue of bonds or notes, and this will be the result of adding up specific components detailed in the Resolution.[84]

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83 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.

84 The components are the following: 1) 40 basis points (bp); 2) 40 bp for one-half of the ratio of the beneficiary's median five-year senior CDS spread over the three years ending one month before the date of issue of the guaranteed bond to the median level of the iTraxx Europe Senior Financials five-year index over the same three-year period, and 3) one-half of the ratio of the median five-year senior CDS spread of all Member States to the median five-year senior CDS spread of the Member State granting the guarantee over the same three-year period. The foregoing components will be calculated for each of the issues made. If CDS spreads are denominated in different currencies, those corresponding to the most liquid markets will be taken into account. Further, certain particularities are established for issuers who have a credit rating but lack CDS spreads data.

LIQUIDITY MEASURES FOR THE REGIONAL GOVERNMENTS

The Royal Decree-Law envisages the institution of a territorial financing mechanism which involves the creation of a Regional Government Liquidity Fund that will be funded with a charge to the State budget with an extraordinary budgetary appropriation for an amount of €18 billion.

The Fund will be assigned to the Ministry of Economy and General Government through the Secretariat of State for General Government, and it will be managed by the OCI.

It will extend loans to the Regional Governments, in order to cover their financial liquidity needs.

The Regional Governments may join this mechanism voluntarily, and it will involve accepting certain fiscal and financial conditions. The fiscal conditions include the necessary presentation or updating of an adjustment plan, regular reporting obligations and even the possibility of control being taken of the Regional Governments if there is a risk of default on the financial debt falling due. The financial conditionality requires fulfilment of the principle of financial prudence, which involves the terms of indebtedness being consistent with the sustainability of the debt.

The loans extended by this mechanism will be guaranteed by the resources under the funding arrangements for the Regional Governments. In this way, the Regional Governments are guaranteed to receive the funding, but retain full responsibility for payment.

The Royal Decree-Law came into force on 15 July.

5.10.2012.