

**ANNUAL
REPORT
1998**

COMISION NACIONAL DEL MERCADO DE VALORES
(SPAIN)

ANNUAL REPORT
1998

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LETTER FROM THE PRESIDENT OF THE CNMV

1. *Last year was a decisive one for Spain's securities markets. Spain's success in joining Monetary Union in the first wave culminated with the securities markets' conversion to the euro on 4 January last, justly rewarding the efforts made throughout the year by the markets, investment firms and the CNMV.*

The euro brings stability and it banishes exchange-rate risk from our investors' portfolios. One of the last effective barriers to the free movement of capital and services has been removed. While evidently an advantage, this also poses a challenge to our markets: an increase in competition, where only the most efficient will survive. And in this constant struggle, we must not forget that our markets are a common good which we must preserve. We need efficient markets which can finance the business projects which our economic progress requires.

2. *The globalization of markets came of age last year with a vengeance, as the crisis spread and brought a considerable increase in volatility. Most experts agree that transparency on the part of governments, monetary authorities, the financial system and markets is the best antidote to crisis and contagion. But transparency, which is so vital, needs other supporting factors: responsibility by market participants, compliance with codes of conduct, and appropriate supervision of investment firms, markets and large investors are essential for preserving the health of the world's financial system.*

Another unresolved conflict which came to the fore in last year's crisis is the need for harmonization of codes of conduct and rules governing the supervision of the financial markets. In a border-less financial world, the persistence of insurmountable barriers in the form of tax havens greatly hinders the task of preserving the markets from destabilizing movements and protecting investors from incalculable losses. The existence of tax havens, closed as they are to supervision, can have no justification in a developed, democratic world.

3. *Last year was marked by the run-up to the euro, low interest rates, stock market euphoria in the first half and a massive influx of household and individuals' savings into the securities markets. In this context, the CNMV applies the maximum rigor in supervising the markets and investment firms and ensuring transparency and good governance on the part of issuers. This Annual Report provides a detailed account of the actions we undertook and the reasons underlying them. During 1998, we issued 15 Interpretative Letters to detail our interpretation of the current regulations on the most relevant items, with a view to enhancing legal security and providing recommendations on action by the market participants.*
4. *We have insistently called for liberalization of the regulations, simplification of procedures and the reduction of red tape with the goal of enhancing competitiveness on the part of issuers, investment firms and markets. The CNMV "one-stop shop" was created with the collaboration of the stock exchanges to centralize all the information to be reported by securities issuers. Shelf and abridged prospectuses were implemented, and the admission prospectus has been eliminated in most cases. Major efforts were also made to improve the quality and comprehensibility of the information provided to investors. Issuers are required to produce a brochure to assist in understanding the vast amount of information contained in prospectuses, and mutual funds were authorized to issue abridged prospectuses and quarterly reports.*
5. *The CNMV is constantly concerned with stimulating responsible conduct on the part of all the parties involved in the markets: compliance with codes of conduct. The regulations are clear and deci-*

sive in their definition of the responsibilities of the markets and of investment firms. All that was missing was a model of governance for issuers. The Code of Good Governance, approved in February 1998 by the Special Commission established by the Cabinet, meets this need. The Code, comprising 23 recommendations, is a valuable handbook of good governance for listed companies, but it is also a very valid guide for internal control and management at all companies. This was the first year in which listed companies considered the advantages of following the Code, and in 1999 they will report to the market as to its implementation.

Because of the CNMV's concern for reporting quality, companies have also made additional efforts in drafting their annual reports, with the result that the number of listed companies presenting qualified auditors' reports has fallen dramatically.

6. *The new Securities Market Law, which updates and modernizes the legal framework in which our markets operate, came into force in November 1998. In the first place, it adapts our legislation to the Investment Services Directive, which enshrines the principle of freedom to provide services throughout the Community. The law clearly defines what is meant by financial instrument and the secure of savings, thereby enhancing the system's legal security and clearly framing the area of investment protection. It also reinforces the CNMV's powers in this area. The law also introduces major changes in rules of conduct for professionals in the sector and for securities issuers. Additionally, it allows for the use of new financial instruments, such as non-voting shares and redeemable shares, it simplifies processes for capital increases and for waiver of the pre-emptive subscription right, and anticipates a future reform of the bond issue process. Also, the new Securities Market Law introduces the idea that listed and unlisted companies must be subject to different legal regimes.*

There were other developments on the regulatory front in 1998, including the possibility of securitizing new types of financial assets and the development of venture capital; both of these factors will dynamize the financial markets and the economy. They also bring new duties for the CNMV, which must supervise them, but we are encouraged by the confidence which is placed in us in this connection.

Also noteworthy is the introduction into our market of preference shares, which were traditionally aimed at foreign markets but come to fill an important gap in meeting Spanish investors' needs in that they offer a level of risk intermediate between equities and bonds.

7. *An area in which we were particularly interested was the development of the Spanish fixed-income market. The signature of the Protocol for the Development of the Fixed-Income Markets, with the Stock Exchanges, AIAF and the SCLV, will boost issuance and trading and facilitate the creation of a single forum for trading in private sector fixed-income securities. The early months of 1999 have already evidenced important results arising from the combined effort to vitalize the market: new tax treatment, the possibility of securitizing assets other than mortgages, simplification of the procedures for issuing securities, possibility of using shelf or abridged prospectuses, and the appearance of new instruments in the market, to name but a few. As a result, Spanish investors can now choose from among a range of intermediate-risk instruments and companies have new forms of raising finance at their disposal.*
8. *Our securities markets are sound, transparent, agile and liquid. Our investment firms are accustomed to competing and the investor protection afforded by our legislation is on a par with that of the most developed countries. The surveillance systems used by the CNMV to ensure market integrity*

and investor protection are increasingly sophisticated, effective and secure. However, undeniably much remains to be done, from new legislation to an in-depth reform of the law on collective investment schemes. We must continue to insist on simplification of paperwork, on transparency in the markets, on responsibility of the market participants and on the creation of new products. Ahead of us lies the challenge of the new millennium and the need to adapt information systems to the Year 2000.

But above all these tasks, to which we are committed, there is the need to further enhance investor protection. This means supervision to combat fraud and promote fair play among investment firms; protection of the relationship between investment professional and client, which must be based on professional duty to the client. Spanish savers' are becoming increasingly sophisticated in their financial knowledge, and we must strive to ensure that their traditional trust in the financial institutions to which they entrust their savings is not disappointed.

Prudence on the part of investors and their active participation in the defense of their own interests, when they believe that they have been unjustly impaired, are essential to ensure market integrity. To facilitate investor participation and make both it and the supervisory work of the CNMV more effective, a new complaint system will be designed in 1999.

I have listed some of the challenges ahead, but we must be prepared for whatever may come in the current context of globalization and considerable volatility in the markets. The winds of change blowing through the financial world are not always predictable.

Madrid, 9 March 1999

Juan Fernández-Armesto

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ABBREVIATIONS

AIAF:	Association of Financial Assets Intermediaries
ANNA:	Association of National Numbering Agencies
AV:	Agencia de valores / Broker
AVB:	Agencia de valores y bolsa / Broker and market member
CNMV:	Spanish National Securities Market Commission
EMU:	Economic and Monetary Union
EU:	European Union
FESCO:	Forum of European Securities Commissions
FIAMM:	Money market fund
FII:	Real estate investment fund
FIM:	Securities investment fund
FTA:	Asset securitization fund
IIC:	Collective investment institution
IOSCO:	International Organization of Securities Commissions
IPO	Initial Public Offering
ISD:	Investment services directive
ISIN:	International Securities Identification Number
MEFF RF:	Fixed-income financial futures market
MEFF RV:	Equities financial futures market
MOU:	Memorandum of understanding
OTC:	Over the counter
SCLV:	Spain's Securities Clearing and Settlement Service
SGC:	Portfolio management company
SGFT:	Securitization fund management companies
SGIIC:	Collective investment scheme management company

SIB:	Electronic market
SIBE:	Spain's electronic market
SIM:	Securities investment company
SIMCAV:	Open-end investment company
SV:	Broker-dealer
SVB:	Broker-dealer and market member
UCITS:	Undertaking for Collective Investment in Tradable Securities

Organization structure

At the beginning of 1998, the Spanish National Securities Market Commission (CNMV) adopted a new organization structure in order to perform its functions more effectively in the current context of the securities markets, which is characterized by strong sustained growth in the sector under supervision and by the challenges of the new situation in Europe. Experience of operating with the new organization structure has been positive and, consequently, no substantial changes have been made to it.

Table 1.1 summarizes the current structure of the CNMV. Its basic activities are grouped in four Divisions: Strategy, Development, Supervision and Primary Markets. The structure was completed with six horizontal divisions: Inspection, Secretariat to the Board and Legal Department, Research, Information Systems, General Secretariat and Communications - and the International Relations Division.

The four main Divisions have the following functions:

- **Strategy:** to implement the strategic plan for the Spanish markets and to develop regulations for them with a view to the new situation which came into being in January 1999, when the third phase of Monetary Union commenced.
- **Development:** support for, and supervision of the creation of new investment firms and collective investment schemes (IIC) and the development of initiatives to promote the securities market.
- **Supervision:** centralization of the functions of monitoring secondary markets and supervising investment firms and collective investment schemes – “distance” and on-the-spot supervision.
- **Primary markets:** clearance and registration of issue prospectuses, admissions to listing and public offerings, authorization of takeover bids and the management of information on listed companies (significant holdings, treasury stock, economic and financial information and financial statements).

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ORGANIZATION AND MANAGEMENT

Table 1.1
STRUCTURE OF THE CNMV IN 1998

	DIVISION	FUNCTIONS
BOARD	Strategy	Strategy planning Regulatory implementation: EU Directives, Spanish legislation, CNMV regulations. Representation of the CNMV in the European Union: High-Level Group of Securities Supervisors (EU).
	Development	Creation and institutional monitoring of securities firms and collective investment schemes. Institutional relations with securities market governing companies and Spain's Securities Clearing and Settlement Service (SCLV). Office in Catalonia: provides all the CNMV's services in Barcelona.
	Primary Markets	Security issues and public offerings. Admissions to listing. Significant holdings. Own shares. Takeover bids.
	Supervision	"Distance" and on-the-spot supervision and intervention at firms. Supervision of secondary markets. Reporting price-sensitive information to the markets. Exclusion and suspension of trading.
	General Inspections	Proposal and processing of disciplinary proceedings. Market Monitoring Unit: inside information, price manipulation and money laundering.
	Secretariat to the Board and Legal Department	Secretariat to the Board and the Advisory Committee. CNMV Legal Department. CNMV litigation service and relations with the justice system.
	Information Systems	Design, development and implementation of the CNMV's information systems. National Securities Numbering Agency.
	General Secretariat	Administration. Relations with the public. Documentation and Official Registries.
	Research	Analysis of the financial situation. Research on securities markets and the financial system. Data bases: financial statistics
	Communications	The CNMV's communications policy . Relations with the media.
	International relations	Multilateral forums: IOSCO, FESCO, Joint Forum. Bilateral relations with securities commissions in other countries.

Administration

Last year saw a continuation of the strong growth in securities market activity observed in recent years. Highlights include the 26% increase in collective investment scheme assets, a 60% increase in trading in equities market, and public offerings (privatizations plus IPOs and other operations) totaling approximately 1.9 trillion pesetas, more than half a trillion up on the previous year. This context of growth in the markets brought a need for increased supervision. As a

result of the pressing need to bring human resources into line with current demand for supervision, in May the Board of the CNMV prepared a Three-year Reinforcement Plan which is compatible with the current framework of budget austerity in the public administration. The Plan was approved by the Ministry of Economy and Finance and the Ministry of the Public Administrations and envisages a sizable increase in the work force between 1998 and 2000. Also, the decision was taken to acquire a larger building because the current headquarters will be unable to accommodate the envisaged increase in staff.

Financial data

Growth in the activities of the securities markets gave rise to a further increase in the revenues earned by the CNMV. Revenues amounted to 4.837 billion pesetas in total, of which 4.451 billion pesetas were from fees. Despite a substantial cut in the tariffs in force in the last quarter (see box below), fee receipts increased 31% over the preceding year. There were particularly significant increases in fees for registration of issue prospectuses (45%) and admission of securities to listing (82%). There was also a sizable increase in the fees for supervision of secondary markets (34%) and collective investment schemes (22%). In contrast with fee revenues, interest revenues fell 47% due to declining interest rates.

Operating expenses amounted to 2.260 billion pesetas, 15% higher than in 1997. The largest item was personnel expenses which accounted for 69% of operating expenses and grew 9.6%. Within this caption, wages and salaries increased by 9.1% due to a general increase in salaries in line with forecast inflation, the increase in the work force (twelve new employees at the end of the year) and several variations in salaries (promotions, seniority bonuses, etc.). Employee training expenses, which had increased significantly in 1997 due to a more active policy in this area, stabilized at approximately 31 million pesetas, i.e similar to the preceding year. There was a noteworthy increase (41.6%) in provisions for CNMV Board Member termination indemnities, which are envisaged in Article 21 of the Securities Market Law, due to the replacement of members of this body.

As regards other expense items, the most notable increase was in external professional services (53.6%) in order to cover the rise in supervisory activities. The rental of new premises in order to cater for the growth in the number of employees gave rise to a sharp increase in this type of expenses (105.7%). The 43.5% increase in security expenses was significant, as was the 21.1% rise in travel expenses of technicians and managers due to the increased presence of the CNMV at international supervision forums.

Income for the year totaled 2.555 billion pesetas. In view of the forecast investment resulting from the Reinforcement Plan, at the proposal of the CNMV's Board, the government resolved to allocate 1.907 billion pesetas of income for 1997 to reserves.

New regulation of CNMV fees

The CNMV is financed by fees for the services it provides in accordance with securities market regulations. The amount of the fees must be sufficient to cover supervision needs but should never be an unnecessary burden on the entities which pay them. Consequently, due to strong growth in securities market activity and the subsequent expansion of the base to which the fees are applied, the latter have been cut on several occasions in recent years. In 1998, fees were reduced for this reason by Royal Decree 1.732/1998, dated 31 July, governing the rates applicable to the activities and services provided by the CNMV; this Royal Decree also aims to expedite fee collection processes.

The main changes introduced can be summarized as follows:

- **Collective investment schemes** : 30% reduction in the supervision fee, maximum limit of 750,000 pesetas for registration of IIC in official registries and elimination of the fee for prospectus registration fee due to overlap with the preceding fee.
- **Issue prospectuses and public offerings** : the previous rates remain the same, but a lower limit of 250,000 pesetas and a ceiling of six million pesetas for fixed income offerings and ten million pesetas for equity offerings are established. Consequently, disproportionate fees for large-scale operations or grossly insufficient fees for small operations are avoided.
- **Authorization of a takeo ver bid**: a lower limit of 500,000 pesetas and a ceiling of ten million pesetas are established.
- **Market members** : the basis for calculating the supervision fee is changed, bringing it into line with the parameters used in the markets. Consequently, it is easier for the operator to calculate its costs. The fee is calculated on the basis of the number of transactions performed and the tariff applicable to each operation is set on the basis of size. Transactions of less than 5,000 pesetas are exempt and the ceiling on operations of more than 50 million pesetas is 180 pesetas.
- **Spain's Securities Clearing and Settlement Service (SCL V) member entities** : in this case it was considered necessary to increase the applicable quarterly supervision rate from 0.002% of the balance of securities held by the entity at the SCLV to 0.012%. Together, the changes regarding market members and clearing members have a neutral impact on the CNMV's revenues and signify a reallocation of fees between the two types of firms of firms which is more in line with their effective supervision costs.

It is estimated that, on the whole, these measures will reduce the CNMV's fee revenues by 20%.

The new system will expedite procedures and reduce the administrative burden of fee-payers since all the data required for performing the settlement are already in the hands of the CNMV by virtue of its supervisory powers and the new regulation determines that it is the CNMV which performs the related settlements.

Human resources

As indicated above, in 1998 the CNMV handled a heavier work load with basically the same number of employees. However, it was considered that the increase in securities market activity reflected a trend which would be sustained and could even accelerate in future years and, consequently, that it was necessary to increase the work force. Thus, on 13 May 1998 the Board of the Commission approved the Plan to Reinforce the CNMV's human resources. Preparation of the Plan involved considerable planning of activities to be performed in coming years in view of the large qualitative and quantitative changes in the area of supervision: general growth in securities market activity, development of new areas of activity, the launch of the euro and the new supervisory scenario in Europe, etc.

The Plan will essentially involve an increase of 65 employees with respect to the work force at January 1 1998, to take place over three years (1998, 1999 and 2000), which represents growth of approximately 34%. In keeping with the State Administration's policy of facilitating a needs-based reallocation of human resources, the Plan reserved 25 posts (38% of the total) for civil servants. In July 1998 the selection processes for the 29 posts for 1998 were announced. The new employees joined the CNMV in January 1999.

Most of the positions are for the Supervision (26 posts), Development (9 posts) and Inspection (5 posts) Divisions. The remainder will be distributed among Information Systems, Strategy, the Secretariat to the Board, the General Secretariat and Research.

The "Técnicos 2000" program for training recent graduates with a sound academic record who join the CNMV under 2-year on-the-job training contracts continued in 1999; 13 of the 14 technicians who joined the CNMV in 1997 continued with their training program. They were joined by another 10 technicians after the second selection process held in July 1998. The main new feature of the selection process was, departing from the traditional focus on graduates in economics and law, the program was extended to include graduates with a mathematical background (physics, engineering, etc.).

Table 1.2
CNMVSTAFF
BY PROFESSIONAL CATEGORY

Category	Number of employees	
	1997	1998
Services	9	9
Administration	45	44
Technicians	108	112
Technicians in training	14	23
Management	16	16
Total	192	204

Information systems

Adapting all computer programs to the introduction of the euro and making them year-2000 compliant were the priorities for management of the CNMV's information systems in 1998. Other particularly noteworthy computer improvements made last year are the development of new applications for collective investment scheme management companies, which enable the periodic transfer of information requested by the European Central Bank and of information stipulated in the new rules on investments in derivatives.

The CNMV's web site includes new features such as the inclusion in real time of price-sensitive information which has been reported, the full text of prospectuses and auditors' reports and the possibility of downloading financial statements for use in spreadsheets.

Introduction of the CIFRADO/ CNMV system for transferring electronically-signed and encrypted information

The CNMV's Information Systems Division developed the CIFRADO/CNMV system, which enables the supervised firms to send documents to the CNMV by electronic means using an encryption and electronic signature system. Its introduction (by resolution of the Board of the CNMV dated 11 March 1998) marked a milestone in that it was the first such system implemented in Spain's Public Administration. In view of the enormous interest in this system, it has been adapted so that it can be used by other areas of the public administration.

The CIFRADO/CNMV system is currently only open to securities firms and collective investment scheme management companies. A total of 20 firms use the system regularly to send their monthly financial statements to the CNMV, with completely satisfactory results. CIFRADO is also used for the addition of assets to Securitization Funds. Soon its scope of use will be extended to listed companies, which will be able to send quarterly and half-yearly information to the market through this channel. Ultimately, the aim is for all entities under supervision to be able to send their periodic information to the CNMV through CIFRADO/CNMV, which will mean considerable savings in the time spent receiving and entering this information, in addition to enabling the process to be automated using only electronic communications.

The office in Catalonia

CNMV's office in Catalonia, which reaches its third anniversary on 17 April 1999, had a year of consolidation in 1998. Now that its internal structure has been established (the office has management units in four large areas of activity: relations with the public, supervision, development and primary markets) and its human resources have been notably strengthened (the office's staff doubled in comparison with 1997, from five to ten employees), the CNMV's Barcelona office is facing up to the challenges of serving investors and the financial community of the Barcelona stock exchange.

As regards supervision of entities subject to CNMV surveillance, the office is making a noteworthy contribution to increasing the effectiveness of on-the-spot supervision of the numerous firms located in Barcelona, for which it also facilitates the processing of reporting requirements and administrative procedures. There has been a considerable increase in the number of projects processed for incorporating and registering new collective investment schemes (a total of 212, in 1998, compared with 121 in 1997). Issuers also took advantage of the office and last year it processed 43 applications in connection with issues and admissions to listing (28 in 1997).

The office has become a point of reference for Catalan investors and professionals in the area of direct information for the public and complaints. In 1998, the Catalonia office direct handled queries about official registries from 1,619 individuals and processed 65 complaints. There were 7,309 entries in the Office's General Registry and 1,984 fee settlements were processed.

The CNMV views relations with the public through queries and complaints as one of its most important activities. In 1998, more than 31,000 requests for information were processed from members of the public interested in certain aspects of the securities market or wishing to file complaints. The Public Relations Department placed the vast information in its official registries and the support of CNMV professionals (insofar as it was required in each case) at the disposal of inquirers.

Table 2.1 provides a breakdown of the queries handled, classified by type. Telephone queries and on-site queries are predominant in these statistics, although there has been an increase in queries made by electronic mail and by direct access to the CNMV's web site. Investors already have access through the Internet to a broad range of essential data contained in the official registries: prospectuses and financial information on issuers, auditors' reports, price-sensitive information, significant holdings, data about IIC and securities entities, etc. Table 2.2 summarizes the information available in official registries and the ways in which it can be consulted.

Table 2.1
QUERIES AND COMPLAINTS HANDLED BY THE CNMV

	1998	1997
Queries by telephone	24,325	21,302
Electronic mail (*)	965	219
Queries by fax.....	532	398
Written queries	98	105
On-site queries	3,826	3,542
Personal interviews	968	752
Complaints	988	609
Total	31,702	26,927

(*) In operation since April 1997.

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QUERIES AND COMPLAINTS FROM THE PUBLIC

Table 2.2
HOW TO CONSULT THE CNMV's OFFICIAL REGISTRIES

	Direct queries at the CNMV			Internet	Diskette and CD-ROM
	Paper	On screen	Optical disk		
Advance notifications	Since 1989	Since 1989	Since 1994	Since 1989	
Issues	Since 1989	Since 1989	Since 1990	Since 1989	
Listings	Since 1989	Since 1989	Since 1990	Since 1989	
IIC registration memoranda	Since 1989	Since 1989	Since 1998	Since 1998	
Registration of broker-dealers and brokers	Since 1989	Since 1989	Since 1998	Since 1998	
Auditors' reports:					
Issuers	Since 1986	Since 1986	Since 1986	Since 1986	Since 1990
Collective investment schemes	Since 1989	Since 1989	Since 1993		
Market participants	Since 1988	Since 1988	Since 1993		
Market participants and consolidable groups	Since 1993	Since 1993			
Market governing companies	Since 1989	Since 1989			
Special reports	Since 1991	Since 1991			
Financial information:					
Issuers	Since 1989	Since 1989		Since 1995	(*)
Collective investment schemes	Since 1991	Since 1991	Since 1993	Since 1997	
Takeover bids	Since 1989	Since 1989	Since 1998		
Book-entry deeds	Since 1989	Since 1989	Since 1998		
Brokerage fees	Since 1993	Since 1989			
Significant holdings	Since 1990	Since 1990		Since 1989	(**)
Price-sensitive events	Since 1990	Since 1989		Since 1989	
Standard brokerage contracts	Since 1996	Since 1989			

The date information in each box relates to the date of the first entry in the record which can be consulted in the corresponding format.

(*) ASCII and Windows formats.

(**) ASCII format.

Complaints department

In 1998 the CNMV received a total of 988 complaints in connection with the action of institutions and companies under supervision in the securities market; this is notably higher than in 1997 even disregarding the AVA case, which alone gave rise to 221 complaints (see table 2.3). Consequently, the previous years' trend of an increase in the use of the CNMV's complaints service continued in line with strong growth in the securities markets' activity, the growth in the investor base and investors' increasing financial awareness.

The complaints filed by investors related mainly to firms which provide services in the securities market (credit institutions, securities firms and management companies) as can be seen in table 2.3. It is noteworthy that credit institutions (banks and thrifts) accounted for 60% of the total. As usual, the number of complaints filed against issuers was also high.

Table 2.3
RESPONDENTS IN COMPLAINTS

	No. of complaints		%	
	1998	1997	1998	1997
Management companies and supervisory bodies	7	3	1	0
Financial institutions	806	441	82	72
Securities issuers	171	163	17	27
Others	4	2	0	0
Total	988	609	100	100

Most of the complaints were substantiated with relevant information by the complainant. The CNMV resolved in favor of the complainant in connection with 57 complaints, and 5% of the complaints were resolved by mutual agreement between the parties.

Table 2.4
FINANCIAL INSTITUTIONS AGAINST WHICH COMPLAINTS WERE FILED IN 1998

Institutions with more than two complaints	Complaints	Of which	
		Resolved by agreement	Decision in favor of the complainant
BANKS AND THRIFTS	594	42	50
ABBAY NATIONAL BANK, S.A.E.	3	1	
BANCO BILBAO VIZCAYA, S.A.	28	2	4
BANCO CENTRAL HISPANO, S.A.	27	3	2
BANCO DEL COMERCIO, S.A.	3		1
BANCO DE FINANZAS E INVERSIONES, S.A. FIBANC	3	2	
BANCO DIRECTO ARGENTARIA, S.A.	16		6
BANCO ESPAÑOL DE CREDITO, S.A.	26		2
BANCO EXTERIOR DE ESPAÑA, S.A. (ARGENTARIA)	20	4	1
BANCO INVERSION, S.A.	7		
BANCO POPULAR ESPAÑOL, S.A.	3		
BANCO SABADELL, S.A.	4	2	
BANCO SANTANDER, S.A.	58	10	12
BANCO URQUIJO, S.A.	3	1	2
BANKINTER, S.A.	9	2	1
BILBAO BIZKAIA KUTXA	3		
CAJA DE AHORROS DE GALICIA (CAIXAGALICIA)	3		
CAJAMADRID	26	3	2
CAJA POSTAL, S.A. (ARGENTARIA)	49	10	6
CITIBANK ESPAÑA, S.A.	4		1
DEUTSCHE BANK, S.A.E	11		
LA CAIXA	9		
MERRYL LINCH (AVA case)	10		
MIDLAND BANK PLC. Branch in Spain (AVA case)	165	2	
OPEN BANK, S.A.	3		
OTHERS	63		

Table 2.4 (Cont.)

