

**COMISION NACIONAL DE MERCADO DE VALORES
(SPAIN)**

**ANNUAL REPORT
1997**

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Translated by: John J. Rynne
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LETTER FROM THE PRESIDENT OF THE CNMV

- 1 *When I took office as President of the CNMV in October 1996, I publicly made two commitments: to simplify the regulations, making their interpretation and application more flexible, and to shorten delays and reduce red tape, formalities and requirements without impairing the other great responsibility entrusted to the Commission, namely, protecting investors. It would of little service to the Spanish securities market if the much-needed process of innovation and flexibility were not accompanied by an increasing emphasis on investor protection and by demands for responsibility by the market players.*

This commitment took shape six months later when I publicly presented and assumed a Program of Action for the full four-year mandate (the full text can be found at the CNMV's web site: <http://www.cnmv.es>). Barely eighteen months later, I have the satisfaction of seeing much of the program completed and the pending matters well advanced. Moreover, the program helped to reveal lacunas and identify new goals and problems. The initial program has been revised continuously, thus confronting us constantly with new challenges and demanding an ever-renewed commitment.

This could not have been achieved without the support, dedication and generous efforts of the Vice-President, Luis Ramallo, the Board and all the professionals who work at the CNMV.

- 2 *One of the main lines of action by the Commission in 1997 was a campaign for transparency in the markets. We spared no effort to ensure that listed companies report loyally and accurately to investors.*

Since we must also practice what we preach, the CNMV is also obliged to provide transparency with regard to its own actions. In this Report the reader will find a multitude of data and commentaries on:

- *the Commission's resources and how we use them,*
- *the forms and goals of our supervision of financial firms,*
- *claims we receive and how we respond,*
- *criteria we