FINANCIAL INSTITUTIONS AGAINST WHICH COMPLAINTS WERE FILED IN 1998

Institutions with more than two complaints	Complaints	Of which	
		Resolved by agreement	Decision in favor of the complainant
SECURITY FIRMS	125	1	6
AB ASESORES BURSATILES SVB, S.A.	6		3
ADEPA A.V., S.A.	3		1
AGENTES DE BOLSA ASOCIADOS SVB, S.A.	3		
AHORRO CORPORACION FINANCIERA SVB, S.A.	3		
AVA ASESORES AGENCIA DE VALORES S.A.	37		
BENITO Y MONJARDIN SVB, S.A.	4		
CENTRAL HISPANO BOLSA SVB, S.A.	3		
EUROSAFEI SVB, S.A.	4	1	
GAESCO BOLSA SVB, S.A.	3		
GENERAL VALORES Y CAMBIOS SVB, S.A./ AVA case (3)	5		
IBERAGENTES ACTIVOS S.V., S.A.	5		1
LINK SECURITIES AVB, S.A./ AVA case (6)	7		
RENTA 4 SVB, S.A.	10		
SIAGA AVB, S.A.	7		1
OTHERS	21		
COLLECTIVE INVESTMENT SCHEME MANAGEMENT COMPANIE (SGIIC), PORTFOLIO MANAGEMENT COMPANIES (SGC) AN SECURITIES INVESTMENT COMPANIES	45	2	-
AB ASESORES GESTION FONDOS SGIIC, S.A.	3		
ARGENTARIA GESTION SGIIC, S.A.	6		
GESBANSANDER, SGIIC, S.A./SANTANDER GESTION SGIIC, S.A.	9	2	
OTHERS	23		
UNREGISTERED ENTITIES	42	Not applicable	Not applicable
DIAGONAL DIVISAS, S.A.	6		
TRANSWORLD FINANCIAL SERVICES, S.L.	5		
DINAMICA DIRECTIVA, S.L.	3		
INVESTAHORRO, S.A.	3		
ASOFI ASES.OP.FINANCIERAS/ VKA	2		
LYDDER CONSULTORES GENERALES, S.L.	2		
OVERSEAS ADVISORY CORPORATION	2		
AGRUPACION DE CAPITALES, S.A.	1		
BARCELONESA DE INV. BURSATILES	1		
BSC ASESORES, S.L.	1		
DELTA FOCUS, S.L.	1		
DOLOK PERMAI I.A.M.	1		
EXCON INC / OST EUROPA, S.L.	1		
EXPERTOS CONSULTORES UNIDOS EN DIVISAS, S.L.	1		
FOREX GESTION, S.A.	1		
INTERCAP OPTRADE & FINANCE, A.G.	1		
IPM (INDEPENDENT PROFESIONAL MANAGEMENT)	1		
LEONARD BERNEY / IPM Inc.	1		
MONDIAL DIVISIAS, S.A.	1		
PACIFIC CONTINENTAL SECURITIES CORP.	1		
PERICIA, S.L.	1		
PROMOCIONES Y ASESORIA FINANCIERA, S.A.	1		
WBB INTERNATIONAL LTD.	1		

Table 2.5.

SUMMARY OF THE OUTCOME OF THE COMPLAINTS FILED IN 1998

Mutual agreement	52
Information supplied to complainant	833
<i>Decision in favor of the complainant</i>	57
Lapsed	14
Outside CNMV jurisdiction	7
Withdrawn	4
Pending	78
Total	988

Some particularly significant complaints

AVA

As a result of the commencement of disciplinary proceedings and the court-approved temporary receivership of this broker, numerous queries were received by telephone and written complaints were filed by investors which requested information about the situation of the broker and their investments. The Public Relations Department attended to all investors and informed them of their rights and the possibility of exercising them within the scope of the legal proceedings which had commenced, in which they could appear as complainants. Direct contacts were made with the firms to which securities managed by AVA but unaffected by the affair were transferred in order to provide a solution to the incidents reported by investors whose securities had been transferred.

Unregistered entities

Despite the warnings given in previous years, in 1998 many claims were filed by investors who performed transactions (and in many instances lost their savings) with entities which are not authorized to provide investment services. The Public Relations Department notified the Inspection Division of all the cases and, in some cases, identified cases within the jurisdiction of the Central Brigade of the Judicial Police (Financial Crimes and Fraud). The CNMV's web site includes a new page called "Public Warnings," where investors are informed about the existence of this type of practices and the measures adopted to eradicate them.

Suspension of trading on reaching the deadline for acceptance of takeover bids for delisting

After the deadline for accepting the takeover bid to take Banco de Vitoria private, which was made in the first half of 1998, shares changed hands in the stock market at prices which were considerably higher than the offer price, despite the fact that it was well known that the securities would be imminently delisted. Many investors complained about the events and, after considering the matter, the CNMV decided that henceforth the trading of securities of companies being taken private will be suspended for the time between the end of the period for accepting the offer and the definitive delisting of the securities.

Incidents regarding the payment of the loyalty bonus envisaged in Telefonica's equity offering carried out in 1997

The prospectus for the equity offering carried out by Telefónica in January and February 1997 envisaged that those investors who maintained the average daily balance of the shares awarded to them for one year would be entitled to a loyalty bonus comprising one free share for every twenty shares awarded to them in the offering. However, although some investors maintained the daily balance of their shares, they transferred their securities to other depositories which, due to computer problems, meant that they did not receive the loyalty bonus at first. After it was evidenced that the complainants had complied with all the requirements, the CNMV contacted the firms involved and arranged for the complainants to finally receive the free shares which corresponded to them and the dividends and the amount of the sale of subscription warrants that said shares had generated from the time when the bonus should have been paid.

Actions of agents of security companies and firms

Several complaints related to improper action by some agents of security companies and firms. The CNMV's concern about these incidents led to the issuance of two Circulars dealing directly with this matter: Circular 1/1998⁽¹⁾, which requires entities that operate through agents to have the appropriate measures in place at all times to monitor transactions and relations between the agent and clients, and Circular 5/1998⁽²⁾, which regulates a new procedure for notifying the CNMV of the appointment of agents and for public disclosure of these relationships.

Liquidating value applicable to subscriptions and reimbursement of units in mutual funds

Many investors filed claims because they considered that the liquidating value applied by their firms to the subscription or reimbursement of units in mutual funds was incorrect. Although the liquidating value applied was correct in practically all cases, investors made mistakes because they did not have clear information about the calculation, application and notification of liquidating values; this confusion arose primarily from the information provided to them at the firms' offices. Aware of these problems, the CNMV published Interpretative Letter 2/1998⁽³⁾, which discloses the Commission's position regarding this matter and suggests measures which firms should adopt to avoid these incidents.

Information received from the firm in the subscription of units in mutual funds

As a result of many complaints, it was ascertained that firms often fail in their obligation to provide a fund prospectus to investors intending to invest in mutual funds. A Ministry of Economy and Finance Order dated 1 October 1998 facilitates compliance with this obligation, which is essential for investors on account of the information in the prospectus, since the Order enables the content of the prospectus and of the quarterly report to be delivered in the form of an abridged prospectus prior to investment. This possibility is undoubtedly more convenient for firms as they can even make the abridged prospectuses available to the public in their offices in place of publicity brochures, in which the information is always incomplete.

(1) Circular, 1/1998 on internal systems of control, monitoring and continuous evaluation of risks.

(2) Circular, 5/1998 on agents of securities firms and portfolio management companies.

(3) On the valuation of subscriptions and reimbursement of units in mutual funds and the daily publication of their liquidating value.

Collapse of the SIBE on 28 and 29 October 1997

Due to the massive influx of orders, the computer system of the continuous market collapsed on 28 and 29 October 1997. Although the bourses adopted exceptional measures (interrupting trading and extending the session), they were unable to avoid substantial delays in executing investors' orders (even without losing their timing priorities). A number of complaints were filed as a result. Although it was found that the various respondents in complaints had not acted incorrectly under any circumstances, it seemed unacceptable that only the investors should suffer the adverse impact of a situation for which no individual or specific entity could be held responsible. Consequently, the CNMV advised the firms to study each specific case and try to reach agreements with their clients.

Consequences of pro-rating in Endesa's final equity offering

The result of pro-rating in Endesa's final equity offering was not as restrictive as on previous occasions. As a result, many investors who had made artificially inflated applications in expectation of considerable pro-rating were adjudicated more shares than they had planned to buy. Since the cost of the investment was higher than expected, many investors' accounts were overdrawn and they were forced to overcome the situation by selling their "excess" shares at lower-than-desired prices. The CNMV indicated that, in similar situations in the future, firms should warn their clients of the possibility of becoming overdrawn if their orders are filled and sufficient funds are not provided.

Some recommendations by the CNMV inspired by the content of complaints filed in 1998

To investors:

- Make sure that the broker you are dealing with is duly authorized to provide investment services.
- Before making an investment, gather all the necessary information required to obtain fuller knowledge of the products' characteristics, including their risks, the characteristics of the markets where they are traded and the cost of the transaction. If the securities will be deposited with a non-resident entity, ascertain its solvency and the guarantees envisaged by the legislation of the country in question. If you are unaware of what type of information should be mandatorily available to investors, the CNMV's Public Relations Department will be able to help you.
- If you entrust the management of your portfolio to a professional, avoid giving totally discretionary management mandates because of the risks involved.
- Beware of promises of returns which are clearly higher than market rates.
- Formalize your relationship with the broker through a contract and pay due attention to the clauses thereof. Always keep a copy.
- Do not enter "inflated" requests in public offerings; this could be detrimental to you if you are awarded more securities than you want.
- Whenever you wish, you can demand that your broker provide you with detailed information in writing about the current status of your investments.
- Remember that the share prices and liquidating values of mutual funds which are published in the media (newspapers, teletext on television, etc.) are not official.
- Diversify the risk of your investment among various products.
- Remember that volatility is a characteristic of investments in equities, and consequently, the price of securities can rise and can also fall considerably.

To the heads of financial institutions:

- Improve your employees' training in connection with the securities market. Employees who are not sufficiently well trained are often the source of deficient information to clients.
- Provide your clients with the mandatory prospectuses and the contractual documentation regarding the transaction which they arrange.
- Never advise your clients to artificially "inflate" requests in public offerings. Remember that the firm can always demand an advance of funds; if you decide not to ask for an advance and accept your client's order, warn him of the possibility that his account may be overdrawn if the account balance is insufficient to meet the subscription costs when the time comes.
- If there are substantial changes in market conditions due to a takeover bid or other material events, contact your clients which have orders pending execution and which might be affected. Ascertain if they want to issue new instructions.
- Remember that fees can only be collected for services which are clearly and specifically included in the tariff brochure. Review them and clarify those items which may be obscure or misleading.
- Provide investors with accurate information about the liquidating values applicable to subscriptions and reimbursements of units of mutual funds.
- When a client asks for his securities to be transferred to another firm, take all the necessary steps to ensure that the operation is concluded within the following forty-eight hours.
- Find out about your client's situation, advise him loyally and do not forget to point out the risks of his investments. Be particularly scrupulous when the transaction involves selecting markets and/or depository entities located in other countries: gather all the relevant information on risks and send it to the client, and abide by current rules.

National Securities Numbering Agency

The National Numbering Agency performs a function which is very important for both national and international participants in the securities market since it facilitates the identification of security issues. Issuers of securities, brokers and investors make numerous queries about the data processed by the Agency, which is managed by the CNMV.

Activity by security issuers in 1998 led to a considerable increase in the number of movements (additions, removals and modifications) in the Agency's data bases, which totaled 7,042 (up from 5,406 in 1997). This increase in activity was also influenced by the creation of new open-end investment companies (SIMCAV) and the fact that many companies performed stock splits in 1998 which, in accordance with current coding rules, means that new ISIN codes must be assigned.

Conversely, movements in the international securities data base decreased (124 modifications in comparison with 258 in 1997) due undoubtedly to the possibility available to code users of accessing information about security issues through the services offered by professional providers of financial information or by connecting directly to GIAM, a private network for exchanging information between the Securities Numbering agencies, access to which has been opened up to other entities.

As regards the dissemination of information, the increased use by ISIN users of code queries offered by the Agency via Internet has led to a decrease in direct queries to the Agency by more traditional methods such as mail, telephone or fax. In 1998 the Agency handled 7,245 queries (an average of 30 queries per day) in comparison with 9,001 in 1997. A slight increase was observed in queries about Spanish issues from foreign Numbering Agencies.

In the international sphere, the Agency has continued to actively participate in the working groups of the Association of National Numbering Agencies (ANNA), which now has 54 member countries.

3

MARKET DEVELOPMENT

Last year there was strong activity in all areas of the securities markets: trading, IPOs, issues, secondary offerings, etc. which evidences the markets' increasing role in financing the economy and as a vehicle for savings.

At the end of 1998 approximately 40% of Spanish household financial savings were invested in securities, either directly or indirectly (through mutual funds). Growth in mutual funds was particularly significant, which led to many funds being registered with the CNMV. Also in 1998, mutual funds were allowed to invest in derivatives and foreign government debt securities. These firms' reporting requirements and the conditions regarding publicity about them were revised due to the diversity and range of savers which have deposited their savings in these instruments. The CNMV took into account the need to combine two objectives in this connection: the relaxation of requirements which entail a cost for the industry, and the mandatory protection of the saver. The first section of this chapter discusses the various measures taken in connection with collective investment schemes.

However, the dynamism of financial activity was not reflected in the number of securities firms (see section two), which remained practically unchanged. Many of these companies used contracts with external marketing agents (who act on behalf of brokerage houses) as a means of expansion. Aware of the importance these agents are acquiring, the CNMV considered that it was advisable to revise the regulations governing this activity, and it established the obligation for agents to operate under an exclusive contract to a single firm and for all agents to comply with the firm's code of conduct.

In this context of growth in the securities business and of its impact on Spanish society, the CNMV directed its development activities at the regulation and operation of markets which are particularly important for the consolidation and continuation of the expansion process. A sizable share of development activities were targeted at the private fixed-income securities market. Last year the presidents of the bourses, AIAF, Spain's Securities Clearing and Settlement Service (SCLV) and the CNMV signed a Protocol to develop this market. The intention is to undertake the reforms required to encourage the issue of this type of securities in Spain and avoid the relocation of business in the future. The time is ripe because the pressure of government debt securities on the market is decreasing and the demand for paper is growing on the back of the boom in collective investment. The Protocol had some effects in 1998, which are set out in the last section of this chapter.

Collective investment schemes

Registration of new schemes

A total of 403 new mutual funds were filed in the CNMV's registries in 1998. Consequently, there was a notable increase in the number of these schemes but it was lower than in 1997, when 512 mutual funds were registered. The range of funds on offer will foreseeably be restructured now due to the adoption of the euro and the forthcoming expiration of the guarantees on many guaranteed funds. The recent reform of the Securities Market Law, which envisages new forms of IICs and mergers of funds by absorption or by creating new funds, will facilitate this process.

The new IICs have different characteristics to existing schemes; the features of the current range of IICs are as follows:

- Guaranteed funds are on the decline and no longer represent the majority of new funds.
- More funds (53% of the total) have investment policies which at least partially target equities.
- Fewer fixed-income funds – they accounted for only 6% of the new funds which were registered, in comparison with 14% in 1997.
- Greater interest in investing in foreign markets; 54% of the funds which were registered stated in their prospectus that they intend to invest abroad. This proportion increased to 78% in the case of guaranteed funds which track foreign stock market indexes.
- An increasingly noticeable (but still not very significant) trend in creating funds which specialize in geographical areas or economic sectors and index tracking funds, which seek to match or exceed indexes; 10% of the funds incorporated in 1998 fit into one of these categories.

Table 3.1
NUMBER OF REGISTERED FIRMS

	Situation at 31/12/97	Additions	Removals	Situation at 31/12/98
FIM funds.....	1,277	399	2	1,674
FIAMM funds.....	204	4	2	206
FII	4	1	0	5
SIM	218	18	5	231
SIMCAV	137	232	1	368
SGIIC	133	3	5	131
SGC	58	2	5	55
Depositories	165	4	1	168
UCITS	110	16	10	116
SV	48	1	2	47
AV	58	2	3	58
Agents	5,643	1,012	630	6,025

The establishment of a “one-stop shop” for open-end investment companies (SIMCAV) in January 1997 and the absence of publicity requirements for their admission to listing and for continued listing on the stock exchange favored higher growth in the number of these companies than in 1997. In 1998 a total of 368 open-end investment companies (SIMCAV) were registered and, consequently, their total number has increased almost five-fold in only two years.

Expansion of operations in derivatives

The increase in the assets managed by collective investment schemes and the growing trend towards investing in foreign assets made it necessary to extend their capacity to hedge in foreign markets. Consequently, to supplement the Ministerial Order dated 10 June 1997, which expanded the possibilities of operations with OTC derivatives, and CNMV Board Resolution dated 27 July 1998 established that all the organized derivatives markets located in OECD member states are suitable for investment by Spanish collective investment schemes. This measure significantly expands the scope for investment since, previously, collective invest-

ment schemes could only invest in Spanish derivatives markets and in Deutsche Terminbörse (DTB), the London International Futures Exchange (LIFFE), Marché a Terme International de France (MATIF) and the American Chicago Mercantile Exchange (CME). This measure establishes the necessary parallel with investment in the spot markets for collective investment schemes.

International investments by FIAMM funds

With the same goal of enlarging the operational possibilities of mutual funds, the CNMV issued an Interpretative Letter⁽⁴⁾ in March 1998 clarifying that securities representing the public debt of any State should be considered highly liquid provided that (i) they are securities or transactions on securities whose maturity period or residual amortization or reimbursement is eighteen months or less, and (ii) they are traded on official secondary markets as envisaged by Article 17 of the IIC Regulation. This measure, which was taken within the context of growing interest in securities and instruments issued in other countries, aims to better satisfy the demand of Spanish investors and to boost the competitive edge of Spanish fund managers in the international arena.

Abridged prospectuses and quarterly reports

It has become necessary to review some of the reporting requirements for mutual funds as a result of growth in the number of savers who rely on this type of vehicle. The aim is that the increasingly varied, and presumably more sophisticated, investors receive accurate and sufficient information quickly.

Consequently, exercising the advisory duties entrusted to it by Article 13 of the Securities Market Law, the CNMV proposed to the Ministry of the Economy and Finance that a Ministerial Order be approved to allow management companies to use and send out abridged prospectuses and quarterly reports for mutual funds instead of the full prospectuses and reports which they have been providing and which are more cumbersome due to their size. The above-mentioned Ministerial Order was approved on 1 October 1998 and was implemented in February 1999 by a Circular of the CNMV.

The minimal content of abridged prospectuses and reports is established by the regulations. It is necessary to set out in writing that the managers must still prepare the full prospectuses and reports and have them at investors' disposal at the offices of the firms which market the fund. All the prospectuses and quarterly reports in their complete and abridged forms which are issued by the funds are available to the public on the CNMV's web site. There has been a reduction in the content of the quarterly reports and the prospectuses without a decrease in information quality. Consequently, the most relevant information about mutual funds is presented clearly and concisely through the abridged format.

(4) Interpretative Letter 1/1998 dated 3 March.

Publicity of collective investment schemes

Due to the popularity of mutual funds, the CNMV has had to pay special attention to the advertising for these savings vehicles. Advertising and, in general, the information that mutual fund management companies provide to investors and the public influences savers' decisions and, consequently, it is essential that those companies appropriately present the characteristics of their products, including the risks involved, without any distortion.

In Spain, although Article 94 of the Securities Market Law envisages the possibility of government regulation of the publicity of activities related with the securities market, self-regulation in this area was preferred in order to avoid an inflexible regulatory model based on prior authorization or subsequent monitoring.

Through self-regulation, the sector can organize the publicity of collective investment schemes responsibly and efficiently. In order to facilitate this task, last year the CNMV issued an Interpretative Letter⁽⁵⁾ which includes the general principles that CNMV believes should be considered by the sector when preparing a new code of conduct for advertising which is in keeping with the current situation of this booming market and promotes, strengthens and updates the self-regulatory system that has been chosen.

Intermediaries

Registration of new securities firms

Last year there were few changes in the number of registered firms. The implementation of the ISD, the introduction of the single currency and the growing internationalization of Spain's markets did not trigger sizable readjustments among Spanish firms, nor is it giving rise to new registrations of subsidiaries of foreign firms, although this sector is expected to adapt to the new scenario in 1999 by adopting strategic decisions to improve its competitive position. The number of independent firms (i.e. which do not belong to financial groups) only increased by one since, although three new firms were registered, two firms were removed. The foreign subsidiaries group decreased by four; two were Japanese firms, undoubtedly due to the restructuring of financial institutions in Japan.

Agents of securities firms and portfolio management companies (SGC)

Established securities firms are making considerable use of agents to extend their commercial network in Spain. As shown in table 3.1, in 1998 there was a sizable increase in the registration of agents; the net result was more than 300 new registered agents. In 1998 the

(5) Interpretative Letter 7/1998 dated 6 May.

CNMV approved an important Circular⁶ in connection with these agents, establishing certain principles which must be respected by securities firms which use agents. Consequently, it was determined that representation must be exclusive for a single firm and the activity of the agents must be clearly limited by contracts which formalize the relationship. It is also essential that these agents abide by the rules of conduct which prevail in the firm and that their activities are included in the firm's internal control procedures. The procedure for notifying the CNMV of new contracts of representation was simplified and this obligation is eliminated for credit institutions providing that the latter have informed the Bank of Spain of the activities of their agents.

Recommendations to intermediaries in connection with investment clubs

The stock market boom has encouraged the creation of investment clubs in which small groups of investors come together to invest in the markets. These are generally praiseworthy initiatives aimed at extending investment in the stock market and the related techniques among the public. However, under no circumstances are these clubs comparable with the forms of collective investment which are recognized by Spanish legislation and, consequently, they cannot advertise to attract funds in the way mutual fund promoters can.

In order to clarify the issue of advertising and other points related to investment clubs and to respond to queries made by some intermediaries, last year the CNMV issued Interpretative Letter 3/1998⁽⁷⁾ which includes a set of recommendations for firms in the event that investment clubs request their services. Thus, before accepting an order, firms should check that the bylaws of the club and the specific service requested do not infringe legally reserved areas of activities.

Securities markets

The adoption of the euro and the process of market internationalization require that Spanish markets make efforts to innovate now more than ever. In 1998, the CNMV promoted or participated in various initiatives to consolidate the competitive position of Spain's markets. Principal among these activities, due to its importance, is the Protocol agreed by the bourses, AIAF, Spain's Securities Clearing and Settlement Service (SCLV) and the CNMV to promote the private fixed-income market. Following on from this important agreement there were several innovations in 1998 which affect the issue and trading of private fixed-income securities. The agreement with the bourses to expedite the dissemination of information to the market by listed companies is also noteworthy.

(6) Circular 5/998 dated 4 November, on securities firms and dealers' agents.

(7) On the regusal to trade, capture of public funds for management and investment clubs.

Protocol for the development of fixed-income markets

Trading of Spanish private fixed-income securities is currently fragmented between two markets with different characteristics: the bourses and AIAF. On the bourses, trading is based on concentrating and matching orders, securities are represented by book entries and settlement is based on a double check of balances and securities tracking numbers. In contrast, AIAF is a price-driven market where securities are predominantly represented by physical certificates and settlement is by balances.

The desire to boost this market, together with the conviction that excessive differences in the characteristics of those two areas of trading restrict the growth potential of the fixed-income market as a whole, led the presidents of the securities market governing companies, AIAF, together with the presidents of Spain's Securities Clearing and Settlement Service (SCLV) and the CNMV, to sign a Protocol⁽⁸⁾ in order to harmonize the operating procedures in both markets and to encourage various types of joint improvements. The signatories to the Protocol undertook, within their powers, to adopt measures to extend the representation of securities by book entries and to establish a joint system for the clearing and settlement of the fixed-income securities traded on the bourses and AIAF. An agreement was also reached to study other measures which contribute to promoting private fixed-income issues in Spain.

Last year important steps were taken in the direction of both harmonization and development as indicated by the Protocol, including most notably the following:

Book-entry system and settlement of securities

AIAF took an important step by introducing the book-entry system for securities listed on this market. Through a Circular issued in June⁽⁹⁾, the market resolved that all new issues must use this system of trading. Also, in order to facilitate the harmonization of fixed-income settlement systems, Spain's Securities Clearing and Settlement Service (SCLV) issued a Circular⁽¹⁰⁾ to define the regulations applicable to the system for recording fixed-income securities represented by book entries for accounting purposes and to the clearing and settlement of transactions performed with these securities on both the bourses and AIAF.

Adjustment to the CNMV's fees for registering issues

A new change was made to the system of fees⁽¹¹⁾ in order to bring them in line with the actual cost of supervision. Minimum and maximum fees were established for processing the registration of fixed-income issues and their admission to listing, which basically reduce the issue costs, particularly for small issues.

(8) Document signed 29 April 1998.

(9) AIAF Circular 2/1998, dated 24 June on securities represented by book entries.

(10) SCLV Circular 2/1998, dated 15 July, on systems for recording, clearing and settling fixed-income securities represented by book entries.

(11) Royal Decree 1732/1998, dated 31 July, on the fees applicable to the activities and services provided by the CNMV, see box in Chapter 1.

Increased flexibility of the procedures for issues, public offerings and admission to listing

- *Measures envisaged by the Reform Law of the Securities Market Law⁽¹²⁾*. The Reform Law of the Securities Market Law includes a number of measures on the processing of issues and admissions to listing, in line with the simplification target envisaged by the Protocol. Noteworthy features include: (i) the relaxation of requirements in issues of securities similar to those which are already traded on a secondary market, especially if there is sufficient information in the market about the issuer of the securities or if the securities are targeted at institutional or professional investors; (ii) greater simplification of the procedure for admission; and (iii) the elimination of the requirement to grant a public deed for issues of promissory notes which will be traded on a secondary market, provided that their characteristics are stated in a prospectus.
- *New forms for prospectuses introduced by Royal Decree 2590/1998, dated 7 December, on amendments to the legal system of the securities markets*. Together with other measures, this important rule introduces a new classification for issue prospectuses to bring registration procedures more efficiently into line with the operation of the market, without affecting the transparency required - see Chapter 4.
- *Clarifications of some cases envisaged by Royal Decree 291/1992, on issues and public offerings of securities*. As a result of several queries made by issuers and financial intermediaries, the CNMV issued an Interpretative Letter⁽¹³⁾ clarifying in which cases fixed-income securities issued by residents and non-residents are subject to the obligations of authorization by, and prior notification to, the Directorate-General of the Treasury and Financial Policy as provided in the above-mentioned Royal Decree 291/1992. These cases are an exception within the system of freedom to issue which is recognized by Spanish legislation and they apply to very few issues. With the same purpose of facilitating interpretation of the regulation, that same Interpretative Letter also clarifies the requirements for fixed-income security issues by residents and non-residents to be able to avail themselves of partial registration exceptions (basically exemption from registering the prospectus) which are envisaged in the above-mentioned Royal Decree.

Use of AIAF securities as a guarantee in the implementation of monetary policy

The new implementation of European monetary policy makes it possible for firms to use private securities as a guarantee in order to obtain liquidity from the central bank. These private securities include numerous AIAF securities, which were already in use in such transactions due to an agreement reached between the AIAF and the Bank of Spain. Obtaining liquidity with private securities is implemented through repos, which were regulated by the market in 1997.

(12) Law 37/1998, dated 6 November, reforming the Securities Market Law 24/1988, dated 28 July.

(13) Interpretative Letter 6/1998, dated 4 May, on the issue of fixed-income securities by residents and non-residents and the admission of securities to listing [Article 5 and Article 7 of Royal Decree 291/1992, on issues and public offerings of securities].

The use of private fixed-income securities in monetary policy operations will undoubtedly contribute to boosting demand and issues of these instruments. As indicated in the section on Spain's Securities Clearing and Settlement Service (SCLV) in Chapter 7, further steps must now be taken to allow the broadest possible use of such securities for this purpose.

Tax treatment

The tax treatment of private fixed-income securities improved notably after the promulgation of Royal Decree 2717/1998⁽¹⁴⁾. This regulation eliminates the withholding at source for payment of interest on private fixed-income securities acquired by legal entities provided that said securities are represented by book entries on an official secondary securities market. Government debt securities already enjoyed this advantage and, consequently, the discriminatory treatment of private issuers has come to an end.

Agreement with the bourses to simplify procedures for reporting to the markets

In order to facilitate compliance with legal obligations and to expedite administrative procedures, the market governing companies of the Barcelona, Barcelona, Bilbao, Madrid and Valencia bourses and the CNMV agreed to implement a "one-stop shop" for channeling: (i) notifications of significant holdings, (ii) filings of applications for admission to listing, (iii) notifications of price-sensitive events and (iv) filings of financial statements and auditors' reports of issuers of listed securities. This agreement⁽¹⁵⁾ is expected not only to greatly facilitate compliance by issuers with these obligations but also to considerably accelerate the disclosure of information to the public.

Adjustment in the tariffs of market governing companies

As a result of the current scenario of growing financial integration it is necessary to consider any measure which will contribute to increasing the competitive edge of Spain's securities markets. The CNMV and the market governing companies are aware of this and their review of the Spanish markets' fee systems was conducted in the light of comparison with fees in other countries and of the need to maintain financial equilibrium.

Consequently, significant changes have already been made to prices and fees applied in the markets; the most noteworthy changes are as follows:

- Fees for stock market operations in the lowest brackets of the scale have decreased by between 3.0% and 8.5%. In other brackets where the tariff is very competitive internationally, the cuts did not exceed 2.5%. Other adjustments were also introduced to effectively decrease the fees applied to a substantial number of operations.
- The variable fee which companies pay for listing their securities decreased by half between 1998 and 1999 and listing fees of the vast majority of listed companies also decreased noticeably: by 25% per million pesetas of stock market capitalization, in the case of equities, and by 50% per million pesetas of the face value of fixed-income securities.

(14) Royal Decree 27/1998, dated 18 December, which regulates personal income tax prepayments and non-residents' income tax prepayments and which amends the Corporate Income Tax Regulation in connection with withholdings and prepayments.

(15) Which took the shape of CNMV Interpretative Letter 4/1998, dated 30 March, which came into force on 1 May 1998.

- Fees for the clearing and settlement of stock market operations (apart from penalties for non-compliance) fell by approximately 49% in 1998. Also, due to the rounding effect and other changes made when converting tariffs to euros, settlement fees fell again by a further 5% on average.
- The size of futures and options contracts on the notional 10-year bond increased to 100,000 euros (16.6386 million pesetas, up from 10 million pesetas), which is an effective cost cut of around 40% for market members. The tariff for futures and options contracts on indexes, which has been adjusted to the new face value of contracts, includes an incentive system based on the volume of contracts traded.

Meetings of the market presidents

In 1997 the presidents of the governing companies of the securities markets (stock markets, AIAF and MEFF), the president of SCLV and the President of the CNMV began to meet regularly. Three meetings were held in 1997 and a similar number took place in 1998. The aim of the meetings is to exchange views about matters of common interest and to make proposals about studying market regulatory or operational issues which might increase the markets' efficiency and, consequently, their competitiveness in Europe. One subject which has constantly been examined is the possible development of the structure of Spanish markets, particularly as regards trading. The degree of the markets' progress in adapting to the euro was also examined. Another frequently-discussed issue was the status of the new Securities Market Law in the legislative process. Noteworthy among the specific issues which were examined at said meetings and which took the shape of agreements or modifications to market operations are the "one-stop shop" project discussed above which expedites the process of certain disclosures required by the CNMV and the markets, and the creation of new block and agreed-price trading systems.

The meetings also received the reports of various working groups in operation at the CNMV which had the same purpose of making proposals for improving the position of Spanish markets in terms of either operating efficiency or cost reduction. The working group on market tariffs pursued this aim in its reports, the conclusions of which served as guidelines for revising operating costs. Other working groups in action are studying the possibility of establishing a new market for small and medium-sized enterprises, the regulatory treatment of extraordinary transactions, the process for developing the fixed-income market, Year 2000 compliance of markets and listed companies and the treatment of new savings products in the light of the Securities Market Law rules.

4

ISSUERS' REPORTING TO THE MARKET

1998 was a very busy year in the securities markets on account of high trading volumes, the prices attained by assets and the dynamism of the primary market. There was significant growth in issues, privatizations and flotations in comparison with the previous year and they contributed to making investment in securities, particularly in shares, more popular. Last year also saw considerable product innovation (preference shares and asset-backed securities), reflecting investors' increasing sophistication and issuers' interest in taking advantage of all market opportunities.

The CNMV is responsible for ensuring that sufficient accurate and timely information about market products and the companies which issue them is made available to investors when they take decisions. Accordingly, year after year it has insisted on the need to improve the quality of financial information provided by listed companies to the market. This insistence is beginning to produce results but there is clearly room for improvement in some areas; consequently, the CNMV will continue its efforts in future. Concern about the improvement in financial information is completely in keeping with recommendations of international organizations which, responding to recent spates of instability in international capital markets, have called for increasing financial transparency.

The CNMV focused its attention on various points in 1998, most notably audits, the linchpin in ensuring quality financial information. It continued to insist on the need for listed companies to file clean auditors' reports on their financial statements. The publication of the recommendations of the Code of Good Corporate Governance is also worth noting as they have become the benchmark par excellence for evaluating the guarantees of oversight that boards of directors can offer to shareholders. Several listed companies have already notified the market about compliance with these recommendations.

Within the scope of primary markets, Royal Decree 2590/1998⁽¹⁶⁾ introduced considerable changes to prospectuses and other matters related to the issue and public offering process in order to expedite it and bring it into line with market developments. The changes introduced uphold the principle that prospectuses must contain full and sufficient information so that investors can form a reasoned opinion about the security and the issuer. The CNMV also delimited publicity in public offerings and made recommendations to firms which participate in flotations about issuing research reports on the company making the placement.

(16) Royal Decree 2590/1998, dated 7 December, on amendments to the legal system of securities markets, which introduces significant amendments to the Royal Decree on issues and public offerings.

Periodic reporting by listed companies

Quarterly and half-yearly reporting

The CNMV continued to pay particular attention to certain captions in listed companies' quarterly and half-yearly reports which, in its opinion, continue to be completed unsatisfactorily. It focused specifically to the "evolution of business" and "bases of presentation and valuation methods" chapters and reminded issuers of the need to include comments about operating results and the company's financial situation. Issuers must increase the amount of quantitative information and also provide qualitative comments, particularly on operating results (net sales, cost of sales, personnel expenses, depreciation, operating profit, financial revenues and expenses, ordinary and extraordinary results and the result for the period), liquidity, capital resources (debt and working capital) and the cyclic nature of their business.

Financial statements and auditors' reports

Last year there was a sizable improvement in the quality of the financial statements filed by issuers and of the auditors' reports on them. However, there continues to be room for improvement in the information companies include in their financial statements and management reports. This can be seen by merely comparing the detailed information provided by the same companies in the prospectuses which are registered for new issues or public offerings of sale of securities.

In connection with audits, the CNMV considers that issuers must file financial statements with clean opinions, otherwise investors find it more difficult to understand them. For this reason, each year the CNMV reiterates the need for issuers to prepare reports of the highest possible quality to avoid qualified opinions and, if qualified opinions are issued, to take all the appropriate measures for a clean opinion to be reissued for that year.

It is satisfying to see that the CNMV's continuous efforts are bearing fruit and, as shown in table 4.1, the number of qualified opinions and denials of opinion or adverse opinions has decreased in the last three years. This table also illustrates the decline in the total number of qualified opinions and a relative reduction in the number of scope limitations and uncertainties.

Table 4.1

AUDITS OF ISSUERS FILED WITH THE CNMV (*)

	1997	1996	1995
1. AUDITORS' REPORTS FILED WITH THE CNMV			
– Individual financial statements	421	425	452
– Consolidated financial statements	237	237	247
– Total auditors' reports filed	658	662	699
– <i>Special reports under Ministerial Order 30/9/92</i>	98	114	152
2. AUDITORS' OPINION			
– Clean opinion	552	520	504
– Qualified opinion	106	142	195
3. TYPES OF QUALIFICATION			
– No. of auditors' reports with exceptions	54	67	98
– No. of auditors' reports with uncertainties, etc.	71	102	145
– No. of auditors' reports with limitations	10	20	27
Total qualified auditors' reports	106	142	195
4.1. EFFECT OF EXCEPTIONS ON RESULTS			
– No. of auditors' reports with positive effects on earnings	17	17	18
– No. of auditors' reports with negative effects on earnings	24	43	69
4.2. EFFECTS OF EXCEPTIONS ON NET WORTH			
– No. of auditors' reports with positive effects on net worth	16	11	24
– No. of auditors' reports with negative effects on net worth	19	26	38
Total auditors' reports with exceptions	54	67	98
5. NATURE OF UNCERTAINTIES, ETC.			
– Going concern	26	37	32
– Tax contingencies	17	39	55
– Recovery of assets	29	38	81
– Assets revalued under Basque country regulations	0	2	16
– Litigation	17	23	29
– Denial of opinion or adverse opinion	6	12	18
– Other uncertainties	19	43	43
Total auditors' reports with uncertainties, etc.	71	102	145

(*) Auditors' reports on financial statements and special reports filed with the CNMV through 31 December 1998.

The CNMV adopted a number of measures regarding the shortfalls detected in financial statements in 1998, the most noteworthy of which are as follows:

- Demands to companies whose auditors' report on the 1997 financial statements did not include a clean opinion, where the accounting impact of the qualification was material. Demands were sent to 35 companies, and a further 9 demands were sent to those companies whose reply was not responsive to the scope and intention of the first demand. Table 4.2 shows the type of reply given to rectify the qualifications; it is noteworthy that most companies have provided a satisfactory solution.
- Monitoring of the scope limitations reported by the auditors in their reports, requiring all companies to provide all the necessary information so that the auditors can perform their work. In this connection, it is worth noting that the number of audits with scope limitations on the financial statements for 1997 decreased by 50%.

- Dispatch of demands (19) to remedy the lack of information in companies' notes to financial statements. Some notes to financial statements had not included all the compulsory information, most notably in connection with two aspects: the failure to mention companies which own more than 10% of the capital stock of the reporting company, and the failure to include information about holdings of 3% in listed companies and of 20% in unlisted companies. The replies to most of the demands were satisfactory.
- In cases where companies had filed auditors' reports without an opinion, trading in the stock was suspended. Trading resumed in Cartemar and Urbas's shares once the circumstances which had caused the suspension had been resolved.

Table 4.2

DEMANDS ISSUED TO LISTED COMPANIES IN 1998 IN CONNECTION WITH THE AUDIT OF THE 1997 FINANCIAL STATEMENTS

Electronic market	Open outcry	Second market
1.- Companies with qualified auditors' reports which have remedied the situation or have set a deadline for remedying it.		
ACS	ALVI	
CEMENTOS PORTLAND	ANDRES RUIZ DE VELASCO	
COFIR	BODEGAS BILBAINAS	
CORPORACION BANESTO	CINSA	
EBRO AGRICOLAS	CONSERVAS GARAVILLA	
ERCROS	EL SARDINERO	
HISALBA	LUCTA	
HUARTE	MANUFACTURAS ANTONIO GASSOL	
PESCANOVA	TUBOS FORJADOS	
SOCIEDAD FINANCIERA Y MINERA	XEY	
2.- Companies with qualified auditors' reports which, in principle, will not be remedied in the short term.		
EPPIC (in liquidation)	CARTEMAR	
GLOBAL STEEL WIRE	CLEOP	
LA SEDA DE BARCELONA	GRAND TIBIDABO	
NUEVA MONTAÑA QUIJANO	INMOBILIARIA ALCAZAR	
SARRIO	MINERO SIDERURGICA DE PONFERRADA	
SNIACE	PEBSA (suspension of trading)	
URBAS		
3.- Companies with qualified auditors' reports which have not responded.		
	BOLSANOR	
	VICINAY	
4.- Companies which had received demands for failure to file the auditors' report and which had not complied at 31/12/98.		
	JUMBERCA (suspension of trading)	
	OROZCO	
	URBI (suspension of trading)	

** Company with listed fixed-income securities.

Note: Demands were sent to Bolsanor, Barcino, Cromogenia Units, Daltar, Esteban Espuña, Forjas de Berriz, Hilanderias Vera, Hispana Tres, Inmobiliaria Carroggio, Inversora de Arriendos Inmobiliarios, Inversiones Cervo, Inversora Condal, Lepanto, Manufacturas Antonio Gassol, Pebsa, Saarema Inversiones, PMRK Investment, Sedatex and Terreva, because their notes to financial statements did not contain all the information that is required under the Companies Law.

Changes in notification of significant holdings at listed companies

Considerable changes have been made in the regulations on the notification of significant holdings (Royal Decree 2590/98, on amendments to the legal system of the securities market). The most notable changes were as follows:

1. With a view to achieving maximum transparency in operations performed by residents in tax or regulatory havens, 1% was established as the threshold for the obligation to provide notification of holdings in listed companies. Nominees who act on behalf of these investors are also subject to this limit.
2. The definition of acquisition extends to concerted action in exercising voting rights. Consequently, notification must be provided of amendments to or dissolution of this type of agreements. In these cases the shareholder who owns most voting rights prior to the agreement being made will be deemed the subject under obligation. The notification must include data on the individuals or legal entities that are party to the agreement and the specific holding of each party involved, in addition to other essential aspects of the agreement.
3. If the acquirer or transferor does not hold legal title, the management company or the party which represents the holding will be considered the subject under obligation to provide notification.
4. Directors are considered to have a special reporting obligation and if they do not have any holding in the listed company when they are appointed as directors, they should make a specific statement to that effect.
5. Special cases of notification are also included: individuals or legal entities representing parties who are appointed to the post of director are also subject to the same obligations as directors.

Introduction of the Code of Good Corporate Governance at listed companies in Spain

The recommendations in the Code of Good Corporate Governance which was published in February 1998 by the Special Commission for studying the boards of directors of companies were mainly aimed at listed companies.

The need for in-depth reform of the governance structures of companies has been apparent for some time. The recommendations in the Code of Good Corporate Governance show awareness of this issue. As in other European countries, the authorities understand that this reform cannot be imposed by regulations but, rather, by the firm belief of directors of listed companies that it is appropriate to adapt their governing bodies to the demands imposed by the economy and society. These demands vary on the basis of the company's characteristics: size, shareholder structure, sector, etc.

Important listed companies have already shown their willingness to adopt the Code of Good Corporate Governance. Companies which account for a third of trading volume on the continuous market have already adopted it. Nevertheless, in order to draw conclusions about its effective implementation, it is necessary to wait until listed companies state in their public annual reports whether, and to what extent, they have taken on board the recommendations of the Code. In order to standardize these reports as much as possible, in December 1998 the CNMV published an Interpretative Letter with the format to be followed for preparing the above-mentioned annual report. The CNMV's web site has extensive information available for consultation on this issue.

Introduction of the Good Corporate Governance Code (data at 31/12/1998)

- At 31/12/98, 13 listed companies had filed their Board of Directors' Regulation with the CNMV. Five of these regulations had been adopted prior to the publication of the Code of Good Governance.

Abengoa	Continente	Funespaña	Tabacalera
Aceralia	Enaco	F. Paternina	Telefónica
Aldeasa	Endesa	Repsol	Tubacex
Argentaria			

All these companies are listed on the continuous market where, at the end of 1998, they accounted for 33% of its capitalization. Eight of the above companies are included in the Ibex-35 and account for 41% of its capitalization.

- As regards other listed companies, according to their prospectuses which have been filed with the CNMV since the above-mentioned report was published, 24 of them have made statements about adopting the recommendations it includes. For example, 16 companies have stated their intention of drafting a Board Regulation to adapt the above-mentioned recommendations to the characteristics of each company:

Azucarera	Ebro SOS Arana	Iberdrola	Superdiplo
Bami	Europac	La Seda de B	Telepizza
Befesa	GMU	Obrascon Huarte	Radiotronica
Cofir	G. Picking Pack Inm.	Sniace	Zabalburu

- Another seven companies have stated that they are studying these recommendations:

Acesa	Cia. V. de Cementos	Unión Fenosa	Zeltia
Catalana Occ.	Enher	Viscofán	

Issues and public offerings of sale of securities

In 1998 there was intense activity in primary markets due to the increased number of issues filed with the CNMV and the almost 70% increase in the value of new issues. The equity segment was most dynamic, particularly public offerings, which amounted overall to approximately two trillion pesetas due to the privatizations. The amount of capital increases was also large, rising from 132 billion pesetas in 1997 to 1.5 trillion pesetas in 1998. The largest capital increases were Telefónica (427 billion pesetas) and Banco Santander (628 billion pesetas).

Table 4.3

ISSUES AND PUBLIC OFFERINGS OF SALE OF SECURITIES

Amounts in billions of pesetas

	No. of Issues and Offerings		Amount	
	1998	1997	1998	1997
Fixed-income	109	113	3,091	2,156
Equities	150	103	2,874	1,445
Warrants	55	42	113	29
Total	314	258	6,078	3,630

Table 4.4

REGISTERED OFFERINGS OF SALE OF SECURITIES

Amounts in billions of pesetas

Company	Amount*	Placed
Privatizations	1,712.6	
Argentaria	372.6	
Tabacalera	287.9	
Endesa	1,052.1	
Other	159.3	
Dogi	4.1	Initial Public offering
Vilesa	3.6	
BBV (1)	2.2	
Fastibex	8.5	
Mia	27.9	Initial Public offering
Superdiplo	27.8	Initial Public offering
Koipe	12.1	
Lucent Technologie (2)	1.1	
Alston (2)	0.3	
Befesa	16.0	Initial Public offering
Europac	7.1	Initial Public offering
Tele Pizza (1)	2.3	
Valauchan (2)	0.9	
Federico Paternina	3.9	Initial Public offering
Transportes Azkar (3)	24.2	
Enaco	9.8	Initial Public offering
Funespaña	7.5	Initial Public offering
Total	1,871.9	

(*) Including the volume offered in the Spanish and international tranches.

(1) Employee stock option plans

(2) Unlisted companies.

(3) A public offering which has been registered but is at a standstill pending research into demand.

Increased flexibility in filing prospectuses

Despite the growth recorded in recent years, the primary securities market in Spain is still small and growing demand for securities means that companies should resort more to the capital markets. Consequently, it is advisable to review and, insofar as is possible, reduce market entry costs. Part of these expenses are generated by legal information and registration requirements and by the time incurred in the process of verifying the documentation filed. Regulators must maintain a balance between the costs for issuers and the benefit of transparency for the market.

In 1998 this concern inspired a number of measures which are included in Royal Decree 2590/1998 and are aimed at increasing the flexibility of the requirements for registering issue prospectuses. The new rules attempt to simplify the procedures for registering prospectuses and matching them with the nature of the issues, while ensuring that all the relevant information for the investor is included in the prospectus. Under these rules, issue prospectuses are classified as full, shelf or abridged. The latter may be prospectuses for an issue or specific offer or schedule. In this way it is possible for an issuer to register a shelf prospectus in which, besides the information on the company, essential characteristics about the issue or issues which are aimed to be carried out over a specific period of time are included; such a prospectus should be complemented by a supplement which includes the specific characteristics of the issue when it occurs. The prospectuses must conform to the forms approved by the CNMV and may vary according to the type of securities to be issued, the characteristics of the issuer, the amount of the issue or other circumstances which justify a difference.

Certain issues benefit from a partial exemption from prospectus registration requirements provided that they are not the same kind of securities or do not have similar characteristics to other securities of the same issuer which are listed on an official secondary market in Spain. Said exemptions are justified on the basis of the small size of the issue and the fact that the investors at which they are aimed already have information about the issuer due to their particular relationship with the latter. Issues which are exempt from said obligations are:

- Issues for employees or retirees of the issuer or its group.
- Shares issued at no charge to the shareholder or issues of securities offered in exchange for other securities of the same company.
- Issues of shares required for merger or spin-off processes.
- Issues whose total amount is less than 1,000 million pesetas.

Finally, it is worth pointing out that the obligation to register prospectuses for admissions in cases where issue or offering prospectus contain a promise of listing has been eliminated. In these cases, the securities must be admitted to listing before the end of the time limit established in the prospectus which under no circumstances may exceed six months.

Warrants

With the same intention of simplifying issue procedures, in June 1998 the CNMV issued an Interpretative Letter⁽¹⁷⁾ aimed at facilitating the issue and admission of warrants, an instru-

(17) Interpretative Letter 8/1998, dated 18 June, on the clearance of issues and/or admissions of warrants at the CNMV.

ment which has become prominent in the Spanish market in recent years. It included the intention “of relaxing the registration of issues and the placement of those issues which, like warrants, require breakdowns of specific information and where speed and the opportunity of market placement are important”. An annual shelf prospectus was designed for this purpose which includes the general conditions of issue; the abridged prospectus for each specific issue is cleared subsequently. Royal Decree 2590/98 envisages that the annual schedule program may be used as an admissions prospectus; consequently, for the purposes of admission it would be sufficient to file the outcome of the placement and a general certificate of validity for the inclusion of the above-mentioned issue in the public register, provided that this occurs within a period of six months from the issue’s registration date.

Publicity in issues

Royal Decree 2590/1998 regulates the publicity of issuers or offerers of securities in greater detail. It is worth noting in this connection that the inclusion of messages or quantifications in the publicity which are not included in the prospectus is forbidden.

The Royal Decree establishes the use of three-page information leaflets called “trípticos”, whose contents it regulates, among the publicity activities. These leaflets must be prepared by the issuer or offerer in order to complete the publicity about its issue or equity offering; they are compulsory when the issue is advertised. Under the new regulation these leaflets must provide a summary of the information included in the prospectus and be easy for investors to understand; they must obligatorily be available to all acquirers at the branches of the issuer, the management firm and the placing firms.

New measures and criteria regarding public offerings

Public offerings have had a huge impact on Spain’s markets, contributing to popularizing investments in securities. These operations have also represented an important source of business for securities firms and credit institutions, which participated to a great extent in the flotations. As many of these firms usually provide company research services which they release publicly or limited to their clients, their participation in large flotations has raised doubts at some point about possible conflicts of interest. In November 1998, the CNMV expressed its concern about this issue through an Interpretative Letter⁽¹⁸⁾ in which it made various recommendations about rules of conduct which are applicable to issuing research. Shortly afterwards, the above-mentioned Royal Decree 2590/1998 addressed this subject once more, prohibiting placement entities from publishing reports on the issuer between the date of the registration of the prospectus and the end of the flotation, apart from periodic reports which are published in accordance with a pre-established timetable. Thus, the aim of this measure is to prevent conflicts of interests from leading to the release of information which is not objective and might distort investors’ decision-making processes.

Also as regards public offerings, the CNMV has required offerers to present a timetable with the dates and the commitments for sending documentation required for approval of the issue. Presentation of this timetable and compliance with the offerer’s commitments facilitate the clearance and registration process at the CNMV, expediting the operation as a whole. It also im-

(18) Interpretative Letter 10/1998, dated november 24, on rules of conduct applicable to research and advice activities.

proves the adjustment of information conveyed by financial institutions to the market on the basis of the stage of the operation.

New products and modifications to existing products

Preference shares

At the end of October, a resolution of the CNMV Board⁽¹⁹⁾ authorized trading in preference shares on the AIAF's fixed-income market. This enlarged the range of assets available to Spanish investors and, in particular, created securities which combine a level of risk intermediate between fixed-income securities and equities with a yield that is higher than that of debentures.

From the standpoint of their legal nature - they are not specifically envisaged in Spanish legislation - preference shares are part of the capital stock of the issuer, but the rights they confer on their owners differ from the rights attached to common stock.

From an investor's point of view some particularly noteworthy aspects of this type of securities are:

- The payment of dividends on preference shares is conditional upon the issuer or guarantor obtaining sufficient profits to pay dividends on all previous and future issues of the same type of securities.
- Dividends are not accumulated, which implies that they are forfeited if they were not paid due to the above-mentioned circumstances.
- The issue is perpetual.

From the issuer's standpoint these securities are not perpetual debt but are part of its capital stock. Consequently, if the issuer or guarantor goes into liquidation, the preference shares will be combined with other shares issued by both parties since they all rank equally in the order of priority of payments.

(19) CNMV Board Resolution dated 21 October 1998.

Table 4.5

PRINCIPAL DIFFERENCES BETWEEN PREFERENCE SHARES AND OTHER ASSETS

	Common Stock	Preference Shares	Debentures
Income	Not fixed	Fixed (cannot be accumulated, conditional upon obtaining sufficient distributable profits and subject to the limits imposed by the Bank of Spain's regulation on equity)	Fixed or variable (not conditional upon obtaining profits)
Time to maturity	Perpetual	Perpetual (with an option for the issuer to make early redemption after the fifth year, coinciding with the dividend payment date) *	Have maturity date
Priority in bankruptcy proceedings	Last	Higher than common stock	Higher than preference shares and common stock
Voting rights	Yes	None	None
Preferential subscription rights	Yes	None	None
Taxation for period income of residents in Spain	Withholding	Withholding	Withholding
Guarantees	No	Yes	Both types

* With prior authorization from the Bank of Spain.

Asset-backed securities

Securitization of assets is highly interesting for companies and investors. For companies, it offers access to attractive financing in terms of cost or the transfer of certain risks. For investors, it means a broader range of financial products and increases their possibilities of risk selection and diversification. These reasons account for the development of securitization in the United States and some European countries. Securitization operations have been performed in Spain since 1993, but they are still not on a par with those countries.

Royal Decree 926/1998⁽²⁰⁾ aims to remedy the deficiency in the regulatory framework for these operations. The new regulation facilitates securitization of a broader spectrum of debt claims provided that the transparency of the process is respected. Consequently, restrictions on the composition of assets for securitisation vehicles have been relaxed; the latter may comprise debt claims which are "homogeneous" to those held by the transferor and, in certain conditions, future debt claims.

(20) Royal Decree 926/1998 dated 14 May, which regulates special purpose vehicles for asset securitisation (asset securitisation funds) and their management companies.

On the liabilities side, more than 50% of the vehicle must be financed with issues of fixed-income securities and the remainder may be bank loans. The securities issued must be listed on an organized secondary market, but this requirement can be waived if the issue is targeted exclusively at institutional investors. In contrast to existing mortgage-backed securitisation schemes, the new vehicles may be open-ended. Thus, the aim is to facilitate securitization on a continuous base of short-term assets, such credit card receivables, corporate promissory notes, commercial credit, tolls from highway concessions and other future rights.

In order to guarantee the transparency of securitisation schemes, according to regulations the CNMV must receive prior notification of the project and various documents and reports for clearance and registration. The requirements are considerably less stringent for vehicles targeted exclusively at institutional investors. Unless they are newly-incorporated firms, the transferors are required to have audited financial statements for the last three years and the latest financial statements must have a clean opinion. Also, scheme managers must provide the CNMV with the financial statements and the auditors' report on the vehicle they manage. The initial reports must also be updated as frequently as is determined.

Criteria used for authorising the first securitisation fund registered with the CNMV under the new rules

The process of authorising the first securitisation fund served to specify certain criteria in connection with the application of the requirements established in Royal Decree 926/1998. The most significant requirements are summarized below:

- Definition of the concept of “homogeneity,” in the broad sense of the word from a legal and economic standpoint.
- Restrictions on the free use of loans or credit lines which may constitute the liabilities of the fund if granted by the parties transferring the assets to the fund. These limitations refer to the indiscriminate acquisition of assets with overdraft or liquidity facilities and not to the issue of securities.
- Provision of reports prepared by the management firm about the assets to be included and reports of independent experts on the compliance with certain attributes by the assets included at a specific date.
- Establishment of an operating procedure to provide notification about the assets incorporated into the Fund through an automated reporting system (*CIFRADO*) in order to comply with Article 2.2.c).2 of Royal Decree 926/1998 whereby the CNMV must clear any new incorporation of assets to asset-backed mutual funds.
- Requirement to execute a related public deed of amendment to make any change in the deed of incorporation which must have the approval of all the rating agencies and will be reported to the CNMV for it to be made available to the public as a price-sensitive event, or by clearance and registration of a supplement to the prospectus.

All Spanish markets began to operate in euros on the first working day of 1999 without substantial problems. This was the successful culmination of an intensive process of preparation which had been undertaken since the end of 1996 by the executives and technicians of the various markets, Spain's Securities Clearing and Settlement Service (SCLV) and firms in the sector, under the coordination of the CNMV. During this period, investors, issuers and other market participants received full information about the future changes. The CNMV contributed to this task by disseminating the recommendations made by the representatives of the institutions and market companies which participated in various working groups set up for this purpose.

The preparatory work was particularly intensive in 1998. During the early months of the year basic issues of the change were defined (price conversion for all traded securities, the impact on the indexes, characteristics of new derivatives contracts in euros, etc.) in order to subsequently make the numerous, complex adaptations to the computer systems. Worth mentioning among the adaptations are those regarding trading procedures, relations with market members and the release of information to supervisory bodies and other institutions in addition to various back-office applications.

The process culminated between 31 December 1998 and 3 January 1999, during which the market was closed. During that period, many professionals remained at their posts in order to perform the necessary operations and tests to ensure what proved to be a smooth transition to the euro. The CNMV set up work shifts over the week-end to supervise these tasks, respond to queries and make the necessary internal adjustments to its computer systems.

The complexity of the switch to the euro emphasizes the success achieved by Spain's markets. However, the markets must not forget that this new stage in the construction of Europe involves a much greater challenge in terms of the increased competition between Europe's various markets. In order to successfully compete in the new scenario in Europe, Spain's markets must take account of the strategic moves which are occurring in Europe, enhance their capacity to innovate and introduce new efficiency improvements in their operating systems.

The challenges of the new situation in Europe also extend to the area of regulation and supervision. The foreseeable creation of supranational market structures and the increase in transnational operations heighten the need to consolidate the mechanisms for cooperation between European supervisors and to continue to make progress in the harmonization of national rules on the securities markets.

5

THE INTRODUCTION OF THE EURO AND ITS IMPACT ON SPANISH MARKETS

Preparatory work at the CNMV

The CNMV tackled the launch of the euro on three fronts: (i) coordination of, and support for, the process of adaptation of the securities industry, (ii) preparation for undertaking the supervisory tasks entrusted to it in the euro environment and (iii) internal adaptation work.

The CNMV encouraged firms in the sector to develop their adaptation processes and coordinated various working groups comprising professional experts which began to function as early as 1997. The outcome of these working groups was the publication of two new reports at the beginning of 1998: *“Manual Operativo para la implantación del euro en las sociedades y agencias de valores”* (“Operating manual for implementing the euro in broker-dealers and brokers”) and *“Introducción del euro en los mercados de valores españoles”* (“Introduction of the euro in the Spanish securities markets”). The former analyzed the main operational, accounting and information technology problems which securities firms could face and suggested methods and procedures for solving them. The latter report set out the strategic and operational lines to be followed by Spain’s organized markets in order to successfully meet the challenge of operating with euros from the first working day of 1999.

The results of the working groups raised the issue that it was advisable to offer securities firms, collective investment schemes and issuers of listed securities more detailed methods and procedures to serve as a guide for adapting to the euro. It was with this aim that *“Manual de procedimientos derivados de la adopción del euro, aplicables a entidades supervisadas y a entidades cotizadas”* (“Manual of procedures arising from the adoption of the euro which are applicable to supervised and listed firms”) was published in 1998 by the CNMV. This document includes information and examples for securities firms and collective investment schemes about the steps to take to convert their capital stock to euros, the surveillance of tariff brochures in euros, the registration of collective investment scheme prospectuses and methods for classifying positions in the currency of EMU countries. Issuers of listed securities were provided with more information about the clearance and registration procedures for the redenomination of their capital stock, fixed-income securities and warrants in euros and the methods for releasing financial information in euros. This Manual also included general methods regarding accounting entries and the preparation, filing and publication of financial statements in pesetas and in euros.

The above-mentioned Manual also divulged the criteria that would be applied by the CNMV to the information reported to it for supervision purposes. Although the CNMV prefers to receive information in euros, it is willing to accept filings in either currency. In this way the CNMV is adapting an essential part of its supervisory system (information provided by supervised firms) to the principle of “no prohibition, no obligation” advocated by the European Union for the period of transition to Monetary Union. Nevertheless, the Manual establishes that the option of filing information in euros will be irreversible once adopted and that it will also be indispensable when the accounts are kept in euros or the financial statements are prepared in euros. It also establishes that when information is filed in euros, the quarterly or half-yearly figures for the previous year must also be presented in euros for comparison purposes and a brief explanation must be included about the conversion from pesetas to euros and about material differences arising from rounding.

Last year the CNMV carried out the appropriate changes to its computer systems in order to make it easier to process information in the new euro environment. The change not only signified updating these systems as regards supervision but it has also made it possible to publish all the statistical information on supervised firms in euros from 1 January 1999.

As a result of the accumulation of euro conversion processes, particularly at organized securities and derivatives markets and clearing and settlement systems, extraordinary work shifts were set up during the last week-end of 1998 in order to maintain direct lines of communication with the various market governing companies, the Bank of Spain and the Directorate-General of the Treasury.

Adaptation of the CNMV's computer system to the euro

Adapting computer systems was one of CNMV's major priorities in the euro conversion process. The preparatory work in this area had already begun in 1997 and was performed externally (as regards the adaptation process of supervised firms) and internally.

With regard to internal work, the Information Systems Division prepared a plan running from June 1997 through 1999 to adapt all its systems to the new currency. Experience confirmed just how tight the forecasts envisaged in that plan were. Among other forecasts, it was estimated that the work would affect a total of 4,867 programs and 1,733,368 lines of code and would require 911 days/programmer. The estimated cost amounted to 32 million pesetas.

The Information Systems Division approached planning the changes by assuming that the very important tasks – data base conversion, twin versions of certain programs in euros and pesetas, the ability to receive information from the supervised firms in euros and pesetas, presentations of information and publications in euros, etc. – must be completed during the critical dates between 31 December 1998 and 4 January 1999. As a whole these top priority tasks accounted for 55% of all the tasks envisaged in the Division's adaptation plan and were performed before 4 January 1999.

The legal framework for adaptation to the euro

The adaptations made by the markets, brokers, issuers and the CNMV for the introduction of the euro are covered by Law 46/1998, dated 17 December, on the introduction of the euro. The Euro Law was promulgated in order to prepare and complete Spain's laws to facilitate the smooth introduction of the new currency and to avoid an undesirable emergence of interpretations of European rules which might derail the process. The promulgation of this Law involved the harmonization of Spain's internal laws with EU regulations on the introduction of the euro: Council Regulation 1103/97/EEC dated 17 June, on certain provisions regarding the introduction of the euro and Council Regulation 978/87/EEC, dated 3 May, on the introduction of the euro.

The Law establishes the mechanism for introducing the euro into Spain's monetary system and harmonizes it with the body of rules affected by the measure. The concept of "redenomination" which is used in European regulations is adopted and specified. The procedure for redenominating government debt securities balances is regulated, establishing that they will be redenominated between the market close on the last business day of 1998 and the first market day in 1999. The redenomination of private fixed-income instruments and the amount of capital stock which serves as the basis for the denomination of the par value of shares in euros is also regulated. The Law also authorizes the change in the unit of account used by securities markets in the securities clearing and settlement systems and payment systems and in the reporting obligations of collective investment schemes.

Pursuant to specific provisions of the Law, at the end of last year the Ministry of the Economy and Finance promulgated a ministerial order * which contains a detailed regulation on the market information received by investors. In accordance with this regulation, official secondary markets must publish all their official information in euros; nevertheless, during the transition period they must at least provide the information on closing prices, weighted average prices and previous prices of listed securities and other traded instruments (other than forward contracts) in both euros and pesetas. The liquidating value of units in mutual funds, their assets and the theoretical value of shares of open-end investment companies (SIMCAV) must also be provided in both currencies. Collective investment schemes or their management companies must also provide information in both currencies when they refer to the assets of the institution, the liquidating value of the unit or the theoretical value of a share in securities investment companies (SIM). These measures are in line with the principle of "no obligation, no prohibition" and their intention is to make investors familiar with the use and equivalent value of both currencies.

The CNMV issued a circular (Circular 7/1998, dated 16 December) which modified and adapted many rules in force in order to replace references to the peseta with the euro, provide a technical solution to matters affected by the adoption of the single currency and establish the accounting methods for processing operations in the currencies of EMU countries. It was also envisaged that, during the transition period, firms can opt to send the public or reserved information required under current regulations to the CNMV indiscriminately in pesetas or euros.

* Ministerial Order dated 23 December 1998 on the unit of account in the reporting obligations of securities market governing companies and of collective investment schemes, and on certain requirements regarding margin trading in spot stock market operations and regarding special stock market operations.

Preparatory work at the markets

Bourses

Spain's electronic market (SIBE)

The schedule set by the working group on secondary markets⁽²¹⁾ envisaged that in 1998 the Sociedad de Bolsas would make the necessary reforms to its trading rules and the required adaptations to its computer systems to facilitate trading in euros of all equity instruments listed on the electronic market (shares, subscription rights and warrants) from 4 January 1999. The measures envisaged included the following, among others:

- Setting prices in euros to two decimal places.
- Real-time calculation of the Ibex-35: conversion of the capitalization of the stocks in the index to euros from 4 January 1999.
- Adaptation of a structure of ticks or minimal variations in prices: one cent of a euro for stocks with a price of 50 euros or less, and five cents for all others.
- Adaptation of trading rules in other cases where the conversion of pesetas to euros involves modifications of a greater scope than mere rounding: definition of minimum amounts of operations outside trading hours, binding orders and authorized operations. Setting the requirements in euros for special stock market operations and operations of the system of margin trading required the amendment of the respective Ministerial Orders, which took place in December⁽²²⁾.

The bulk of the adaptation of the electronic market's information systems had already been completed by mid-1998; in the second half of the year, tests were performed and operators were trained in trading in euros, routing (the system for channeling orders) and access to the back office system (information and the detail of operations). During this period the communications operations with the Securities Clearing and Settlement Service (trading, details, reception of confirmations, rejections and challenges) were reviewed. The hardware and software for communications between the bourses and the CNMV as regards the transfer of files were also implemented in the third quarter of 1998.

On 31 December, after the fixed, irrevocable exchange rate between the peseta and the euro had been released, the Sociedad de Bolsas performed the last operations required for the definitive fine-tuning of the trading system in euros: price conversions, adjustment of capitalization for calculating the Ibex-35, conversion of balances pending settlement (after processing operations which were still under way) and cross-checking the result with Spain's Securities Clearing and Settlement Service (SCLV), conversion of tariffs and fees in force, etc. After these operations, the new programs for trading in euros were activated and, as indicated above, 4 January 1999 began without incident.

(21) See *"Introducción del euro en los mercados de valores españoles"* ("Introducción of the euro in Spain's securities markets"). January 1998. CNMV

(22) Ministerial Order date 23 December 1998 on the unit of account in information obligations of security market management companies and of collective investment schemes, and on stating certain requirements regarding the credit system in spot stock market operations and special stock market operations in euros.

Fixed-income

The process of adjusting listed fixed-income securities to the euro affected public issues (book-entry government debt and autonomous community debt) and private issues. After 4 January 1999, both continued to be listed in percentage terms or in equivalent yield. However, public issues were subject to a massive redenomination of the balances in force on the last day of 1998, in accordance with the procedures set out by the Book-entry Service for issues listed on that market; this did not happen with private issues, whose face value continued to be stated in pesetas.

The preparations in the area of private fixed-income securities were aimed at ensuring that effective trading was stated in euros and, consequently, to facilitate settlement in euros also. The bourses' technical departments proceeded to modify the computer programs on the electronic and open outcry markets for that purpose.

Open outcry (equities)

The preparatory process in the open outcry segment followed similar guidelines to those established for Spain's electronic market (SIBE): stating prices in euros with two decimal places, setting the minimum price variation (one cent of a euro), the minimum volume in euros for price changes and, in general, reviewing all operating rules. An important step was taken in the adjustment process at the beginning of 1998 by replacing this segment's traditional system of quotations (percentages of par values) with prices in pesetas. During the key conversion period (between 31 December and 3 January), the conversion was performed and the pending operations from prior sessions were processed appropriately. Trading in euros commenced without incident.

Securities Clearing and Settlement Service (SCLV)

Early in 1998, Spain's Securities Clearing and Settlement Service began its adaptation to operation of the bourses in euros. Technically, the operating and computer processes already in place at the SCLV supported operation in euros without having to make sizable changes. Consequently, it was envisaged that the SCLV could receive and transmit communications in euros without great difficulty from 4 January 1999, in all aspects regarding the various types of entries arising from the clearing and settlement process: amounts traded, payment of commissions, brokerage charges and fees, transfers against payments, supporting documentation, rejects, etc. The SCLV's decision to work in euros also implied that financial operations (dividend and interest payments) would be settled in euros.

Although operating in euros did not pose particular difficulties, the preparations for the critical first week-end of 1999 required careful planning, mainly due to the handling of operations which were in the process of settlement. During 1998, the SCLV issued several instructions in this regard to member firms and established a test schedule to be performed between September and December, to perform a dry run of the procedures which would take place during the conversion week-end: conversion of data to euros, checking the transfer of forms in euros against the conversion result for advance settlement, breakdowns and data on volumes traded sent to member firms and management companies, and checking of "return" messages from member firms (confirmations, rejections, supporting documentation for sales, transfers, etc). The SCLV demanded proof from its members that they had run the tests for three weeks and certification of the accuracy of the conversion and of correct use of the euro.

These preparations enabled the operations of the conversion week-end to pass off smoothly without notable incidents. Together with the operations pending settlement, the SCLV converted financial operations in process, transfers against payments and loan operations. Once the operations in process had been completed, the SCLV converted the positions of the member firms in cash and securities by retiring amounts in pesetas and subsequently adding the amounts in euros.

AIAF

At the AIAF, as on the bourses, the introduction of the euro was not accompanied by a redenomination of fixed-income issues *en masse*. The peseta and euro will co-exist on this market during the transition period through January 2002. During that time issuers will be able to issue securities in both currencies and voluntarily redenominate existing issues.

The AIAF's preparations for the euro were set in that context of gradual redenomination. In order to exchange information and finalize the operating procedures required by the new situation, the market governing company held meetings with the members in 1998. In order to introduce the agreed procedures, the market adopted various instructions, including most notably:

- The Association of Financial Assets Intermediaries (AIAF) did not consider that it was appropriate for its members to redenominate peseta issues by converting their balances to euros, a possibility envisaged in Article 18 of Law 46/1998, governing the introduction of the euro. Issuers whose securities are listed on AIAF and choose to redenominate them must do so by converting the unit face value of the issues. In these cases, AIAF advises that the face value of the issues be readjusted, in general, to one cent of a euro.
- The coexistence of issues in the two currencies made it necessary to modify the minimum trading unit in each case. For issues which were not redenominated or were adjusted by the simple redenomination method, the unit of trading is the security. In issues where the face value was re-established to cents of euros or in new issues which adopt the cent as the face value, the minimum unit of trading was set at 50 euros.
- The price is stated in all cases in percentage form or as a yield and the effective amount traded is stated in euros to two decimal places. The euro must be used in operations with settlement against payment (for example operations resulting from purchase or sale) and in communications with the Espaclear settlement system when another currency has been agreed in "payment free" settlements (for example transfers).
- Coupon payments, redemptions and partial redemptions due to the reduction of face value must be performed in euros, after converting and rounding the original figures in pesetas.

Adopting the euro made it necessary to introduce changes in programs for handling data bases, programs related with clearing and settlement processes and programs for handling information outflows (to members, regulators and publications in general). As a result of adapting the minimum trading volumes and the trading multiples, the regulations governing blind trading on the electronic system had to be amended. All modifications were tested on several occasions in 1998.

During the week-end prior to January 4 1999, AIAF performed internal monitoring of the market operations and the daily close processes and activated the various modifications envisaged for its computer systems: historical data bases, data bases of issues, blind trading on the electronic system, programs for data capture and exchanging information, applications for preparing publications and disseminating information to the market, etc. During the same period, Espaclear converted the operations pending settlement at 31 December to euros.

Financial futures markets (MEFF)

The measures adopted by the fixed-income financial futures market (MEFF RF) and the equities financial futures market (MEFF RV) to introduce the euro attempted to preserve market liquidity while ensuring the transparency of the process and its neutrality with respect to prices. The conversion was undertaken without cost for members and market clients and the continuity of open positions and the protection of investors were guaranteed by allowing put-throughs to offset the effect of conversion on positions and the initial risk for portfolios.

The introduction of the euro in these markets not only required modifications to the computer programs in the area of trading and in the clearing and settlement house in order for operations to be performed in the new currency and to facilitate the voluntary conversion of positions. It also involved adapting the conditions of the traded contracts because of the changes envisaged in the markets of the underlying assets. Likewise, it was necessary to settle in cash the peaks resulting from the conversion of positions.

MEFF RF

In June 1998 the fixed-income financial futures market (MEFF RF) approved the changes to be made to its contracts (General Conditions) and the details of the euro conversion process. As indicated above, positions could be converted voluntarily, although the peseta-denominated contracts would be settled in euros in 1999. Trading in euros involved a change in face and tick values for new contracts, which were assigned a new code.

Open positions had to be converted account by account. The resulting positions in euros had to be rounded down, with the difference being distributed proportionally between the buyer and seller. Positions which could not be converted were settled in cash. As mentioned above, in order to maintain neutrality on the position and initial risk, it was permitted to adjust the position by put-throughs subject to a cap equal to the unconverted rounded amount. MEFF RF performed a number of simulations with market members at different times in 1998: obtaining conversion results based on the existing position at a specific date, obtaining data files with the new format, general test of the conversion process, etc.

MEFF RF performed dry runs of the operations to be performed from 31 December. That day, the market was open until midday but closed before the conversion rate was released in order to make the necessary transfers to adjust positions. After the conversion rate had been released, the session was settled and on 1 January the conversion process as such was undertaken, which mainly comprised closing all the peseta-denominated contracts and opening euro-denominated contracts according to the closing prices on 31 December. Once this process had been completed, the market sent the data to member firms and clients' software was updated so that they could apply the conversion method to all of their positions after the house had performed the conversion of the net position per account holder.

MEFF RV

In March 1998 the new General Conditions of contracts on MEFF RV and the regulations detailing the euro conversion process were approved. As regards Ibex-35 futures contracts and options, it was envisaged that trading would continue in points of the index and a multiplier of 10 euros was set, which entailed an increase of 68% in the face value of the contracts. As regards options on shares, strike prices and premiums were to be expressed in euros to two decimal places.

As with MEFF RF, it was envisaged that positions in peseta-denominated contracts would be closed and equivalent positions would be opened in euro-denominated contracts during the last week-end of the year. The increase in the face value of Ibex-35 contracts meant that there would be fewer contracts for equivalent positions. The conversions also had to be made by the account holder. The new number of resulting contracts had to be rounded down to the nearest whole number and the fraction which could not be transferred had to be settled in cash. In order to guarantee the equality of final positions of buyers and sellers after the conversion, the final position had to be for the lower of the two, and the difference had to be distributed proportionally between the parties.

During the year, MEFF RV made various tests which culminated on 24 October with a full dry run of the conversion to be performed during the transition week-end. This began in operational terms on 30 December. After closing the daily account, the profits and losses in pesetas were settled for that session at special prices in order to subsequently simulate the conversion with a notional conversion factor using the positions at the end of the day. On 31 December, the trades on 30 December were settled in pesetas and the related transfers were made. Once the definitive exchange rate had been released, all the positions in pesetas were converted. The unconverted remainder was settled in cash. The margins to be deposited for new euro contracts were also calculated in that currency and became effective on 4 January.

New challenges for the markets and supervision in the competitive framework of the euro

Strategic moves in European markets

Bourses

Europe's securities markets are making important strategic decisions to face the foreseeable increase in competition following the introduction of the euro. During the last two years, some moves had been made to create clearly pan-European market structures through a number of formulae. These include the almost simultaneous creation of Easdaq and the Euro NM network comprising new markets linked to some of the major European bourses (Paris, Frankfurt, Brussels and Amsterdam). Easdaq and Euro NM are two alternatives within Europe for trading securities issued by companies with high growth potential, a segment which has been underdeveloped in Europe and has a well-known exponent in the United States in the shape of Nasdaq. In order to study the possibility of its implementation in Spain, a working group comprising the CNMV, the bourses and the Bank of Spain was set up.

The most recent moves are more far-reaching. The most significant is probably the alliance between the Europe's two principal bourses: the London Stock Exchange (LSE) and the Deutsche Börse (DB). The announcement of the alliance in July 1998 was a surprise since, prior to that point, there had been every sign that the two markets were preparing to compete with each other – the LSE on its own and the DB through an alliance with the Paris Bourse and other European markets. Now the London-Frankfurt alliance heralds the creation of a large trading center for the most liquid equities in Europe and is an essential reference for other European markets when they take decisions about their future.

Both bourses have stated that the ultimate aim of their alliance is to form an efficient low-cost market with considerable capitalization, liquidity and depth, making it possible to take advantage of the opportunities arising from the new scenario in Europe. In particular, the new market should provide institutional and private investors with the appropriate trading environment for restructuring and managing their equity portfolios in accordance with the new conditions of risk generated by the adoption of the euro. The main challenge facing this project arises from the diversity of operating systems, customs, procedures and regulations in the two markets. These difficulties will tend to multiply if, as seems likely, other stock markets join the initiative.

The London-Frankfurt agreement envisaged (i) creating a common access system for the respective markets and a single point of liquidity for the most important markets (the blue chips) which will come into operation with the launch of the euro (ii) harmonizing the legislation of the various participating markets during 1999, and (iii) creating a common platform for electronic trading where the main European firms would be listed. It was estimated that the market could include approximately 300 companies; between ten and fifteen of them could be Spanish.

Table 5.1
MAJOR EUROPEAN BOURSES: CAPITALIZATION, TRADING AND NUMBER OF LISTED SECURITIES

Market	Capitalization ⁽¹⁾	Trading ⁽²⁾	No. of listed securities ⁽³⁾
London	2,297.651	2,887.990	2,920
Frankfurt	1,094.252	1,491.796	3,525
Paris	985,227	2,053.300	962
Switzerland	689,199	686,956	425
Amsterdam	603,182	405,217	359
Italy	569,732	488,166 (*)	243
Spain	421,550	305,801	903
Pro-memoria: New York	10,271.900	7,317.949 (*)	2,669
Tokyo	2,439.549	750,831 (*)	1,890

(1) Capitalization of shares of domestic companies at the end of December 1998, in millions of dollars.

(2) Cumulative figures in 1998, in millions of dollars. (*) The accounting method used does not include the same operations as in the rest, and consequently, the figures could be understated.

(3) At 31 December 1998.

Source: International Federation of Stock Exchanges and CNMV.

Derivatives markets

The strategic moves in the area of derivatives markets are also very important. The euro has a more immediate impact on these markets than on spot markets since it makes a substantial amount of the interest-rate contracts traded on the various European domestic markets redundant. Although moves have been made to create markets at a regional level (for example the Scandinavian countries and Benelux), two large alliances are currently taking shape at European level. The first large agreement of this type was announced in September 1997 between Germany's DTB⁽²³⁾ and Switzerland's SOFFEX⁽²⁴⁾ and will constitute a combined electronic trading platform called Eurex. June 1998 saw the announcement of Euro-GLOBEX, an alliance between the Spanish financial futures markets (MEFF) and France's SBF, which signed a protocol to link up their electronic trading systems for derivatives and to apply harmonized marketing policies. This platform was implemented at the end of 1998 for members of MEFF RF and MATIF⁽²⁵⁾. The members of MEFF RV are expected to join the platform in 1999.

The alliances in the field of derivatives indicate a scenario dominated by competition between the three large trading centers: Eurex, Euroglobex and Liffe⁽²⁶⁾. The latter has remained aloof so far. Nevertheless, under pressure from the progress of DTB, which has recently managed to snatch a considerable share of trading in German bond futures from it, Liffe has had to announce that it will be replacing its traditional outcry system with an electronic system. Simultaneously, in order to facilitate the global distribution of its products, it has entered into agreements with futures markets in other time zones (Chicago and Tokyo).

Consolidating the competitive position of Spanish markets

The financial map of Europe is in a phase of adaptation and transition and these strategic moves will foreseeably continue. Participating at an early stage in the new network of European markets as it takes shape has unquestionable advantages and Spain's securities markets should consider the various available alternatives carefully.

The need to continue to innovate and improve the quality of services offered should not be neglected due to the evaluation of possible alliances. The governing companies of the various markets, the SCLV and, in general, entities with responsibility in the sphere of securities markets in Spain have reached the same conclusions and have been making considerable efforts to compete in the new European scenario. The following measures and projects are examples in this connection:

- The stock market became more flexible in 1998 with the introduction of new methods of block trading and fixing, details of which are provided in chapter 7.
- The Madrid Stock Exchange is encouraging the creation of a market for shares in the principal Latin American countries, which would be listed in euros. This initiative aims to facilitate access to the Latin American market for European investors through a smooth and transparent system.

(23) Deutsche Terminbörse.

(24) Swiss Options & Financial Futures Exchange.

(25) Marché à Terme International de France.

(26) London International Financial Futures Exchange.

- Within the framework of the above-mentioned Euroglobex agreement, in October MEFF RF announced the launch of the first futures contract and 3-month options on EURIBOR, the new index which will become one of the benchmarks in the euro interbank market. This contract will replace current contracts on Spain's MIBOR, France's PIBOR and, possibly, Italy's RIBOR. In the long-term segment, with the same intention of consolidating its competitive position, in June 1998 MEFF RF commenced trading in Europe's first futures contract on a notional 30-year bond, thus extending its product range to the whole yield curve.
- The current economic climate has created favorable conditions for developing private fixed-income securities (growth in collective investment and pension funds, reduction in government bond issues, increase in appeals to the market from financial firms and other companies, etc.) which should not be wasted. In 1997 this idea led to the drafting of the "Protocol for the Development of Fixed-Income Markets" which was signed by the stock market governing companies, AIAF, SCLV and CNMV, accepting the need to improve various aspects of the regulation, operating procedures and organization of the market in order to encourage its growth. The Protocol has already begun to have results and there were several innovations in the private fixed-income market during 1998 (see Chapter 3).

Market supervision in the new European context

Alliances and, in general, various strategic movements which affect European securities markets today may lead to a completely new situation from the standpoint of supervision. Although this process will give rise to supranational market structures, market regulations and supervision will continue to have an essentially national base. The Investment Services Directive, which was approved in 1993, considered the need to foster coordination between national authorities with powers in this area in order to meet the supervisory demands in the new framework of the deregulated provision of financial services. The current acceleration in the process of European integration makes it more essential than ever to strengthen mechanisms for cooperation and coordination between national supervisors and to boost harmonization in various regulatory areas which affect the operation of the securities markets.

The CNMV participates actively in European supervisory bodies which currently attempt to respond to that complex situation, such as the Forum of European Securities Commissions (FESCO). The CNMV is a permanent member of FESCO's General Secretariat and of the High-Level Group of Securities Market Supervisors. Among its objectives in this field, the CNMV pays particular attention to obtaining new advances in the exchange of information among supervisors which is essential for national organizations to be able to continue to effectively exercise their functions in the new situation in Europe. The supervisory institutions which are members of FESCO recently made progress in this regard by signing an important multilateral cooperation agreement (see box in Chapter 10).

Spanish savers' increasing participation in the securities market makes it particularly important to oversee the bodies providing services in this area. It is no longer true to say that brokers, broker-dealers, portfolio management companies, collective investment scheme management companies, depositories and other providers of investment services in the securities market are involved in a minority business with limited impact on society; in fact, many Spanish households which have chosen to invest their savings in securities or collective investment products depend on the skill and good conduct of professional investment service providers (there were nearly eight million investors in mutual funds at the end of 1998).

As in previous years, because of the growth in collective investment schemes and their impact on the public at large, the CNMV devoted particular attention to supervising this sector. In addition to usual checks to ensure compliance with prudential rules and reporting obligations and the correct application of valuation principles, supervision focused particularly on certain practical features of these funds which have gained in importance due to market developments or changes in regulations: i.e. the funds' foreign portfolios, investments in derivatives and the impact of OTC⁽²⁷⁾ hedges on guaranteed funds.

In addition to the normal controls on investment firms – i.e. broker-dealers, brokers and portfolio management companies – supervision focused on specific features including most notably the detection of conflicts of interest and the analysis of the activities of agents, a role which is growing in importance within the sector and over which it is essential that firms exercise control. Growth in securities market business has had a positive effect on firms' solvency. The main item of concern in 1998 was the AVA/Socimer crisis, which required considerable dedication by the CNMV's inspectors⁽²⁸⁾.

The growing importance of the supervision of registered firms required the CNMV to constantly adapt its resources to this task. Over one year ago, to facilitate adoption of overall objectives in this area and to better coordinate the available resources, it was decided to merge the (formerly separate) areas for the supervision of dealers and broker-dealers and of portfolio and collective investment scheme management companies into a single division - Supervision⁽²⁹⁾. As a result, a considerable improvement was observed during 1998 in the coordination and, consequently, the efficacy of the inspection functions. In order to handle the extraordinary growth in the sector under supervision, a process is under way to greatly increase this Division's human resources as part of a general plan to strengthen the CNMV which runs until the year 2000.

6

SUPERVISION OF INTERMEDIARIES AND OF COLLECTIVE INVESTMENT SCHEMES

(27) OTC (over the counter) are those arranged outside organized markets.

(28) For more details, see the "AVA/Socimer" box in chapter 8.

(29) This Division also oversees the secondary markets -see chapter 7.

Supervision of registered firms is based on a combination of two complementary types of surveillance – distance and on-the-spot. On-the-spot supervision makes it possible to check the information reported by the firms to the CNMV; at the same time, the efficacy of on-the-spot inspections is enhanced by the information and analysis afforded by distance controls. Nevertheless, it should be noted that complaints filed directly by the public are playing an increasing role in triggering supervisory action. On occasions, public participation in defense of its interests has led to the detection of problems which were quite widespread and to the development of specific plans to eliminate them.

Distance supervision

Collective investment schemes

The CNMV constantly monitors to ensure compliance with prudential regulations, correct calculation of liquidating value, reporting obligations and other regulations which substantially relate to investors in collective investment schemes. In addition to these controls, in 1998 the CNMV had to devote particular attention to certain matters relating to trends in the market and the entry into force of certain regulatory changes. Some of these controls and their significant results are discussed below:

- *Supervision of mandatory coefficients.* Customary controls in this area include oversight of compliance with some recently-changed limits, such as those on investment in time deposits or on assets issued or underwritten by a State of the European Union, a Spanish Autonomous Region or an International Body of which Spain is a member. In the first case, checks revealed that certain firms had not included the limits in their internal control systems. It was also observed that changes in the regulations governing obligations to diversify investments in government debt securities had led to a minor number of breaches.
- *Systematic analysis of yields.* These important surveillance measures detected a number of cases of liquidating values being calculated incorrectly for a number of reasons: errors at the management firms, problems with the valuation of certain assets, deficient controls, etc. Where the CNMV detected that subscription and reimbursement operations were affected, the firms corrected the individual impact on each of the investors involved.
- *Specific checks.* Among the numerous spot checks performed during 1998, the following are noteworthy because of their importance:
 - *Limits on concentration of credit risk.* In view of the proliferation of guaranteed index-tracking funds whose guarantees are arranged in the form of bilateral financial structures (OTC contracts), the CNMV devoted specific attention to the compliance with risk limits at those firms. Although these limits were occasionally exceeded due to developments in the equities markets, the new regulation on derivatives generally facilitates compliance. The most widely-used methods to overcome these problems were the provision of guarantees to reduce the credit risk and the provision of internal guarantees in addition to the external guarantees.
 - *Investments in foreign markets.* The growth in foreign portfolios during the year, plus the prospect of further growth in 1999, particularly within the European Union, led to the per-

formance of specific tests in this area to check compliance with the regulations in certain respects: prices of securities on legally appropriate markets, adequate valuation, etc. In the same line, specific analyses were conducted into the acquisition by Spanish mutual funds of foreign mutual funds. There was generally a larger number of incidents in investments of this type due to their greater administrative complexity. The CNMV maintains its advice regarding the importance of maximizing controls in this area.

- *New content in quarterly reports.* A specific analysis was conducted to ascertain whether quarterly reports conformed to the regulatory minimum levels, and it disclosed the inevitable problems in adapting to the new regulation. The CNMV has recently issued a Circular on abridged quarterly reports to assist in investor comprehension of their content.

Investment firms

- *Supervision of mandatory coefficients.* Isolated cases were detected where the limits had been temporarily exceeded, and specific responses were designed in each case. As stated above, the solvency coefficients were positively impacted by the good performance of the markets in 1998.
- *Specific controls:*
 - *Conflicts of interest in portfolio management.* Aware that certain firms invest part of the assets of clients with which they have portfolio management contracts in mutual funds managed by firms in the same corporate group, the CNMV closely monitored these situations and warned firms about the possible conflicts of interests which might arise. In particular, they were warned of the need to adhere to certain criteria as regards transparency before the client in connection with the possibility of double commissions: for the portfolio management contract and for mutual fund management.
 - *Prohibition of financing.* In order to oversee appropriate compliance with this prohibition, which is established in the regulations, a number of checks were performed during the year, including most notably a review of client balance aging.
 - *Agents.* A number of complaints filed by clients of investment firms revealed the need to conduct an in-depth review of the sector's operating procedures where agents are involved. The checks detected that there were cases of double empowerment of the agent – by the investment firm and by the end client, direct management of individual portfolios by the agent and even processing by investment firms of orders given by certain agents on behalf of third parties which did not have management contracts with the investment firm in question. In addition to handling the individual cases affected by these practices, an analysis of the complaints led to regulation of certain aspects of the relations between securities firms and their agents through Circular 5/1998, dated 4 November – see Chapter 3.

Transparency in determining the liquidation value of mutual funds

The current regulations governing IICs allow management companies to apply the liquidation value of the previous day, the same day or the following day to subscriptions and reimbursements by investors, depending on the individual fund's Regulations. At times of considerable volatility in the securities markets, the application of the previous day's liquidation value facilitates speculation, particularly in funds which are very sensitive to market fluctuations (equities funds, mixed funds, medium-long duration bond funds, funds invested in foreign markets, etc.), with the resulting harm for investors who stay in the fund.

Consequently, Interpretative Letter 2/1998 reminded IIC management firms that the liquidation value applicable to subscriptions and reimbursements must be chosen in the best interests of the investors and the characteristics of the individual fund and, therefore, the use of the previous day's liquidation value should be avoided in funds which are sensitive to market movements.

That Circular also reminded IIC management firms of the obligation to inform investors without delay about developments in the liquidation value by means of daily publication in the stock markets' gazettes. Compliance with this obligation ensures that fund investors are aware of the trend in the value of their investments and allows them to compare the liquidation value applied in their subscriptions and reimbursements with that published each day, whereas a simple delay in complying with this obligation can create error or confusion among investors.

Systems of internal control, monitoring and ongoing evaluation of risks

Broker-dealers, brokers and portfolio management firms encounter a number of risks in the course of their business: market risk, credit risk, liquidity risk, operating risk, etc. It is essential to evaluate and control these risks as, otherwise, severe losses might ensue for their assets and those of their clients. The Securities Market Law obliges firms to have sufficient resources to undertake this task. To facilitate correct coverage of the obligations in this area, the CNMV issued Circular 1/1998, dated 10 June, on systems of internal control, monitoring and ongoing evaluation of risks. This regulation established the general guidelines to which securities firm's internal control systems must adhere in creating specific mechanisms to identify, measure, quantify and monitor risks.

Because of the diversity in the firms' size, structure, business and risks, the Circular delegates to them the exact definition of their internal control systems. However, it specifies the obligations of the board of directors, to which it attributes ultimate responsibility in this area. The board must approve the firm's general risk limits, the operating limits structure and the powers for trading and settling transactions. Moreover, the board must ensure that the organization has sufficient material and human resources to guarantee efficient management of the business and appropriate separation of functions, as required to implement effective control measures. The board is also responsible for establishing the general measures and policies which inspire the internal control system, and these must be developed and executed by the specific unit. Such systems must provide the board of directors with accurate and timely information on the potential risks of the firm and its clients.

The Circular establishes certain obligatory measures to ensure that clients receive appropriate information about the risks which they incur. Firms must have a risk limit structure in the portfolio management area which is similar to that which they would establish for their own portfolios. They are also obliged to obtain authorization from clients when transactions are made with securities issued by companies resident in tax havens or when firms in those territories act as counterparty. They must also seek authorization when the client's securities are deposited in omnibus accounts at other firms.

Supervision of the process of adaptation to the euro

Anticipating that the entry into force of the euro might considerably affect the operating processes of investment firms and collective investment schemes, during 1998 a request was made for the boards of all supervised firms to participate directly in planning the work relating to this event and to approve internal adaptation plans. The processes relating to the “year 2000” effect were also supervised.

On-the-spot supervision

In 1998, the CNMV conducted a total of 41 on-the-spot inspections at investment firms and collective investment scheme management companies (specifically at 6 broker-dealers, 12 brokers, 15 IIC management companies and 8 portfolio management companies). Some of the inspections, which related to firms authorized to trade in the Spanish government bond market, were coordinated with the Bank of Spain’s inspection services.

CNMV inspections are generally conducted as part of a systematic plan drafted by the Supervision Division and they are exhaustive. In certain cases, remote monitoring suggests that inspectors focus on specific areas. In 1998, specific attention was paid to compliance with codes of conduct, reporting obligations and formalization of relations with clients through the appropriate contractual documents. Agents’ actions were revised in detail in all cases. Examination of firms’ solvency and, generally, of compliance with prudential limits was performed in line with the consolidated approach envisaged in the legislation.

As on previous occasions, the courts called CNMV inspectors to give evidence as experts, taking advantage of their technical abilities and knowledge of the securities markets.

Custody of securities

Securities firms and management companies are obliged to know the risks of their business, particularly those relating to the deposit of securities. They must also have the appropriate resources to monitor these risks and safeguard their clients' interests.

The deposit of securities is vital for the protection of investor's property rights. Depositories have the duty to ensure the integrity of the securities in their custody, which means that they must keep client securities accounts separate from firm accounts and fully itemize client accounts with respect to other third-party accounts.

Additionally, the increasing number of cross-border transactions makes it necessary to be aware of the risk of situations of insolvency in other countries, implying the need to establish rigorous control procedures in the supervision of depositories. It is important for investment firms to be aware of the differing legal situations existing in other countries and to demand the necessary guarantees to cover possible losses for investors.

In order to ascertain the nature of the depositories with which the supervised firms operate on a habitual basis, the CNMV conducted a survey of the firms in mid-1998. The main conclusions were as follows:

1. Most depositories are Spanish and they custody approximately 34 trillion pesetas in securities out of a total of approximately 37 trillion pesetas. As regards securities deposited abroad, there was a considerable degree of concentration at depositories in Belgium and Luxembourg.
2. The level of familiarity with insolvency legislation in other countries is generally very low, although there is also a lack of knowledge about Spanish legislation.
3. Control procedures are scant or simply not known, leading to a failure to answer this question in the survey. In many cases, control is delegated to the depository itself.
4. In a very large number of cases, the firms do not have information about the depositories' solvency and rating.

As a result of this survey, the CNMV organized courses in Barcelona and Madrid in January 1999, aimed at all firms in the sector, in order to raise awareness of the risks involved in the deposit business. On 10 December 1998, the Supervision Division sent the firms a letter with a number of recommendations as to the selection of depositories by investment firms, the minimum contents of contracts with depositories and the basic internal control procedures.

Solvency of securities firms and management companies

The considerable volume of trading witnessed in 1998 had a positive impact on service revenues at broker-dealers and dealers which, combined with containment of overheads and sustained trading for their own account, enabled firms to boost pre-tax earnings by over 60% with respect to 1997. This also increased annualized pre-tax returns on equity from 58% in 1997 to 76% in 1998.

This situation, which has been repeated over the last few years, enabled firms to strengthen their financial and balance sheet structures. Specifically, their computable equity increased by 22% over 1997 to more than 140 billion pesetas, whereas the number of firms remained stable. As in 1997, this trend was helped by good market performance and the positive results in 1997, which are computed in 1998. Broker-dealers accounted for 66% of the 140 billion pesetas in computable equity.

Because of the growth in equity, the surplus over minimum requirements increased by 27% to 103 billion pesetas. No individual firm presented an equity shortfall. This situation evidences the low level of risk being assumed and, consequently, that prudent investment policies are being applied. It should be noted that the firms' equity levels are always well above the mandatory minimum. As is habitual, 80% of broker-dealers and dealers calculated their equity requirements as a percentage of the minimum required capital stock.

There were no noteworthy breaches of the minimum liquidity requirements established in the legislation.

The collective investment scheme management companies (of which there are 132) have a sound financial position and a very high return on equity. This is evidenced by the fact that their computable equity (around 150 billion pesetas in June 1998) was more than 40 billion pesetas higher than the minimum equity requirements.

There were no noteworthy breaches of the minimum liquidity requirements by these firms; the only firm which breached the limit was in the process of liquidation and its lack of activity is the reason for the gradual decline in equity, although the assets in the fund under management were much lower than the management firm's own equity. Additionally, another management firm briefly breached the minimum equity requirements due to a massive influx of funds for management shortly before its reporting deadline in June.

There are 46 portfolio management companies which have a total equity of about 8 billion pesetas, well above the mandatory minimum (which is about 3 billion pesetas). These firms did not breach the solvency coefficient requirements in any case.

New regulation on operations by collective investment schemes with derivatives

Derivatives are irreplaceable in the process of managing financial risks, principally market risk. This fact and the desire to provide better investment opportunities within the framework of generally accepted financial prudence led to the amplification in 1997, via a Ministerial Order dated 10 June, of the scope of action by collective investment schemes in derivatives, including the possibility of hedging with OTC products under certain conditions. Although certain aspects of that Ministerial Order were implemented by in 1997 (through CNMV Circular 3/1997, dated 19 July), some crucial features of the new regulation remained to be implemented, most notably the establishment of precise criteria for measuring IICs exposure to derivatives and for supervising compliance with operating limits. This was the purpose of Circular 3/98, dated 22 September, on operations in derivatives by collective investment schemes.

Circular 3/98 introduced novel proposals in the Spanish securities market based on progress in financial theory and recent international trends in prudential supervision. The Circular identifies the term “exposure” used in the Ministerial Order on the basis of the estimated maximum potential loss to which a collective investment scheme is subject due to its positions in derivatives, and it accepts two alternative methods for estimate it: the so-called “standard” method, which is similar to the current approach for determining equity for the purpose of covering market risk in the trading portfolio of financial intermediaries and credit institutions, and the “free” method, which allows the use, among others, of mathematical models designed by the firms themselves to estimate their exposure.

The Circular takes account of the current state of the art in market risk measurement models, which allows a considerable degree of discretion in choosing methodologies and parameters, and the recommendations of international regulatory bodies, such as those contained in *“Methodologies for determining minimum capital standards for internationally active securities firms which permit the use of models under prescribed conditions”* published recently by IOSCO. In line with the content of that document, the Circular requires prior authorization from the CNMV for the use of the “free” method and establishes a number of criteria for this purpose, most of which are qualitative and relate to the internal control requirements contained in Circular 3/97.

It is important to note that, regardless of their usefulness for regulatory purposes, mathematical models for assessing market risk are of great interest in risk management at collective investment schemes and, consequently, their use is highly recommendable. In this connection, collective investment scheme management firms should make greater efforts to appropriately train their personnel and make broader use of these modern tools in their management methods.

7

SECONDARY MARKETS

The equities markets continued to grow in 1998, underpinned by favorable interest rates and the good economic outlook. Despite major capital increases and privatizations, expanding demand (mutual funds, non-resident investors) generated strong upward pressure on share prices practically from the beginning of the year. The sources of uncertainty which had affected the markets since the beginning of the Asian crisis (i.e. Japan, Russia and Latin America) triggered a severe correction in share prices at the end of July and led to high volatility. Nevertheless, the recovery at the end of the year meant that equities prices concluded the year in a very favorable position: trading volume was up 60% and the market had appreciated by 36%-37%.

AIAF and MEFF RV also registered considerable growth. At MEFF RV this was due to the considerable volatility in the spot market. In contrast, MEFF RF saw the volume of contracts on bond and interbank rates shrink considerably with respect to 1997 due to the low level of volatility in the underlying assets (government bonds, MIBOR) and the subdued performance by government bonds during the year.

From an operating standpoint, the markets' economic and competitive situation in 1998 was overshadowed by the introduction of the euro, which affected both the adaptation of reporting and information systems and the trading rules (discussed in greater detail in chapter 5). Because of this transformation, the European markets considered strategic alliances between markets or the search for new markets in order to face the new environment, which will foreseeably be more competitive. This aspect is also discussed in greater depth in chapter 5.

From the supervisory standpoint, particular attention was paid to the process of introduction of the euro and the influence of derivative hedges on price-setting in the electronic market.

Market surveillance

Price-setting

The closing price of certain securities was distorted on occasion by the entry of orders in the final moments of the session. There were several reasons for this: firstly, the increased number of trades linked to derivative hedges based on listed securities, baskets of securities or the Ibex-35 index. Another reason was that certain investors conducted large transactions in comparison with the standard market volume just before closing, when the other investors did not have time to react. Finally, there were orders for small amounts entered in the final moments of the session with the sole purpose of setting the closing price. In connection with these practices, the CNMV issued Interpretative Letter 5/1998 whose content is discussed in greater detail in the box below.

The CNMV is also trying to eradicate the practice of crossing trades in the SIBE orders market without there being any change in the ultimate owner of the shares. There are occasionally trades which lead to a significant variation in the listed price but which do not correspond to a true meeting of supply and demand and create a false picture of activity in the stock which may confuse other investors.

Criteria recommended by the CNMV in connection with handling orders at the end of the session in the SIBE and the choice of reference prices for financial products whose yield is linked to stocks traded in that segment (Interpretative Letter 5/1998, dated 30 March)

In the area of listed equities, both the Ibex-35 and some of the principal securities in the SIBE are used frequently as the underlying or reference security for the purposes of valuation of various types of contract - OTC derivatives, warrants, indexed deposits, guaranteed funds, etc. In general it can be said that such contracts have a positive effect on spot trading on the SIBE due to the hedging trades they generate. However, the CNMV has also observed with concern that there are practices of entering orders at the end of the session, apparently with the purpose not of participating in trading but of significantly influencing the closing price, which is very important in valuing many such contracts.

Articles 80.a) and 99.i) of the Securities Market Law establish absolutely prohibit market members and their clients, respectively, from triggering artificial variations in prices and from distorting the free formation of prices. Aware of the importance for market integrity of the effective compliance with these principles, the CNMV has always been particularly zealous in pursuing violations in this area and, on occasion, it has imposed considerable penalties as a result. To the same end, it has used the resources at its disposal to address market intermediaries and warn them of the liability that they might incur if they accepted certain types of orders which, in the opinion of the CNMV, violate those principles. Note also that the General Code of Conduct regulated in Royal Decree 629/1993, dated 3 May, governing rules of action in the securities markets, obliges intermediaries to act with care and diligence and to take account not only of the operating regulations but also the customs prevailing in each market, whose integrity they have a duty to maintain.

The CNMV had already expressed its concern about practices of entering orders in the SIBE in a CNMV interpretative letter to the presidents of all the securities firms and credit institutions in 1997 (Interpretative Letter 5/1997, dated 3 April). Nevertheless, the CNMV observed that certain investors continued to conduct last-minute trades for considerable amounts, when the other market participants did not have an opportunity to react. It also observed that certain market members entered minor orders during that period apparently with the sole intention of setting the closing price. Consequently, in March 1998, the CNMV decided to issue another Interpretative Letter to the same addressees (Interpretative Letter 5/1998, dated 30 March) with more detailed recommendations regarding the entry of orders at market close. With the same intention, the new Interpretative Letter makes a number of recommendations regarding the choice of reference prices for valuing financial contracts.

Entry of orders at the end of session

After highlighting the impact these orders can have on the closing price, the CNMV notified market members that they should reject them whenever they are aware that the client's intention is to artificially alter or to distort the price trend. The CNMV also drew attention to market members' obligatory loyalty to the principle of free price formation which is implicit in the General Code of Conduct and some of its practical consequences, such as the obligation to act with caution during the final moments of the session and to enter gradually any orders which, because of their size with respect to the depth of the market or the time at which they arise, might lead to an artificial closing price. Where the market member has grounds for believing that an order might have this effect and the client does not accept execution in such a way as to avoid this risk, then it must reject such an order.

Referencing financial products to closing prices

Because of the implications for the formation of spot prices, the CNMV advises financial intermediaries against using SIBE closing prices as the reference for their products and suggests the use, in their place, of references which are less sensitive to individual transactions, such as the weighted average price of the session. For this purpose, it is suggested that such transactions be concentrated in a single market member and firms are discouraged from trading for their own account in the same securities and in the same direction as their hedging trades during the same session.

New forms of trading in equities

Noteworthy among the innovations in market operation in 1998 were the changes in the equities segment, with the introduction of fixing and block trades. The former's purpose is to improve price-setting in less-liquid securities and the latter's purpose is to create a system for channeling large transactions which was much in demand by institutional and foreign investors. The next two boxes describe these matters in greater detail.

The new trading system of "fixing" in the equities market

Major changes were made in the system of trading in the Spanish equities market during 1998 in order to maintain a high level of efficiency in the market in an increasingly competitive environment. For this purpose, in its Circular 1/98, the Sociedad de Bolsas established a new form of trading called "fixing" which came into force on 1 July 1998. Its purpose: to improve the price-setting mechanism in medium-cap stocks traded on the SIBE which did not have sufficient order flow to ensure a frequent matching of trades during the lengthy electronic market session.

Under this new system, buy and sell orders are concentrated in a given time interval to determine a representative or "fixing" price. The book is open daily from 09.00 to 16.00 but fixing takes place at only two points in the session: at 12.00 and at 16.00. The procedure used for this purpose is the same as that used to set the opening price after the pre-opening period on the main SIBE market.

The new system is applied basically to stocks which were already listed on the SIBE when it came into effect. Some stocks which were traded at the time by the open outcry method also switched to fixing. The Sociedad de Bolsas has established that companies listing for the first time may choose between the main order system and the fixing system, and can subsequently change their option on the basis of their trading activity.

A total of 25 issuers joined the fixing system at the outset and 23 securities are currently traded in this way. Since its implementation, 11 issuers have abandoned the fixing system (four due to delisting and seven due to transfer to the main market) and 9 have joined it. The trading volume last year (around 23 billion pesetas) suggests that the segment has yet to consolidate.

Block trading in the equities market

On 6 November 1998, the Sistema de Interconexión Bursátil Español (SIBE) - Spain's electronic market - inaugurated two special new trade types in order to provide flexibility in large trades (blocks), in line with Europe's main markets. The increasing participation by mutual funds and, generally, by large investors in the Spanish market has led to a considerable increase this type of transaction. The purpose of these new types of trades is to make operators feel comfortable with trading blocks in the Spanish market and to avoid a shift in this business to the OTC market or to other trading centers.

The two new trade types are called "block trading by price" and "agreed price". The first is clearly the most novel: it is open to trades of over 250 million pesetas in any SIBE stock which represent at least 10% of the average daily trading volume in the last quarter, and it allows operators to directly choose the offer which they find most appropriate, in terms of volume and price, from among those which are entered. Prices are set freely within the general maximum fluctuation band established by the SIBE ($\pm 15\%$).

The second form - "agreed price" - consists of a system of reporting and validating trades in Ibex-35 stocks which have already been agreed upon by the parties and which amount to more than 100 million pesetas and represent at least 5% of the daily trading volume in the last quarter. In this system, the price must be set within the range of the weighted averages of the best six bid and asked prices on the market.

To assure an adequate level of transparency, the trades conducted under both forms (price, volume and intermediaries) must be disclosed before commencement of the pre-opening period on the day following that on which they took place.

In the period of less than two months in which the new block market has been operating, a total of 347.362 billion pesetas were traded on it, i.e. 6.5% of the total volume on the main market. The average trade was for approximately 2.5 billion pesetas. Many of the special trades previously conducted under Royal Decree 1416/1991, dated 27 September, governing special stock market transactions, are now conducted under the new forms. Also, since they came into force, the volume of trades pre-matched by members on the main market has shrunk by 3%.

Temporary suspensions of trading

In 1998 there were 80 cases of temporary suspension of trading which affected 56 issuers. The most frequent cause was the release of price-sensitive information - in which there was a considerable increase over 1997. Of the suspensions for this reason, 25 related to announcements of takeover bids and 11 to news about mergers; 12 suspensions were due to filings of takeover bids with the CNMV. A new feature in 1998 was the introduction of suspensions of trading at the deadline for delisting takeover bids so as to avoid the speculative movements which occur in these situations.

Table 7.1

TEMPORARY SUSPENSIONS OF TRADING ON THE MARKET

	1997	1998
Number of issuers suspended	35	56
Number of suspensions	48	80
Due to presentation of takeover bid	15	12
Release of price-sensitive information	25	62
Insufficient reporting	8	1
Technical reasons	1	0
Other	0	5

Delistings

There a total of 36 delistings in 1998, of which 15 were conducted by Autonomous Region governments by use of their powers: Basque Government (9), Catalan Government (5) and Valencia Government (1). The second-most frequent cause (7 cases) was due to settlement of takeover bids launched by the companies themselves for the purpose of delisting.

Volatility and margins on MEFF

MEFF RF

Because of the sharp decline in volatility in the bond markets, the margins demanded by MEFF RF in the early part of the year proved to be considerably larger than necessary. They did not appropriately reflect the daily price variations observed or, consequently, the risk incurred in that derivatives market. Taking account of the new situation, the level of daily margins (which had remained unchanged since early 1994) was revised in May 1998.

Table 7.2

CURRENT DAILY MARGINS VS PREVIOUS MARGINS

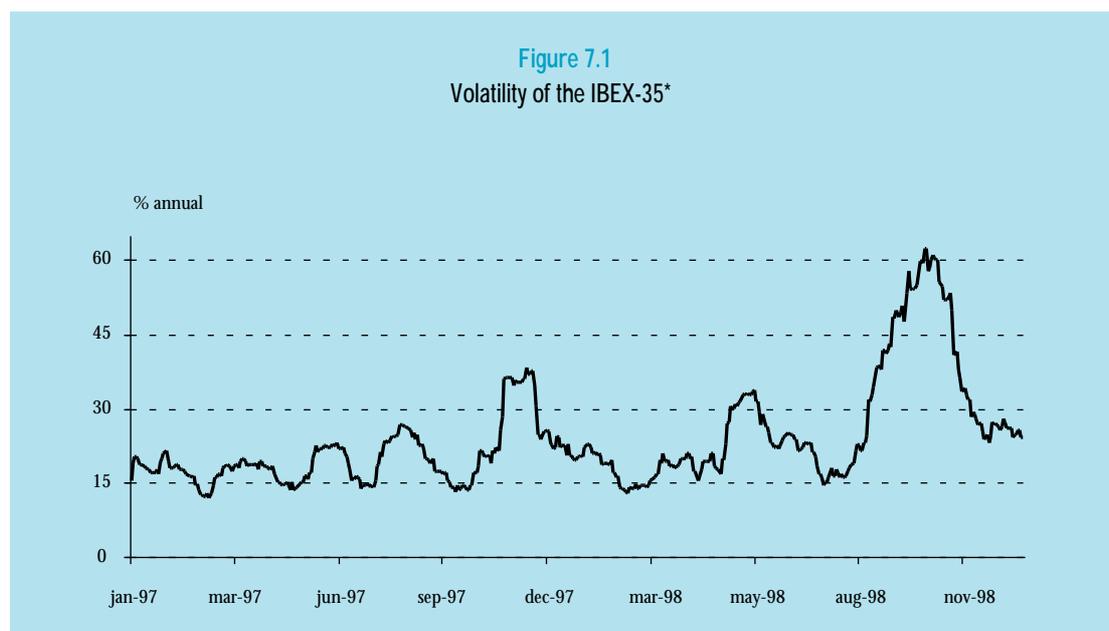
Contract	Current daily margins	Previous daily margin
Notional 5-year bonds	100,000 Pesetas/contract	100,000 Pesetas/contract
Notional 10-year bond	165,000 Pesetas/contract	300,000 Pesetas/contract
Mibor 90 Plus	75,000 Pesetas/contract	300,000 Pesetas/contract
Mibor 360 Plus	300,000 Pesetas/contract	1,200,000 Pesetas/contract
10Y Bund-Bono spread	115,000 Pesetas/contract	230,000 Pesetas/contract

The reduction in margins particularly affected contracts with a short-term underlying security - Mibor 90 plus and Mibor 360 plus - which fell to 25% of their previous level. In contrast, conditions remained unchanged for the contract on the notional 5-year bond since this contract was introduced at the end of 1997 and its margin levels were much more in line with the new market conditions.

This new scheme of daily margins demanded by MEFF RF is in line with that of its European counterparts, making it a further step in matching technical conditions in order to face Europe-wide competition.

MEFF RV

The situation on MEFF RV differed radically from that at MEFF RF. In fact, the volatility of daily price fluctuations in equities increased considerably during 1998 - see Figure 7.1.



* Annualized volatility calculated from the daily yield in the last 30 sessions.

The increase in volatility was particularly significant in August and September due to the worsening of the international crisis and even led MEFF RV to issue extraordinary margin calls in several sessions. This mechanism, which is covered by the market regulations, is aimed at enabling the Clearing House to regain a level of margins which enables it to handle hypothetical situations of default at any given time. Extraordinary margin calls are issued when the variation in price with respect to the previous day's closing prices is greater than the safety level determined in advance by the Clearing House. Extraordinary margin calls had previously only been issued on very few occasions, the first being on 18 July 1997.

Because of the persistence of high volatility and the high level attained by the index, MEFF RV increased the daily margin for contracts on the Ibex-35 four times in the course of 1998. Consequently, the daily margin for a future contract on the Ibex-35 rose from 375,000 pesetas/contract at the beginning of 1998 to 850,000 pesetas/contract on 5 October. On 30 November, responding to a reduction in intraday volatility, the margins were reduced to 700,000 pesetas/contract (7,000 euros/contract after the conversion process).

Increased in the initial guarantees by clearing members of MEFF RF and MEFF RV

In order to strengthen the solvency of clearing members and the financial protection of the clearing houses for derivatives on financial assets, on 2 October a new Circular on initial margins came into force jointly and simultaneously on MEFF RF and MEFF RV.

The Circular increased the initial margin required of clearing members to 40 million pesetas (from 20 million pesetas at MEFF RF and 10 million pesetas at MEFF RV). Additionally, the Circular established equity-linked limits on the open positions held by clearing members. Specifically, the margins claimable from settling members cannot exceed 35% of their equity and this limit can only be exceeded by means of a loan from another member's limit, a bank guarantee, a pledge of government debt securities or a cash payment.

Additionally, the new Circular standardized on MEFF RF and MEFF RV not only the amount of the initial margins but also the criteria for action when the limit on open positions, expressed as a percentage of equity, is surpassed.

Takeover bids

There was a considerable increase in the amount of takeover bids processed in 1998 due to the size of the offer launched by Banco de Santander, S.A. for Banco Español de Crédito S.A. There were a total of 18 takeover bids in 1998, for a potential total of 779 billion pesetas, of which 734 billion pesetas in transactions actually materialized.

More than half of the offers were for own shares of the offerer, either with the purpose of delisting (9 cases) or to reduce capital by retirement of the acquired stock (1 case). Of the remainder, four were aimed at attaining over 50% of capital, two sought to gain control of the target and two to consolidate it. Two offers were made in compliance with the regulations on indirect and supervening acquisitions of significant holdings; one was to consolidate a holding of between 25% and 50%, and one was made voluntarily for unlisted shares in order to provide small shareholders with liquidity.

Table 7.3
TAKEOVERBIDS

Amounts in millions of pesetas

	1994	1995	1996	1997	1998
Filed in the year ⁽¹⁾					
Number	17	22	20	14	18
Potential amount ⁽²⁾	136,676	285,442	292,457	107,829	779,249
Performed ⁽³⁾					
Number	17	22	19	13	18
Amount	71,068	212,231	268,604	95,663	733,911

(1) Authorized in the year.

(2) Does not include the potential amount of offers which were withdrawn.

(3) All those filed in the year, even if they concluded in the following year, not including those which were rejected or withdrawn.

As in prior years, the CNMV devoted particular attention to analyzing the consideration in those cases where it was established by regulation. Many offers were filed whose price required express authorization. Nine of these were offers for the purpose of delisting and two were made in compliance with the rules on indirect or supervening acquisitions. In several cases the price initially proposed for the offer was raised. In all cases, independent appraisals of the target companies were used.

In two takeover bids, the consideration consisted of securities to be issued by the offerer. In these cases, care was taken to ensure that the valuation and characteristics of the securities offered in exchange, and the related proportions, were expressed clearly.

The following takeover bids in 1998 were particularly noteworthy:

- *Because of the amount.* As mentioned above, the largest takeover bids was that made by Banco Santander, S.A. for Banco Español de Crédito, S.A. in which shares changed hands for an effective market value of over 500 billion pesetas. Other large transactions included the offer by Sol Meliá, S.A. for Meliá Inversiones Americanas, N.V., involving stock with a market value of over 62 billion pesetas, and the offer by Promotec, 5000, S.L. for Grupo Anaya, S.A. (approximately 33 billion pesetas).
- *Offers by foreign groups.* Three transactions were registered for a total of 54 billion pesetas; in the event, 38 billion pesetas changed hands.

Table 7.4
TAKEOVERBIDS IN 1998

Target	Bidder	Purpose	% of capital stock covered by the offer	Actual cash amount ('000 pesetas)	Outcome as % of shares initially targeted
Banco de Vitoria	Banco de Vitoria	Delisting	10.10	1,527,471	61.58
Cartera Baseibar, S.I.M.	Cartera Baseibar, S.I.M.	Capital reduction	33.28 (maximum)	2,100,000	73.94
Banco Español de Crédito	Banco Santander	Increase stake	51.89 (minimum=4.98)	597,819,520 ¹	95.21
Estacionamientos Subterráneos	Grupo Ferrovial	Increase stake	75.32	13,308,276	93.92
Banco de Alicante	Banco de Alicante	Delisting	6.39	1,007,036	69.41
Asland Catalunya y del Mediterráneo	Asland Catalunya y del Mediterráneo	Delisting	1.41	666,364	89.65
Sociedad Española de Carburros Metálicos	Sociedad Española de Carburros Metálicos	Delisting	2.24	1,481,662	72.57
Inmobiliaria Alcázar	Caja de Ahorros y Monte de Piedad de Baleares	Increase stake	20.00 (maximum)	791,527	100.00 (prorated)
Citroën Hispania	Citroën Hispania	Delisting	3.27	2,541,084	74.57
Banco Simeón	Banco Simeón	Delisting	0.79	268	0.24
Conservas Garavilla	Conservas Garavilla	Delisting	5.73	499,239	89.96
Sociedad Financiera y Minera	Ciments Français	Compliance with Art. 3 (supervening holding)	10.00 (maximum)	5,046,856	89.27
Promotec 5.000, S.L.	Grupo Anaya	Acquisition of control	100.00 (minimum=63.51%)	33,193,068	94.84
AGF Unión-Fénix, Seguros y Reaseguros	Allianz AG	Compliance with Art. 3 (supervening holding)	13.23	8,461,233	61.57
Compañía Andaluza de Cementos y Derivados ⁽²⁾	Cementos Portland	Provide target's minority shareholders with liquidity	2.48	594,052	73.17
Bankoa	Bankoa	Delisting	3.34	193,888	49.83
Sociedad Financiera y Minera	Sociedad Financiera y Minera	Delisting	3.49	1,770,249	89.75
Meliá Inversiones Americanas, N.V.	Sol Meliá	Increase stake	82.57	62,909,103 ⁽³⁾	96.51

(1) The cash amount was calculated by assigning a price of 1,975 pesetas per share to Banesto as a result of the share-swap ratio (5 shares of Banco Santander for 15 shares of Banesto) based on the closing price of Banco Santander shares on 18 February 1998, the day prior to filing of the takeover bid, which was 6,320 pesetas per share.

(2) Not listed.

(3) The cash amount was calculated by assigning a price of 6,710 pesetas per share to Meliá Inversiones Americanas (MIA) as a result of the share-swap ratio (9 shares and 9 warrants of Sol Meliá for 10 shares of MIA) based on the closing price of Sol Meliá shares on 20 November 1998, the day prior to filing of the first takeover bid (which was later replaced by this one), which was 5,739 pesetas per share plus the amount of the warrant (1,835 pesetas).

- *Transactions for securities to be issued by the offerer.* Two offers of this type were made: that by Banco Santander, S.A. for Banco Español de Crédito, S.A. and that by Sol Meliá, S.A. for Meliá Inversiones Americanas, N.V. The aim in both cases was to integrate the target. The former was outstanding because of the market value of the shares which were exchanged - over 500 billion pesetas. The latter presented several features which make it unique among the takeover bids presented in Spain to date:
 - The target company had carried out an IPO only months before and the takeover bid involved a change in the business and stock market strategy pursued by this hotel group since Sol Meliá itself was floated in 1996.
 - The bidder initially offered newly issued shares of Sol Meliá in exchange for shares of the target. Given the market's mixed reaction, the initial takeover bid was withdrawn and a new one presented in its place.
 - In addition to newly-issued stock of Sol Meliá, the new takeover bid included other securities (warrants) to be issued by the offerer which guaranteed a given appreciation of Sol Meliá stock at a preset date, as an incentive to acceptance of the offer. The maximum amounts to be paid on maturity of the warrants would be paid by the hotel group's majority shareholder.
- *Because of their consequences in the stock market.* Noteworthy were the takeover bids which directly or indirectly entailed delisting of the target: Banco de Vitoria, Banco de Alicante, Asland Catalunya y del Mediterráneo, Sociedad Española de Carburos Metálicos, Citroën Hispania, Banco Simeón, Conservas Garavilla, Sociedad Financiera y Minera and Bankoa. At least three of the companies which were targets of takeover bids in 1998 must regularize their stock market situation in the next few months, either to comply with the regulations governing dissemination of the stock and remain in the market or to delist.

Securities Clearing and Settlement Service (SCLV)

The Securities Clearing and Settlement Service's actions in 1998 were aimed at two main objectives, which will also determine its action in 1999, to a great extent: the introduction of the euro and the Protocol for the development of the fixed-income markets (signed on 29 April 1998 by the Presidents of the four stock market governing companies, the president of AIAF Mercado de Renta Fija, the president of the SCLV and the president of the CNMV).

The adoption of the euro as the unit of account for trading and settlement (trading and settlement in the securities markets will be conducted in euros from 4 January 1999) has led to the need to adapt all computer processes to the new currency before that date. The adaptation and conversion process took place in 1998. SCLV's members also had to certify to the Service that they have sufficient capacity to handle settlement in the new unit of account, passing a number of technical tests for this purpose. All these procedures were regulated by circulars and instructions issued by the SCLV⁽³⁰⁾.

(30) See chapter 5 for further details.

In connection with the Protocol for the development of the fixed-income markets⁽³¹⁾, the SCLV laid the technical foundations for the establishment of a single platform for clearing and settling fixed-income securities traded in AIAF and the stock exchanges. Circular 2/1998 and a number of complementary regulations define the rules applicable to the new accounting system, the clearing and settlement mechanisms, the procedures for reporting between firms and the clearing and settlement system for private-sector book-entry fixed-income securities.

The SCLV also made a number of improvements to its procedures, including those for bilateral loans of securities, transfers of securities between firms and the supporting documentation for sales. In connection with bilateral loans, on 15 April 1998 new operating procedures and new forms for reporting to the SCLV came into effect in order to further expedite transactions between member firms. As regards transfers of securities, on 15 October 1998 the period for transfers of securities between firms, both free of payment and delivery versus payment, was reduced to one business day. As regards supporting documentation for sales, the deadline for reporting was extended to 10.00 hours on D+3. This measure seeks to foster better overall compliance with the settlement deadline.

(31) See chapter 3 for further details.

8

MARKET INTEGRITY

Market Monitoring Unit

The Market Monitoring Unit (MMU) was created in 1997 to facilitate early detection of price manipulation and improper use of inside information, i.e. practices which seriously impair the integrity of the securities markets. In its second year of existence, the MMU increased its operating capacity through the acquisition of new technical resources and by perfecting its investigation procedures. It conducted a total of 52 investigations, in the course of which it issued 778 demands for information.

Table 8.1

ACTION BY THE MARKET MONITORING UNIT

	1997	1998
Investigations conducted	43	52
Inside information	23	19
Price manipulation	15	24
Other	5	9
Subpoenas (*)	1,119	778
Visits	56	35
Depositions	36	44
Results of investigation	14	51
Notifications	9	24
Prior notification of breach	4	20
Opening of file	1	7
Collaboration with foreign institutions	0	3

(*) The process of requesting ownership data from the SCLV was simplified by the introduction of the electronic owner query system.

Action based on the results of investigation by the Market Monitoring Unit

As a result of detecting customs which departed from good market practice or organizational deficiencies not codified as violations, the Market Monitoring Unit issued a total of 24 notifications (15 more than in 1997), the most noteworthy being as follows:

- To seven issuers of securities for transactions in own shares whose volume might influence prices. They were generally recommended to add to their internal codes of conduct a regulation governing transactions with own shares to ensure neutrality on the price-setting process.

- To one finance entity which had acted as principal in ordering a sale transaction executed at the close of the SIBE session in connection with the maturity of a derivatives contract. The financial entity was warned to review its procedures for hedging transactions so as to avoid artificially influencing prices. Two broker-dealers which intermediated in the transaction were recommended to observe certain principles in order to avoid entering orders of this type⁽³²⁾.
- To a Spanish issuer for placing company information at the disposal of certain analysts without releasing it to the market at the same time in the form of price-sensitive event. This circumstance coincided with an increase in the market price of the security in question.

Acceleration of the procedure for ascertaining ownership data

One of the principal steps in any investigation by the Market Monitoring Unit is that of ascertaining, as quickly as possible, the individuals and legal persons which engaged in transactions on the security or securities of interest in a given time period.

The creation of the Market Monitoring Unit and its full involvement in the tasks entrusted to it made it necessary to revise the process followed to obtain this information. The new procedure, applied by agreement with the SCLV, standardizes the content of requests made by the MMU (now regulated by a transmission form adopted in February 1998) and makes it easier for member firms to comply with demands for information on securities owners since they can now use the channels already in place for the exchange of information between firms and the SCLV.

The implementation of the new system greatly accelerated the process of compiling information. It is now possible to obtain the information within 10-12 business days from the request date, which is considerably lower than the five weeks which was standard under the previous system.

Collaboration with foreign institutions in investigating security ownership

Investigation as to formal ownership of securities transactions is one of the principal tasks in the work of the MMU. Where the transactions are conducted by non-residents, such investigation generally requires the assistance of foreign regulatory bodies.

(32) For details of these principles, see Interpretative Letter 5/1998, dated 30 March. A box in chapter 7 discusses this Circular.

In 1998, the MMU issued requests for information to the following regulators: Commission des Opérations de Bourse (France), Comissao do Mercado de Mobiliários (Portugal), Swiss Federal Banking Commission (Switzerland), Financial Services Authority (UK), Commissariat aux Bourses (Luxembourg) and Commission Bancaire et Financière (Belgium). Also in 1998, the Unit provided assistance with investigations conducted by three foreign regulatory bodies: Commission des Opérations de Bourse (France), Financial Services Authority (UK) and Securities and Exchange Commission (USA).

The phenomenon of globalization means that cooperation and the reciprocal exchange of information is now essential to the work of supervisory bodies in all countries. As such requests for information proliferate, it is to be expected that the requests and responses will be standardized, which will facilitate the work of the investigators.

In connection with collaboration between regulators, it is worth noting the major progress made in Switzerland, where a legislative reform has made it possible to obtain ownership information in that country (see box in Chapter 10). The CNMV benefited from the cooperation of the Swiss authorities in 1998.

Action by the Inspection Division

The CNMV's disciplinary action was significantly greater in 1998, as evidenced by the number of proceedings which were concluded and the number of violations which were handled (see table 8.2). The increase in penalties came basically in two areas:

- Capture or attempts to capture funds from the public without authorization or without submission to the securities market regulations; this is one of the main concerns of the supervisory body as it is seriously harmful to investor interests. Charges were brought in this connection in 8 cases.
- Rules of conduct demanded of all persons and firms operating in the securities market, whose observance is essential to protect investors and maintain the quality of our market. In this area, charges were brought in 24 cases for various violations: price manipulation, inside information, absence of Chinese walls, simulation of transfers and violation of the "client first" principle.

Despite the larger number of cases handled, the average processing period remained stable at seven months. The Inspection Division made considerable efforts to resolve cases in reasonable time periods while fully respecting the guarantees and time periods granted under the procedural regulations to the parties involved in order to enable them to exercise their right to defense.

Table 8.2
NUMBER OF VIOLATIONS

	1998	1997
Violations leading to the opening of a file	54	21
– Very serious	29	18
– Serious	22	3
– Minor	3	1
Violations in procedures which had concluded	39	32
Very serious offenses	24	25
• proceedings dating from 1995	-	4
• proceedings dating from 1996	-	16
• proceedings dating from 1997	13	5
• proceedings dating from 1998	11	-
Serious offenses	12	6
• proceedings dating from 1995	-	1
• proceedings dating from 1996	-	2
• proceedings dating from 1997	-	3
• proceedings dating from 1998	12	-
Minor offenses	3	1
• proceedings dating from 1996	-	1
• proceedings dating from 1997	-	-
• proceedings dating from 1998	3	-

Table 8.3
TYPES OF VIOLATIONS

	Opened		Closed	
	1998	1997	1998	1997
Very serious offenses:	29	18	24	25
I. Price manipulation	-	5	3	2
II. Failure to report significant holdings	1	-	-	6
III. Forbidden activities	7	4	6	5
IV. Simulated transfers	1	-	-	5
V. Inside information	8	6	9	1
VI. Breach of coefficients	1	-	-	1
VII. Concealment of price-sensitive information	-	1	1	1
VIII. Breach of Company Law	2	2	2	2
IX. Breach of general securities market regulations	1	-	-	1
X. Breach of general IIC regulations	2	-	2	1
XI. Accounting offenses	2	-	-	-
XII. Obstruction of inspection	1	-	-	-
XIII. Unregistered issues	1	-	-	-
XIV. Breach of authorization requirements	2	-	1	-
Serious offenses:	22	3	6	8
I. Chinese walls	3	1	1	1
II. Accounting offenses	2	-	-	1
III. Violation of the "client first" principle	6	-	3	2
IV. Breach of regulations on orders and transaction records	1	1	1	1
V. Reserved information	-	1	-	1
VI. Forbidden activities	-	-	-	2
VII. Breach of coefficients	2	-	-	-
VIII. Breach of general securities market regulations	6	-	1	-
IX. Price manipulation	1	-	-	-
X. Breach of code of conduct	1	-	-	-
minor offenses:	3	1	3	-
I. Breach of code of conduct	3	1	3	-

Table 8.4
PENALTIES IMPOSED

	1998			1997		
	Number	Amount*	Period	Number	Amount*	Period
I. Fines	50	1,400,533,260	-	37	1,195,834,954	-
II. Disqualification of directors	-	-	-	6	-	30 years
III. Limitation of activities	-	-	-	1	-	1 year
IV. Reprimands	2	-	-	2	-	-
V. Withdrawal of authorization	-	-	-	2	-	-

*Pesetas.

Unregistered intermediaries

As it has done since it was founded, the CNMV devoted considerable efforts during 1998 to detecting intermediation activities by unregistered firms and pursuing their officers. A total of 35 firms, many already defunct, were investigated on charges of capturing public savings without the appropriate authorization. The CNMV brought charges against five of them and imposed sizeable penalties on three of them. As is customary, possible criminal activities were detected in many cases and were reported to the police and the judicial authorities.

The CNMV has stated repeatedly that care and diligence by investors is the main shield against the harm which can arise from the action of (generally unscrupulous) unregistered intermediaries - for example, see the "Investor's Guide", available at the CNMV's web site. However, this does not prevent the CNMV from constantly honing its ability to detect and pursue such parties. A major step was taken in this direction with the recent promulgation of the Law reforming the Securities Market Law, which empowers the supervisory body to adopt relevant measures in eradicating unauthorized activities.

That Law, which came into force on 18 November last, ratifies the existence of a framework of action reserved for investment companies in connection with investment services and complementary services relating to financial instruments. To safeguard this reservation of activities, the reformed Securities Market Law assigns broad powers of action to the CNMV. Article 64.6 of the law provides that no individual or entity may habitually engage in investment services or complementary activities without having obtained the necessary authorization and having registered with the appropriate official registers. Point 7 of that same article establishes that, without prejudice to the criminal liabilities which might arise, the CNMV may adopt all the measures it deems appropriate in order to curtail conduct which is in breach of the aforementioned prohibition, particularly:

- a) It may issue repeated orders and impose coercive fines of up to two million pesetas on the violator and, where appropriate, on the entity's officers.
- b) It may seize the books, archives, accounting records and generally all documents, on any medium, relating to the activity, including computer programs and magneto-optical and other types of disks.
- c) It may order the closure of the violator's establishment.
- d) It may notify the public of the existence of these practices and, as appropriate, the measures adopted to curtail them.

Despite the short time elapsed since the new regulations came into force, the CNMV made use of them in December 1998 to demand the cessation of activity by a firm - Diagonal Divisas, S.A. - and to impose coercive fines. The CNMV intends to warn the public of this type of practice by various means, including its own web page. Diagonal Divisas was the first case in which this system of warnings was used.

AVA/SOCIMER case

The most significant event in the supervision area in 1998 was the crisis at securities dealer AVA, Aseores de Valores, S.A. Because of its impact on society, the case was widely reported in the media. The crisis led to suspension of payments by the dealer, criminal proceedings before the National Court, penalty proceedings by the CNMV and, subsequently, removal from the CNMV's registers.

In compliance with its prudential supervision duties, the CNMV issued a demand giving AVA until 10 February 1998 to appropriately inform its clients of the risks involved in the management of certain securities which, under discretionary portfolio management contracts, had been acquired through Socimer International Bank Limited, a finance entity domiciled in Bahamas and owned by Spanish company Transáfrica S.A. AVA's failure to comply with the CNMV's demands coincided with the outbreak of the crisis at the Socimer group.

In view of the repeated breaches by AVA and the likelihood that its clients' risks would materialize, the CNMV's Board held an urgent meeting on 18 February and approved the following resolutions:

1. Adoption of precautionary measures, including prohibiting AVA from operating with foreign securities for clients with portfolio management contracts and the obligation to refrain from obtaining new clients and from conducting further transactions with this type of product.
2. Demand that AVA refrain from conducting transactions which alter its clients' rights or favor some unduly with respect to others.
3. Commencement of the process of intervention in AVA by opening the prior discovery procedure.
4. Opening of penalty proceedings against AVA, Socimer and their Boards of Directors.
5. Remittal to the Public Prosecutor of all the available information to ascertain whether other liabilities might arise from the events detected by the CNMV.

To guarantee compliance with the resolutions relating to AVA, a team of CNMV investigators was installed at AVA's head office in Zaragoza. As a result of the process for administrative intervention of AVA set in motion by the CNMV, AVA opted for court intervention and filed for temporary receivership on 25 February, which halted the intervention procedure commenced by the Commission. Since AVA's filing for temporary receivership and the commencement of criminal proceedings by the National Court, the CNMV's action has consisted of ongoing cooperation with justice. CNMV personnel have been called upon as expert advisers by the instructing magistrate. The CNMV also issued a demand that AVA take all the necessary measures to safeguard the interests of the investors involved and its own interests in the insolvency process at Socimer.

Several clients of AVA requested the opening of proceedings against the CNMV for patrimonial liability in connection with its supervisory action in this case. The Council of State was not favorable to the application and it was rejected by the Ministry of Economy.

Court judgments on appeals against penalties

In 1998 the courts ruled on a number of administrative appeals against penalties imposed by the CNMV or the Ministry of Economy and Finance - see list in table 8.6. Because of their interest, some of these cases are discussed below⁽³³⁾.

Director's position as guarantors

In connection with directors' liability and their status as guarantors within a company, the National Court ruling dated 22 January 1998 (R. 621/94), in connection with pleas by the directors of a penalized firm that they were not liable on the grounds that the board had not met in one year, found that there was a lack of diligence and abandonment of duties because the Board of Directors had not met in that period. That is to say, far from exonerating them, the fact was taken to be a manifestation of negligence in the discharge of their duties, which is particularly serious in the case of the members of the Board of Directors of a Collective Investment Scheme Management Company since lack of diligence in the discharge of their duties can be deleterious not only to the company of which they are directors but also to those who have entrusted their assets to that company, as can be deduced unequivocally from article 29 of the Law on Collective Investment Schemes and article 58 of the corresponding Regulation.

This matter is also affected by National Court judgment dated 9 March 1998 (R. 656/98) which accurately summarizes the case law on the question of directors' liability. It commences by proclaiming the applicability of the constitutional principles of administrative penalty law, which excludes the question of objective liability, but it adds as a general principle that "both under criminal law and under administrative penalty law, it is possible to claim liability due to inactivity by the defendant when the legislation imposes a positive action on him, particularly when it places him in a position of guarantor; however, at all events such omission requires that there be intent or negligence." Referring to the duty of diligence imposed on directors by article 127 of the Companies Law, the judgment concludes that "it is easy to understand that directors, who have the obligation to adopt the measures required to ensure orderly management of the company and the legal means to attain its ends, are liable for the result of such management except where it is evidenced that they used all legal means at their disposal to ascertain and correct the situation forbidden by law or that they were unaware for reasons not attributable to them." Accordingly, the judgment concludes by stating that "when a company incurs in forbidden conduct, in order to avoid liability a director must at least provide specific evidence that he actually acted in an attempt to clarify and resolve the forbidden acts or that he did not do so due to force majeure or acts of God."

Directors' status as guarantors is also referred to in National Court judgment dated 23 April 1998 (R. 6/884/95), which states, in connection with directors of broker-dealers and dealers, that it cannot be accepted that a member of a board of directors, with the obligation of personal and professional honorability imposed by Royal Decree 1393/90, and the knowledge appropriate to the business to be performed by the company, is unaware of transactions of great importance for the company.

(33) A query about court rulings on administrative appeals is available at the CNMV's web page.

This position is further amplified by National Court judgment dated 14 May 1998 (R. 1117/95) which establishes that “this special situation in which directors are placed by virtue of articles 127 and 133 of the Companies Law is what imposes a double liability on them: intra-company (i.e. to the shareholders, the company and the creditors) and extra-company, as referred to in article 89 of the Companies Law (which refers to directors’ liability in matters of treasury stock). That judgment states that: “based on the foregoing principles, it is easy to understand that directors, who have the obligation to adopt the measures required to ensure orderly management of the company and the legal means to attain its ends, are liable for the result of such management except where it is evidenced that they used all legal means at their disposal to ascertain and correct the situation forbidden by law. That is not to say that this is a case of objective liability under Administrative Penalty Law but, rather, that the liability is attributed to the directors at least on the grounds of willfulness as, by failing to exercise due diligence as required for the discharge of their duties, they caused, albeit with the combination of the positive actions of others, the violation which is punished by law. Evidently, the elements of action or omission and willfulness or intent will have to be assessed in setting the severity of the penalty, but they all comprise the administrative violation.”

Partial acceptance of an appeal to reduce the amount of penalties

Two judgments reduced the amounts of penalties imposed on the grounds that the Constitutional and Supreme Court case law considers that the principles underlying criminal law are applicable, with qualifications, to administrative penalty law. Accordingly, in the case covered by National Court judgment dated 1 April 1998 (R. 605/94), by applying the techniques of criminal law the penalty imposed on an individual for violation of article 99.o of the Securities Market Law (acquisition of shares of a listed company while in possession of inside information) was reduced since the court considered as an attenuating circumstance the fact that the appellant had voluntarily rectified the attempt to conceal the transactions.

Also, National Court judgment dated 24 September 1998 (R. 6/992/95) partly granted the appeal filed by a SIM and the members of its Board of Directors in that, even accepting that the investment operations performed can fall under the type envisaged in article 32.4.b of Law 46/84, which codifies as a very serious violation the investment in any asset other than those authorized legally so as to seriously jeopardize or harm the interests of shareholders, investors or third parties or depart from the purpose of the institution, the loss in the share as a result of the penalized conduct was minor and, therefore, the court did not share the extension of the penalty applied by the Administration and decided that it should be corrected by reducing the amount by application of the principle of proportionality.

Reduction in the classification of the violation

The Madrid Higher Court of Justice judgment issued on 13 May 1998 (R. 281/96) reduced the classification from a serious violation of articles 32.3.j and 32.5 of the Law governing Collective Investment Schemes to a minor violation under articles 32.2.f and 32.5.a of that same law. The court rejected the administration’s interpretation of article 32.3.j of the Law governing Collective Investment Schemes, whereby the performance of the acts described therein is sufficient for classification as a serious violation. In contrast, the court judgment found that, in order to be able to classify a violation as serious, it is necessary that the Administration demonstrate also that the effects envisaged in the regulations actually occurred; i.e. that the breach of the duty of vigilance certainly and seriously jeopardized the interests of shareholders, investors or third parties. Since the Administration had failed to produce evidence to that effect, the appellant’s appeal was recognized and the classification of the violation was reduced.

Table 8.5

OUTCOME OF DISCIPLINARY PROCEEDINGS IN 1998

Reference	Resolutions
(1/98)	<u>Ministerial Order dated 14 January 1998</u> Resolution on the alleged supply to the CNMV, by an issuer company, of inaccurate or untrue data (art. 99.n of the Securities Market Law). Fines were imposed amounting to 210 million pesetas.
(2/98)	<u>Ministerial Order dated 11 March 1998</u> Resolution on alleged practices by an issuer company aimed at distorting the free formation of the prices of its shares in the securities market (art. 99.i of the Securities Market Law). A fine of 20 million pesetas was imposed.
(3/98)	<u>Ministerial Order dated 27 July 1998</u> Resolution on the alleged habitual performance by a company, without authorization, of the activity consisting of the reception and transmission of investors' orders (art. 99.q of the Securities Market Law). Fines were imposed amounting to 266,440,000 pesetas.
(4/98)	<u>Ministerial Order dated 27 July 1998</u> Resolution on the alleged habitual performance by two companies, without authorization, of the activity consisting, on the one hand, of the reception and transmission of investors' orders and, on the other, of management of third parties' securities portfolios (art. 99.q of the Securities Market Law). Fines were imposed amounting to 142,498,510 pesetas.
(5/98)	<u>CNMV Board Resolution dated 7 October 1998</u> Resolution regarding the alleged use of inside information by an individual in transactions with securities (art. 99.o of the Securities Market Law). The charges were dismissed.
(6/98)	<u>CNMV Board Resolution dated 7 October 1998</u> Resolution regarding the alleged use of inside information by an individual in transactions with securities (art. 99.o of the Securities Market Law). The charges were dismissed.
(7/98)	<u>CNMV Board Resolution dated 7 October 1998</u> Resolution regarding the alleged use of inside information by an individual in transactions with securities (art. 99.o of the Securities Market Law). The charges were dismissed.
(8/98)	<u>Ministerial Order dated 14 October 1998</u> Resolution on the alleged performance, by an issuer company, of practices aimed at distorting the free formation of the prices of its shares in the securities market (art. 99.i of the Securities Market Law). Fines were imposed amounting to 200 million pesetas.
(9/98)	<u>Ministerial Order dated 14 October 1998</u> Resolution on the alleged performance, by an issuer company, of practices aimed at distorting the free formation of the prices of its shares in the securities market (art. 99.i of the Securities Market Law). Fines were imposed amounting to 497,444,750 pesetas.
(10/98)	<u>CNMV Board Resolution dated 4 November 1998</u> Resolution regarding alleged breach by an individual of the terms of art. 81.1 of the Securities Market Law, which action is codified as a serious violation of art. 100.r of that same law. A fine of 2 million pesetas and a public reprimand were imposed.
(11/98)	<u>CNMV Board Resolution dated 4 November 1998</u> Resolution regarding alleged breach by an individual of the terms of art. 81.1 of the Securities Market Law, which action is codified as a serious violation of art. 100.r of that same law. A fine of 2 million pesetas and a public reprimand were imposed.
(12/98)	<u>CNMV Board Resolution dated 19 November 1998</u> Resolution regarding alleged performance by an unlisted company of two violations of the Companies Law in the area of treasury stock. Fines amounting to 2,250,000 pesetas were imposed on the company's directors.
(13/98)	<u>CNMV Board Resolution dated 2 December 1998</u> Resolution on the alleged performance by a portfolio management company of 11 violations, two of them very serious due to performance of forbidden activities (art. 99.q of the Securities Market Law), four of them under point n) (three for violation of the "client first" principle and one for breach of article 83 of the Securities Market Law - Chinese walls), one under point m) (breach of regulations governing reporting to clients) and another under point c) (breach of regulations governing keeping the record of transactions), and three minor violations of article 101 of the Securities Market Law, two for breach of the rules of conduct and one for breach of the regulations governing agents. Charges for two very serious violations were dismissed and fines totaling 29,900,000 pesetas were imposed for the other violations.

OUTCOME OF DISCIPLINARY PROCEEDINGS IN 1998

Reference	Resolutions
(14/98)	<p><u>Ministerial Order dated 9 December 1998</u> Resolution regarding the alleged use of inside information by two individuals in performing transactions with securities (art. 99.o of the Securities Market Law). Fines were imposed amounting to 10 million pesetas.</p>
(15/98)	<p><u>CNMV Board Resolution dated 16 December 1998</u> Resolution regarding the alleged performance by a collective investment scheme management company of five violations, four of them serious, for various breaches of the regulations governing collective investment scheme (art. 32.3.c and 32.3.j of the Law governing Collective Investment Schemes) specifically breach of the management function, investment in excess of established coefficients, breach of accounting rules and valuation criteria and violation of the "client first" principle, plus a very serious violation due to breach of the regulations governing issuance and reimbursement of shares in the mutual funds under management (art. 32.4.g of the Law governing Collective Investment Schemes). Charges of one very serious violation were dismissed and fines totaling 3 million pesetas were imposed for the other violations.</p>
(16/98)	<p><u>CNMV Board Resolution dated 16 December 1998</u> Resolution regarding the alleged performance by a broker of four violations, three of them serious due to breach of the regulations on agents (art. 100.g of the Securities Market Law), breach of the regulations on accounting for transactions and keeping of accounts (art. 100.c of the Securities Market Law) and violation of the "client first" principle (art. 100.n of the Securities Market Law), plus a very serious violation due to lack of the organization and personnel and material resources in keeping with the performance of the activity. Charges of one very serious violation were dismissed and fines totaling 4,500,000 pesetas were imposed for the other violations.</p>
(17/98)	<p><u>CNMV Board Resolution dated 16 December 1998</u> Resolution regarding the alleged acquisition by a portfolio management company of securities for its own account on a sporadic basis in excess of the legally established limits (art. 100.o of the Securities Market Law). A fine of 500,000 pesetas was imposed.</p>
(18/98)	<p><u>Ministerial Order dated 17 December 1998</u> Resolution regarding the alleged use of inside information by two individuals in performing transactions with securities (art. 99.o of the Securities Market Law). Fines were imposed amounting to ten million pesetas.</p>

Table 8.6

COURT JUDGEMENTS HANDED DOWN IN 1998 IN APPEALS AGAINST PENALTIES

No.	Date	Court	Appeal number	Appealed Order
1	22/1/1998	National Court	621/94	Ministry of Finance Order dated 20/12/1993 Confirmed the penalty imposed on four directors of a collective investment scheme management company, consisting of a public reprimand and fines of 2 million pesetas each, for a very serious violation of article 32.4.b in connection with article 25, both of the Collective Investment Scheme Law (acquisition by a FIAMM of assets other than those legally authorized).
2	26/1/1998	National Court	266/94	Ministry of Finance Order dated 16/3/1994 Confirmed the penalty imposed on a corporation, consisting of a fine of four hundred million pesetas for a very serious breach of article 99.p of the Securities Market Law (failure to report significant holdings in a listed company acquired through a third company owned 99.9%).
3	9/2/98	National Court	606/94	Ministry of Finance Order dated 6/5/94 Confirmed the penalty imposed on the General Manager of a Stockbrokers' Instrumentality Company consisting of a fine of five million pesetas for a very serious violation of article 99.t of the Securities Market Law (refusal or resistance to the CNMV inspectorate by individuals or legal entities referred to in article 84 of the Law, provided that there has been an express written demand in this connection).
4	14/2/98	National Court	6/61/95	Ministry of Finance Orders dated 12/12/94 Confirmed the penalties imposed on the chairman of the board of directors of a broker-dealer consisting of fines amounting to five million and 1.5 million pesetas for a violation of article 81 in connection with article 89 of the Companies Law (provision of financial assistance to third parties for the acquisition of shares) and for a very serious violation of article 99.k of the Securities Market Law (reduction of the entity's equity to below 80% of the required minimum and persistence of this situation for more than six consecutive months).
5	16/2/1998	National Court	62/95	Ministry of Finance Order dated 19/12/1994 Confirmed the penalty imposed on a director of a broker-dealer, consisting of a fine of 1.5 million pesetas, for a very serious violation of article 99.k of the Securities Market Law (reduction of equity to below the required minimum).
6	16/2/1998	National Court	59/95	Ministry of Finance Order dated 12/12/1994 Confirmed the penalty imposed on a director of a broker-dealer, consisting of a fine of 1.2 million pesetas, for four very serious violations of article 99.p of the Securities Market Law (failure to report significant holdings in a broker-dealer).
7	16/2/1998	National Court	58/95	Ministry of Finance Order dated 12/12/1994 Confirmed the penalty imposed on a director of a broker-dealer, consisting of a fine of three million pesetas, for a very serious violation of article 89 of the re-consolidated Companies Law, approved by Legislative Royal Decree 1564/1989, dated 22 December (financial assistance for the acquisition of own shares).
8	9/3/1998	National Court	656/96	Ministry of Finance Order dated 19/7/1996 Confirmed the penalties imposed on a collective investment scheme management company, consisting of final suspension of his status as director for a very serious violation of article 32.4.a of the Law governing Collective investment schemes (accounting irregularities) and a fine of 10 million pesetas for another very serious violation of article 32.4.a of the (falsehood or omission of information).
9	9/3/1998	Madrid H.C.J.	1448/93	CNMV Board Resolution dated 3/2/1993 Confirmed the penalty imposed on the chairman of the board of directors of a broker-dealer, consisting of a fine of two million pesetas, for a serious violation of article 100.n of the Securities Market Law (violation of the "client first" principle).
10	12/3/1998	National Court	914/94	Ministry of Finance Order dated 14/3/1994 Confirmed the penalty imposed on a corporation, consisting of a fine of 24,422,635 pesetas, for a very serious violation of article 99.i of the Securities Market Law (practices aimed at distorting the free formation of prices of a listed company).

Table 8.6 (Cont.)

COURT JUDGEMENTS HANDED DOWN IN 1998 IN APPEALS AGAINST PENALTIES

No.	Date	Court	Appeal number	Appealed Order
11	23/3/1998	National Court	596/94	Ministry of Finance Order dated 7/2/1994 Confirmed the penalty imposed on a limited liability company, consisting of a fine of 128,510,645 pesetas, for a very serious violation of article 99.q of the Securities Market Law (management of third-party portfolios without authorization).
12	1/4/1998	National Court	605/94	Ministry of Finance Order dated 6/5/1994 Reduced the penalty imposed on an individual, consisting of a fine of 20 million pesetas, for a very serious violation of article 99.o of the Securities Market Law (acquisition of shares of a listed company while in possession of inside information), to 12 million pesetas.
13	14/4/1998	Madrid H.C.J.	808/96	CNMV Board Resolution dated 6/9/1995 Confirmed the penalties imposed on a director of a broker-dealer, consisting of two fines of two million pesetas for two serious violations of article 100.g of the Securities Market Law (breach of liquidity coefficient and exceeding risk concentration limit).
15	16/4/1998	National Court	877/95	Ministry of Finance Order dated 25/7/1995 Confirmed the penalty imposed on a securities investment company, consisting of a fine of twenty-five million pesetas, for a violation of article 32.4.f) of the Law governing Collective Investment Schemes, in connection with article 89 of the re-consolidated Companies Law, approved by Legislative Royal Decree 1564/1989, dated 22 December (acquisition of own shares in excess of the legal limit).
16	23/4/1998	National Court	884/95	Ministry of Finance Order dated 25/7/1995 Confirmed the penalty imposed on the secretary of the board of directors of a portfolio management company, consisting of four fines for a total amount of 3,500,000 pesetas, for four very serious violations of article 99.q of the Securities Market Law (performance of activities without a permit).
17	30/4/1998	National Court	997/95	Ministry of Finance Order dated 25/9/1995 Confirmed the penalties imposed on an individual and four limited companies, consisting of fines of 1,250,000 pesetas and 25,000 pesetas, respectively, for very serious violations of article 99.p of the Securities Market Law (failure to report significant holdings in a securities investment company).
18	30/4/1998	National Court	991/95	Ministry of Finance Order dated 25/9/1995 Confirmed the penalties imposed on two individuals, a corporation and a limited liability company, consisting of 1,250,000 pesetas on the individuals and of 5,000 pesetas on the legal entities, for very serious violations of article 99.p of the Securities Market Law (failure to report significant holdings in a securities investment company).
19	13/5/1998	Madrid H.C.J.	281/96	Ministry of Finance Order dated 24/11/1995 Reduced the classification from a very serious violation of articles 32.3.j and 32.5 of the Law governing Collective Investment Schemes, to a serious violation of articles 32.2.f and 32.5.a of that law, and reduced the fine of 2,500,000 pesetas to 100,000, imposed on a depository of collective investment schemes (for failure to supervise operations by the management company and failure to formally report improper action which was detected to the CNMV).
20	11/5/98	National Court	156/95	Ministry of Finance Resolution dated 12/12/94 Confirmed the penalty imposed on the appellant, consisting of a fine of 300,000 pesetas, for a very serious violation of article 99.p of the Securities Market Law (breach of reporting obligation contained in article 53 of the Securities Market Law or a delay in reporting beyond the deadline which was equal or greater than the latter).
21	14/5/1998	National Court	1117/95	Ministry of Finance Order dated 25/9/1995 Confirmed the penalties imposed on a broker-dealer and its chairman - C.E.O, consisting of fines of 26,500,000 pesetas and 2,000,000 pesetas, respectively, for very serious violations of article 99.e of the Securities Market Law (keeping of the accounts and the legally required records with fundamental defects or irregularities which made it impossible to ascertain the firm's financial and net worth position).

Table 8.6 (Cont.)

COURT JUDGEMENTS HANDED DOWN IN 1998 IN APPEALS AGAINST PENALTIES

No.	Date	Court	Appeal number	Appealed Order
22	1/6/1998	National Court	32/95	Ministry of Finance Order dated 31/10/1994 Annulled the penalty imposed on a foreign entity, consisting of a fine of 70,750,831 pesetas, for a very serious violation of article 99.q of the Securities Market Law (performance of activities without a permit).
23	8/6/98	National Court	119/95	Ministry of Finance Resolutions dated 12/12/94 Confirmed the penalties imposed on a director of a broker-dealer, consisting of a fine of five million pesetas for a violation codified in article 81 in connection with article 90 of the Companies Law (financial assistance for the acquisition of own shares) and a fine of 1,500,000 pesetas for a very serious violation of article 99.k of the Securities Market Law (reduction of the equity of broker-dealers and dealers to below 80% of the minimum required level and maintenance of this situation for at least six consecutive months).
24	12/6/1998	National Court	178/95	Ministry of Finance Order dated 28/12/1994 Confirmed the penalties imposed on an individual, consisting of two fines amounting to three million pesetas each, for two violations of article 99.p of the Securities Market Law (failure to report significant holdings) and one of article 99.r of the Securities Market Law (acquisition of a significant holding in a listed company without launching a takeover bid); and it confirmed the penalties imposed on two corporations, consisting of two fines of ten million pesetas and 500,000 pesetas, respectively, for violations of article 99.r of the Securities Market Law (failure to launch takeover bid).
25	3/7/98	National Court	389/95	Ministry of Finance Resolution dated 21/4/98 Partly granted the appeal filed by a broker-dealer in that it annulled the penalty consisting of a fine of four million pesetas for a very serious violation of article 99.l of the Securities Market Law (failure by broker-dealers and dealers to comply with articles 66, 69, 71, 72 and 75), and confirmed the penalty of four million pesetas for a very serious violation of article 99.e of the Securities Market Law (accounting irregularities).
26	9/7/98	National Court	386/95	Ministry of Finance Order dated 21/4/95 Partly granted the appeal in that it annulled the penalty imposed on the appellants, who are members of the board of directors of a broker-dealer, consisting of a fine of 625,000 pesetas for a violation of article 99.l of the Securities Market Law (lack of the appropriate organization and personnel and material resources) and confirmed the penalty consisting of a fine of 625,000 pesetas for a violation of article 99.e of the Securities Market Law (substantial accounting irregularities).
27	9/7/98	National Court	06/388/95	Ministry of Finance Resolution dated 21/4/95 Partly granted the appeal in that it annulled the penalty imposed on the appellant, who was chairman of the board of directors of a broker-dealer, consisting of a fine of 1,250,000 pesetas for a violation of article 99.l of the Securities Market Law (lack of the appropriate organization and personnel and material resources), and confirmed the penalty consisting of a fine of 1,250,000 pesetas for a violation of article 99.e of the Securities Market Law (substantial accounting irregularities).
28	10/7/1998	National Court	140/97	Ministry of Finance Order dated 19/7/1996 Confirmed the penalties imposed on a director of a collective investment scheme management company, consisting of definitive suspension as director, for a very serious violation of article 32.4.a of the Law governing Collective Investment Schemes (accounting irregularities) and a fine of 10 million pesetas for another very serious violation of article 32.4.a of the Law governing Collective Investment Schemes (falsehood or omission of information).
29	10/9/98	National Court	1086/95	Ministry of Finance Order dated 25/9/95 Granted the appeal by the C.E.O. of a broker-dealer against the aforementioned Ministerial Order in which he was fined 5 million pesetas for a very serious violation of article 99.e of the Securities Market Law (... lack of the accounts and legally required records or keeping of same with fundamental defects or irregularities which made it impossible to ascertain the entity's financial and net worth position, or failure to book transactions which it performed or brokered), since the Court found that the Administration had violated article 24 of the Spanish Constitution by undue denial of evidence and breach of the right to presumption of innocence.

Table 8.6 (Cont.)

COURT JUDGEMENTS HANDED DOWN IN 1998 IN APPEALS AGAINST PENALTIES

No.	Date	Court	Appeal number	Appealed Order
30	11/9/98	National Court	6/895/95	Ministry of Finance Resolution dated 25/7/95 Confirmed the penalties imposed on a director of a portfolio management company, consisting of fines of 400,000 pesetas for three very serious violations of article 99.q of the Securities Market Law (in connection with articles 71 and 76.d; and a fine of 1,100,000 pesetas for another very serious violation of the aforementioned article 99.q (performance of investment activities in commercial paper for own account without a permit).
31	24/9/98	National Court	6/992/95	Ministry of Finance Order dated 25/9/95 Partly granted the appeal filed by a securities investment company and the members of its board of directors against the aforementioned Ministerial Order in that it reduced the penalty imposed for violation of article 32.4.b of Law 46/84, governing Collective Investment Schemes (omission or falsehood in accounting), by reducing the amount of the fine.
32	1/10/98	National Court	521/96	Ministry of Finance Resolution dated 29/4/96 Rejected the appeal filed by a collective investment scheme management company and confirmed the penalty, consisting of a fine of 10,000,000 pesetas for violation of article 32.4.g of Law 46/84, governing Collective Investment Schemes (violation of procedure for issuance and reimbursement of units in a FIM fund).
33	7/10/1998	Madrid H.C.J.	1316/96	CNMV Board Resolution dated 18/4/1996 Confirmed the penalty imposed on the C.E.O. of a sports company, consisting of a fine of five million pesetas, for a violation of article 89, in connection with article 74.1, both of the re-consolidated Companies Law, approved by Legislative Royal Decree 1564/1989, dated 22 December (subscription of own shares).
34	22/10/98	National Court	237/96	Ministry of Finance Order dated 15/2/96 Confirmed the penalty imposed on the agent of a broker, consisting of a fine of five million pesetas, for a violation of article 99.t of the Securities Market Law (refusal or resistance to the CNMV inspectorate as a result of failure to furnish documentation demanded by the latter in the exercise of its inspecting functions).

9

MARKET REGULATION

In addition to its more characteristic functions of supervision and inspection, the CNMV also undertakes other tasks which are of considerable importance for the integrity of the securities markets. One important area of activity for the CNMV is to check the fitness of market regulation.

The CNMV's activities aimed at improving market regulation are based on three pillars: exercise of its role as adviser to the Government on matters relating to the securities market, exercise of its regulatory powers (materialized in its power to issue Circulars) and its executive activities, which require ongoing interpretation of the existing rules and establishment of criteria for action. Using these instruments, the Commission works intensively to achieve more efficient and transparent markets with a high level of investor protection.

Because its daily activity places it in permanent contact with investors, issuers and market operators, the CNMV is ideally placed to detect the regulations which no longer respond to market needs and expectations and to advise legislators on how to change existing regulations and how to regulate new sectors. Moreover, because of its close relations with other supervisory bodies in the framework of various international forums, it has first-hand information on experiences in other markets and moves under way in other countries.

There were considerable regulatory changes in 1998 due to the need to transpose the Investment Services Directive into Spanish law. The CNMV closely monitored the process of drafting the regulations which might have an impact on the securities markets. Consequently, a wide range of regulations were introduced, all aimed at providing increased efficiency and transparency, in line with investor demands, thereby enhancing our markets' capacity to compete internationally.

Law to Reform the Securities Market Law

The approval of *Law 37/1998 to reform Law 24/1988, dated 28 July, on the Securities Market*⁽³⁴⁾ was a milestone in the development of Spain's securities markets. The law introduced numerous changes and important new features which go far beyond the regulation of the securities market per se and affected a broad range of regulations, ranging from the Companies Law, the Law on Collective Investment Schemes and the Law on Money Drafts and Checks.

The reform Law arose mainly from the need to transpose the Investment Services Directive (ISD) into Spanish law and to adapt certain parts of the Securities Market Law to the Constitutional Court judgment dated 16 July 1997⁽³⁵⁾. Other modifications were made in order to introduce technical improvements and liberalize certain sectors of the markets.

(34) The text of the legislation which affects the securities market can be found on the CNMV's web page.

(35) For details of this judgment, see chapter 10 of the 1997 Annual Report.

The Comisión Nacional del Mercado de Valores made a number of proposals in the process of drafting the Reform Law. Certain items in the Law which seek to remedy major deficiencies existing previously in the legislation on the securities markets are the result of CNMV proposals. These fundamental changes, which market operators had been calling for insistently, relate to such matters as pledges and loans of securities, netting, double and simultaneous transactions and the right of separation for the SCLV and the Stock Exchanges with respect to the guarantees provided to them.

For example, the Sixth Additional Provision of the Law contains a new regulation on pledges of securities listed on the secondary markets and represented by book entries, when the pledge is given to cover obligations acquired vis-à-vis a secondary market or its clearing and settlement systems. The new system allows pledges to be constituted in the form of private documents or merely by means of a unilateral declaration, and it establishes a very fast, efficient system for execution. This makes securities pledges into the fast, flexible instrument which the markets had demanded for the purpose of providing guarantees. This system was also extended to pledges to secure obligations acquired to the Bank of Spain in the exercise of the latter's monetary policy transactions.

In the same line of improving the workings of the markets by enhancing the system for provision of guarantees, rights of separation have been given to the SCLV and the Bank of Spain in connection with transactions in the market of book-entry government securities and to the market management companies in respect of guarantees provided to them.

The Eleventh Additional Provision establishes that in financial transactions on derivatives carried out under a netting agreement, where one of the parties is in a situation of insolvency, only the net amount of the financial transactions covered by the agreement will be included in the creditor's assets. Recognition of netting reduces the equity requirements and brings Spain's regulations into line with the most advanced countries in this area.

Article 36 of the Securities Market Law regulates the loan of securities traded on a secondary market. This improves legal security and the market's efficiency and also provides a regulatory framework under which an appropriate tax regime can be established - an essential requirement for the development of this practice. Moreover, the Twelfth Additional Provision provides the possibility for double transactions and repos to be recognized as secondary-market transactions.

In addition to these modifications, in which the CNMV played a major role, the Reform Law also contained other important new features which include, among others, the following:

- The scope of the Law was extended to new financial instruments in the terms of the Investment Services Directive.
- The composition of the CNMV's Advisory Committee was modified to admit members of the official secondary markets in general (and not only of the stock markets) and the Autonomous Regions with powers in the area of securities markets which have an official secondary market. Moreover, the powers of the Advisory Committee were adapted to the new provisions of the law on subjects and the market.

- The requirements for issuance of securities similar to those already traded on the secondary market were eased.
- The distribution of powers between the State and the Autonomous Regions conforms to the differentiation between State-wide markets and regional markets.
- Certain modifications were made with regard to listing and delisting of securities.
- Another modification made as a result of the ISD is a new classification of transactions. A distinction is made between market operations and off-market operations. The former are divided into ordinary and extraordinary, depending on whether or not they are subject to rules of the official secondary market in question.
- Spanish broker-dealers, brokers and credit institutions and investment firms and credit institutions authorized in other Member States of the European Union are allowed to become members of the official secondary markets. Nevertheless, this will not apply to credit institutions until 1 January 2000.
- The law regulates markets in derivatives, which are already developed in the Spanish financial system.
- The concept of public offering of securities was extended to cover not only unlisted securities but also those already listed on a secondary market.
- Title V regulates the “investment firms” covered by the ISD. The law applies the term investment firm, in its strict sense, to broker-dealers, dealers and portfolio management companies. Credit institutions are treated as equivalent to investment firms as regards their capacity to operate in the markets. The possibility of creating institutions or of empowering other persons or institutions to carry on any of the activities of the investment firm, subject to limitations, is provided.
- The law regulates the “Community passport” for European Union companies and for Spanish companies to operate in the rest of the EU.
- Title VI lays the foundations for the creation of one or more investor compensation funds to compensate investors who fail to recover cash or securities in the event of insolvency or bankruptcy of investment firms.
- The supervisory powers of the CNMV were extended and new penalty types were introduced.

- The Fifth Additional Provision amended certain items in the consolidated Companies Law in order to facilitate the financing of companies in the financial markets. In this line, preferred shares and, in particular, non-voting shares were regulated. The regime for listed companies was made more flexible in view of their greater transparency. The possibility was introduced of issuing securities which are a cross between equities and fixed-income. Noteworthy in this connection was the new regulation of what are called “redeemable shares.” The period for exercising the pre-emptive subscription right in listed companies was reduced to fifteen days. The requirements for elimination of the pre-emptive subscription right were made more flexible in order to facilitate capital increases as a source of finance for companies. The aim is also to facilitate faster listing of the shares issued in a public offering of new shares.

Book on a decade of case law in the securities market

To mark the tenth anniversary of the Securities Market Law, the CNMV’s legal department compiled, selected and systematized the case law which has been handed down in that time on the subject of securities markets. There are more than 60 judgments, mostly from the Madrid High Court of Justice (in appeals against CNMV Resolutions), the National Court (in appeals against Ministry of Finance Resolutions) and a few judgments by the Supreme Court in response to further appeals.

Most judgments related to penalties (considering the size of the penalties which can be imposed under Title VIII of the Securities Market Law and under Law 46/1984, dated 26 December, governing Collective Investment Schemes). However, they do not deal only with penalties and some of the judgments contain vital decisions on such questions as takeover bids, the interpretation of the concept of group in article 4 of the Securities Market Law and the legal status of the clearance of prospectuses.

The book is structured so as to reveal which articles were covered most often in the court decisions and includes a brief summary of the court’s position plus the full text of the judgments.

By publishing this document, the CNMV’s legal department seeks to provide researchers, jurists and, generally, anyone interested in the law of the securities markets, with a very useful instrument in a field in which case law was relatively little known due to the difficulty of obtaining certain judgments and the lack of a systematic compilation.

Royal Decree modifying the legal regime of the securities markets

In addition to the Law for the Reform of the Securities Market Law, 1998 also saw the approval of another important instrument in the regulation of the markets, namely *Royal Decree 2590/1998, dated 7 December, modifying the legal regime of the securities markets*, which had a pronounced tendency towards liberalization and flexibility; the Royal Decree amended the following Royal Decrees:

- Royal Decree 291/1992, dated 27 March, on issues and public offerings of securities .
- Royal Decree 377/1991, dated 15 March, on reporting of significant holdings in listed companies and acquisition of own shares by listed companies.
- Royal Decree 116/1992, dated 14 February, on the representation of securities by book entries and the clearing and settlement of stock market transactions.
- Royal Decree 1814/1991, dated 20 December, regulating the official futures and options markets.
- Royal Decree 1197/1991, dated 26 July, on the regime of takeover bids.

The amendments to the decrees on issues and significant holdings affected their overall content, whereas the amendments to the other decrees were more restricted and scope and consisted basically of technical improvements.

The purpose of the amendment to the decree on issues is to provide greater flexibility in issues and public offerings of securities. In addition to numerous technical improvements, certain new features were added to the issues decree which will have a considerable impact on the primary securities market and will facilitate and increase the efficiency of issues and placement of securities in the Spanish market. It also specifies more precisely the scope of the Decree, increases the number of partial exceptions, covers new types of prospectuses and simplifies the method for modifying securities in circulation. An immediate consequence of this reform will be the forthcoming approval of a CNMV Circular modifying the issue prospectuses for fixed-income securities, which will undoubtedly play an important role in revitalizing the fixed-income markets.

The main new feature introduced into the significant holdings decree is the reduction of the threshold for disclosing the acquisition from 5% to 1% if the acquirer is resident in a tax haven. Moreover, the CNMV is also empowered to update the information contained in the register of significant holdings and treasury stock and to remove any information which is no longer accurate due to failure to update it.

The main change in the decree on the representation of securities by book entries and the clearing and settlement of stock market transactions is the possibility of establishing an alternative procedure to the tracking numbers.

Other regulations which affect the securities markets

Many other regulations relating to the securities markets were approved in 1998. Although, unlike those described above, they did not affect market regulation on an overall level, some of them are particularly relevant and are discussed below.

The system of CNMV fees, which directly affects issuers and supervised firms, was substantially modified by *Royal Decree 1732/1998, dated 31 July, on the fees applicable for activities and services provided by the Comisión Nacional del Mercado de Valores*. This decree was a major effort to adjust the fees to actual supervision costs. At the same time, it combined in a single regulation all the rules on this subject and increased the legal security of its users.

Particularly noteworthy with regard to the primary securities markets was *Royal Decree 926/1998, dated 14 May, which regulates asset securitization funds and securitization fund management companies*. Article 16 of Royal Decree-Law 3/1993, dated 26 February and, subsequently, Law 3/1994, dated 14 April, adapting Spanish legislation on credit institutions to the Second Banking Coordination Directive, had already provided the possibility of extending the system for mortgage-backed securities to other loans and debt-claims. The two basic features of an asset securitization fund are, on the asset side, the possibility of including present or future financial assets and other debt claims. On the liability side, the general rule is that the funds must issue fixed-income securities. Moreover, the Royal Decree provides for the formation of securitization fund management companies, a new type of company into which the current mortgage securitization fund management companies can convert.

Also of note in connection with primary markets was the approval of *CNMV Circular 4/1998, dated 22 September, amending the forms for half-yearly public reporting by insurance institutions with securities admitted to listing on the securities markets*.

Regarding collective investment schemes, in order to contribute to the development of the rented housing market, *Law 29/1998, dated 1 July, reforming the legal and tax regime for real estate collective investment schemes and on the assignment of certain debt claims of the General State Administration* seeks to foster the development of real-estate collective investment schemes. The main new features introduced by the Law are as follows:

- It is possible to make contributions in kind, and to acquire unfinished properties. In certain cases, the same person may be an investor and a lessee at the same time. It is also possible to be flexible with the deadlines for attaining the coefficients of obligatory investment in real estate.
- The company tax rate is 1% if the investment in housing totaled 50% of the assets during the entire tax year.
- Real-estate collective investment schemes may invest in university residences and retirement homes.
- The period for retaining properties in order to qualify for the specific tax regime is reduced from 4 to 3 years.
- The scope is extended for regulations to permit contributions in kind by shareholders or investors.
- The State was authorized to dispose of the debt claims arising from the loans granted by the National Housing Institute and, subsequently, by the Institution for the Public Development of Housing.

In 1998, a number of Ministerial Orders and Circulars were approved relating to collective investment schemes, specifically the *Order dated 23 April 1998 amending the Order dated 12 July 1993 governing prospectuses and other implementations of Royal Decree 291/1992, dated 27 March, on issues and public offerings of securities and the Order dated 1 October 1998, on causes for updating of prospectuses and the abridged quarterly report by securities investment funds and money market investment funds.*

Also on the subject of collective investment schemes, the Comisión Nacional del Mercado de Valores approved *CNMV Circular 3/1998, dated 22 September, on transactions in derivatives by collective investment schemes*, which complements the preceding CNMV Circular 3/1997, dated 29 July, governing the obligations on reporting to shareholders and investors by financial collective investment schemes and certain implementations of the Ministerial Order dated 10 June 1997, on transactions in derivatives by collective investment schemes. The fundamental goal of this Circular is to specify the limits on the use of financial derivatives in terms of market and counterparty risk. The Commission also approved *CNMV Circular 2/1998, dated 27 July, on the statistical reporting requirements applicable to collective investment schemes in the European Monetary Union.*

In connection with broker-dealers and dealers, the CNMV approved two important regulations: *CNMV Circular 1/1998, dated 10 June, on systems of internal control, monitoring and on-going evaluation of risks and CNMV Circular 5/1998, dated 4 November, on agents of broker-dealers, dealers and portfolio management companies.* The latter established the new procedure to be used in notifying to the CNMV the powers granted by broker-dealers, dealers and portfolio management companies to operate in the securities market.

With regard to the secondary market in securities, the *Order dated 23 September 1998 amending the Order dated 25 March 1991 on the credit system in spot transactions in the stock market* amended section 6 of point one of the Order dated 25 March 1991 by establishing the minimum cash amount for buy or sell orders for securities in margin trading.

Also noteworthy was the approval of *Law 46/1998, dated 17 December, on the introduction of the euro*, whose aim was to complete the legal regime required for the introduction of the euro as the single currency within the Spanish monetary system, as provided in Council Regulations numbers 1103/97, dated 17 June, on certain provisions relating to the introduction of the euro, and Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro. The introduction of the euro also led to the approval of the *Order dated 23 December 1998 on the unit of account in the reporting obligations of the management bodies of the securities market and of collective investment schemes and on the expression in euros of certain requirements relating to the system of credit in spot stock-market transactions and special stock market transactions and CNMV Circular 7/1998, dated 16 December 1998, making euro-related amendments and adaptations to certain circulars on the secondary markets in securities and the market management companies, broker-dealers and dealers, collective investment schemes, reporting of significant holdings and periodic public reporting by entities with securities admitted to listing on the stock markets.*

European Community Directives

- *European Parliament and Council Directive 98/26/EEC of 19 May 1998 on settlement finality in payment and securities settlement systems⁽³⁶⁾*. With a view to the attainment of EMU, this Directive seeks to contribute to the efficient and profitable working of cross-border payments and securities settlements in the Community. To this end, it establishes provisions regarding netting and transfer orders, insolvency proceedings, and the rights of holders of collateral security in the event of insolvency of the party which provided the guarantee.
- *European Parliament and Council Directive of 98/31/EEC of 22 June 1998, amending Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions*. The amendment to Directive 93/6/EEC was due to the need to specify the market risks relating to transactions in commodities and derivatives on them, and to extend the definition of portfolio to include positions in commodities or their derivatives.
- *European Parliament and Council Directive 98/33/EEC of 22 June 1998 amending Article 12 of Directive 77/780/EEC on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, Articles 2, 6, 7, 8 and Annexes II and III of Directive 89/647/EEC on a solvency ratio for credit institutions and Article 2 and Annex II of Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions*. This amended Directive 93/6/EEC by introducing a new definition of what is understood to be derivatives traded on unorganized markets. It also amended Annex II of the Directive by declaring Annex II of Directive 89/647/EEC to be applicable to the calculation, by firms, of the capital requirements for their derivatives traded on unorganized markets.

(36) The text (Spanish-language version) of the Directives relating to the securities market can be found in the DELFOS section of the CNMV's web page.

CNMV working papers available for public consultation

Like the regulatory bodies of other countries (basically the US and the UK), the CNMV has posted a web page containing working documents in order to obtain opinions on the content and scope of possible draft regulations. The aim is to seek maximum transparency and a broad consensus with the sector in the process of drafting regulations governing the securities market. Heading the web page is an express commitment by the CNMV to carefully study all comments it receives and to take them into account, as appropriate, in the process of drafting regulations.

To date, the following CNMV working papers have been posted on the web:

- No. 1/98: Working paper on the establishment of limits on transactions in derivatives by collective investment schemes.
- No. 2/98: Working paper on the modification of the forms for periodic public reporting to the CNMV by listed insurance firms.

This initiative has greatly facilitated access by the sector to information on the guidelines behind the two proposed regulations. Consequently, although very few written comments on the two documents have been received to date, there has been a significant increase in the number of telephone queries and comments on these proposals, in which callers have expressly identified the working paper posted on the Internet as the source of information motivating the call.

Executive acts: CNMV Interpretative Letters⁽³⁷⁾

The CNMV's activities in regulating the market are not confined to the strict framework of the regulatory sphere. Its Interpretative Letters – simple letters addressed by the CNMV to all parties operating in the markets – are an important executive instrument for regulating market activity since they enable the CNMV to inform the market participants of the interpretations and criteria which will guide its actions on a given subject. Though introduced only very recently (the first was issued in 1996), the Interpretative Letters have gained recognition in the markets as an instrument which increases legal security and enables the supervisor's interpretations and recommendations to be conveyed quickly to the market.

Because they are drafted quickly and easily, CNMV Interpretative Letters have become very useful, as evidenced by the fact that most Securities Commissions in the advanced countries have similar mechanisms in place.

In 1998, the Comisión Nacional del Mercado de Valores continued to draft Interpretative Letters with the intention of enhancing communication with the market players. Some of the principal Interpretative Letters issued in 1998 were the result of the exchange of views with the parties involved during intense working sessions.

(37) For an explanation of their significant, see the box on "CNMV Interpretative Letters" in chapter 10 of the 1997 Annual Report.

Treasury stock

In order to address such a sensitive matter as treasury stock, the CNMV maintained close contact with representatives of Spain's big banks and principal issuers in order to attain a high degree of consensus. After several joint working sessions, an Interpretative Letter was drafted to provide a number of criteria enabling issuers to operate with own shares with the assurance of not affecting the price-formation process. Accordingly, a "safe harbor" was created which can be used by issuers that frequently operate with own shares to provide liquidity in the market. The creation of the safe harbor does not pre-judge the actions of issuers who choose not to make use of it.

The introduction into the Spanish market of the US-style safe-harbor approach greatly increases players' legal security and is particularly beneficial for operators as, without introducing any prohibitions or altering existing legislation, it delimits areas in which market players can operate with greater security. While scrupulously respecting listed companies' freedom to operate with own shares provided the legal limit of 5% of the capital stock is not exceeded, the Interpretative Letter established criteria which allow those who comply with it to buy or sell own shares in the continuous market with the assurance that they are not affecting the price-setting process and, consequently, are not violating the prohibition on manipulating prices.

During 1999, the CNMV will carefully analyze how operational the criteria contained in this Interpretative Letter have actually proven to be in practice and will obtain opinions for this purpose from securities issuers, particularly credit institutions, so as to modify the criteria if it is considered advisable.

Price-sensitive events

Over one year after the first Interpretative Letter on the subject of price-sensitive information, which was dated 7 July 1997, the CNMV observed that, although the Letter contributed notably to reflection on the forms and scope of notification of price-sensitive events and served to increase securities issuers' sensitivity to this matter, it also had some areas susceptible to improvement. The Letter was revised while taking careful note of the opinions which had been received from some of the addressees, particularly the Asociación Española de Banca.

The result of this process was a new Interpretative Letter on price-sensitive information which was issued in December 1998 in place of its predecessor. One of the major changes was the distinction between "events" and "decisions", which is of vital importance in determining when to disclose the information. Issuers were reminded that, if they did not wish to divulge a decision, they could notify the CNMV on a confidential basis or, in certain circumstances, maintain the decision secret. The new Interpretative Letter provided a number of recommendations for strengthening secrecy in the phase prior to decision-making and, generally, the confidentiality of information which has not yet been disclosed.

Reporting on compliance with the Code of Good Corporate Governance

Of the several possibilities open to the CNMV in connection with reporting on the adoption of the Code of Corporate Governance, the one which is most respectful of the voluntary nature of adoption was chosen. The CNMV considers that, since compliance with the Code is voluntary, its recommendation no. 23, which establishes that “the Board of Directors should include information about its rules of governance in the annual report, and justify any departures from the recommendations of this Code,” is only applicable to those listed companies which have decided to apply the Code.

However, without prejudice to the framework of freedom with respect to the content and form of the information, the CNMV considers that it is more effective if it reaches its users in a systematic, homogeneous and readily-comprehensible form. Consequently, the CNMV has developed a reporting form which can be used by companies which decide to adopt the Code. This form should be included in the public annual report as a document in addition to financial statements, notes to financial statements, management report and auditors’ report.

Other Interpretative Letters

In addition to the three discussed above, in 1998 the CNMV drafted other Interpretative Letters relating to such matters as publicity relating to collective investment schemes, special block trades of shares and that contained in the manual of procedures deriving from the euro and applicable to supervised firms and listed entities.

10

INTERNATIONAL ACTIVITY

IOSCO

The CNMV is a member of the IOSCO's Technical Committee and participates actively in this worldwide organization's five working parties, which include representatives of nearly all the national authorities with supervisory powers over securities markets. In connection with this important international organization, Spain (through the CNMV and the Ministry of Economy and Finance) has presented its candidacy to host the organization's headquarters in Madrid.

The activities of IOSCO's working parties in 1998 include most notably the following:

Multinational offerings of securities and accounting

After several years' work, a noteworthy achievement was the approval of a form of prospectus which can be used in cross-border issues. This document refers only to shares and is not applicable for internal purposes. In this connection, "internal" is taken to refer to the territory of the European Union as a whole, where the related Directives remain in force. Consequently, the approval of this prospectus facilitates issues and public offerings of shares in non-EU states by issuers domiciled in the EU. Likewise, non-EU issuers may use the form when offering securities in EU markets.

The working group must also complete the process of harmonization, possibly during 1999, by approving the international accounting criteria which must be accepted in the various jurisdictions which subscribe to the IOSCO agreement. This will significantly reduce the costs incurred by transnational issuers when drafting financial statements in line with the accounting criteria of their home country and the country of issue. The immediate impact of the approval will be a modification of the accounting Directives, which must be amended to take account of certain fundamental principles, such as the "fair value" principle applicable to financial instruments. In the medium and long term, individual countries' accounting standards, or at least those applied to entities admitted to listing in regulated markets, are likely to converge on those accepted internationally.

The group is also discussing the advisability of further harmonizing the general auditing principles applicable to the financial statements of cross-border issuers. The final decision in this connection must be adopted by the IOSCO's Technical Committee.

Secondary Markets

This group focused on the Year 2000 problem in the markets' computer systems. It is also drafting a number of practical recommendations for the supervision of secondary markets and it continues to work on matters related to loans of securities, in coordination with the Basle Committee.

Securities firms

Two very important documents in the area of prudential supervision were approved in 1998:

- *“Methodologies for determining minimum capital standards for internationally active securities firms which permit the use of models under prescribed conditions”*. The CNMV took account of the recommendations contained in this document when it drafted its CNMV Circular 3/98⁽³⁸⁾, which allows collective investment schemes to use a “free” method for measuring market risk.
- *“Risk management and control guidance for securities firms and their supervisors”*. Lays down principles which should inspire securities firms and supervisor in connection with the implementation, subsequent operation and supervision of internal control systems⁽³⁹⁾.

Other matters dealt with in the framework of IOSCO

In addition to the results produced by the two working groups mentioned above, two major special projects⁽⁴⁰⁾ which commenced in 1997 were concluded in 1998:

- The approval of the document entitled “Objectives and principles of securities regulation”, considered to one of the most important in the organization’s history. It establishes 30 principles aimed at protecting investors, making markets fair, efficient and transparent and reducing systemic risk. They may also serve as a reference for the institutions which report on or study the systems in place in the various countries.
- “Securities activity on the Internet”, drafted by an ad hoc group of experts. The resulting report makes 24 recommendations aimed at orienting regulators’ policies vis-à-vis the Internet.

IOSCO also took note of the difficulties created by the crisis in the Asian and Latin American markets and concerns raised about the difficulties of supervising hedge funds; as a result, it has launched special projects to improve supervisory action in such situations.

European Union

FESCO

The *“Forum of European Securities Commissions”* (FESCO), which comprises the Securities Commissions of all the European Union countries plus Norway and Iceland, was launched in 1998 under the presidency of Germany. The CNMV is one of the five Securities Commissions comprising FESCO’s permanent General Secretariat.

Four working groups were established to explore possible pathways for harmonization in areas not covered by the Directives. The areas of work which they cover are as follows:

(38) CNMV Circular 3/98, dated 22 September, on transactions in derivatives by collective investment schemes. For details of same, see the box entitled “New regulation on operations by collective investment schemes with derivatives”, in chapter 6.

(39) See the box entitled “Systems of internal control, monitoring and ongoing evaluation of risks”, in chapter 6.

(40) All the IOSCO documents are available at its web site (www.iosco.org) and some are available on the CNMV’s web site (DEL-FOS section).

- Exchange of information among supervisors.
- Standards to be complied with by regulated markets.
- Rules of conduct applicable to providers of investment services.
- Qualification of partners and administrators of investment firms.

FESCO is also designing the standards applicable to participants in public offerings and, in the near future, it will begin to explore possible ways of updating the Directive on issue prospectuses.

Progress in cooperation among FESCO member countries

Multilateral agreement on exchange of information and surveillance of securities markets

The increasing internationalization, harmonization and interdependence of Europe's financial markets, arising from technological progress and the consolidation of the internal market in financial services, requires efforts by regulators in order to efficiently perform their functions.

To this end, at the end of January 1999 the members of FESCO signed a document entitled "Multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities" whose principal objective is to foster the exchange of information among regulators in the course of their duties.

It is also expressly acknowledged that the competent authorities affected by a specific investigation in any of the matters covered by the Agreement may conduct such investigation jointly, share work and responsibilities and decide, by mutual agreement, on the action to be taken.

FESCOPEL

In connection with the content of the aforementioned Agreement and as a necessary step towards its full implementation, the signatories agreed that the persons in each country in charge of surveillance of the securities markets and the exchange of information should meet regularly to discuss any matters which are considered necessary in the framework of international cooperation. This group, called FESCOPEL, may use informal procedures to share experiences on problems and difficulties detected in the discharge of their duties and propose modifications to improve the Agreement's efficacy.

EU Directives

In the specific area of EU regulation of the securities markets, 1998 saw the approval of the Directive on the finality in payment and securities settlement systems⁽⁴¹⁾, and the proposal for a Directive on contracts for remote provision of financial services between providers and clients was revisited. Moreover, work is continuing on the modification of the Directive on UCITS⁽⁴²⁾ and of the Directive on takeover bids.

Collaboration with the Swiss Federal Banking Commission

Switzerland's March 1995 Federal Act on Stock Exchanges and Securities Trading brought considerable improvements in the field of international cooperation, facilitating cooperation by Switzerland's regulator (Swiss Federal Banking Commission) with foreign supervisors which, like the CNMV, meet certain requirements as to confidential treatment of information and its use in the supervision of the securities markets.

As an immediate application of the new legal provision, in January 1999 Spain was among the first three countries to receive from the Swiss regulator a response to requests for information on ownership made by the CNMV in an investigation into possible use of inside information in a takeover bid. This opening to cooperation by a country which has traditionally been reluctant to exchange information provides new avenues for detecting and combating illegal activities in the securities markets.

Other activities

The CNMV continued to participate as a member in the Joint Forum, comprising some representatives of IOSCO, the Basle Committee and the International Association of Insurance Supervisors. The objective of this forum is to study, through its working groups, the problems of supervising financial conglomerates operating in the banking, securities, and insurance businesses.

In the area of information exchange and international cooperation, CNMV signed two new memoranda of understanding in 1998, one with the Commission des valeurs mobilières du Québec on 14 September and one with El Salvador's Superintendencia de Compañías on 23 November.

Additionally, the traditional contacts with Latin American supervisory bodies were intensified in 1999, and delegations from Argentina, Costa Rica, Mexico, El Salvador, Bolivia, Ecuador, Venezuela and Guatemala were received and provided with technical assistance.

(41) European Parliament and Council Directive 98/26/EEC, of 19 May 1998, on settlement finality in payment and securities settlement systems.

(42) Undertakings for collective investment in tradable securities.

Annex 1

COMPOSITION OF THE CNMV BOARD

President: Juan Fernández-Armesto

Vice-president: Luis Ramallo García

Commissioners: José Manuel Barberán López
Jaime Caruana Lacorte ⁽⁴³⁾
Miguel Martín Fernández ⁽⁴⁴⁾
José M^a Roldán Alegre ⁽⁴⁵⁾
Pilar Valiente Calvo ⁽⁴⁶⁾

Secretary: Antonio J. Alonso Ureba

(43) Director-General of the Treasury and Finance Policy

(44) Deputy Governor of the Bank of Spain.

(45) Appointed on 19 March 1998 in place of José M.^a Gondra Romero, whose mandate concluded on 3 November 1997.

(46) Appointed on 3 December 1998 in place of Francisco L. de Vera Santana, whose mandate concluded on 3 November 1998.

Annex 2

COMPOSITION OF THE CNMV ADVISORY COMMITTEE

President: D. Luis Ramallo García

Secretary: D. Antonio J. Alonso Ureba

REPRESENTATIVES

Issuers: D. Agustín Ramos Varillas
D. Luis Menéndez Onrubia
D. Manuel Vecino Riera

Investors: D. Mariano Rabadán Fornies
D. Jesús Barreiro Sanz

Stock Exchange Members:

D. José Atonio de Bonilla y Moreno
D. Enrique Piñel López
D. Jaime Aguilar Fernández-Hontoria
D. Gregorio Arranz Pumar

Consumers and Users Council:

D. Manuel Pardos Vicente

Autonomous Regions:

Valencian Government:

D. José Manuel Uncio Lacasa

Basque Government:

D. Juan Miguel Bilbao Garai

Catalan Government:

D. Francesc Xavier Ruiz del Portal i Bravo

ALTERNATIVE REPRESENTATIVES

Issuers: D. Pablo Lamberto Urrutia
D. José Antonio Guzmán González
D. José Luis Martinavarro Ferrer

Investors: D. Antonio Malpica Muñoz
D. Francisco Javier Palomar

Stock Exchange Members:

D. Fernando de Roda Lamsfus

D. Ignacio García Barrero

D. Carlos Morales Martinol

D. Pablo Prada Hernández

Consumers and Users Council:

D. Enrique García López

Autonomous Regions:

Valencian Government:

D. Julián Fernando Talens Escartí

Basque Government:

D. Miguel Bengoechea Romero

Catalan Government:

D. Jaume Pera i Lloveras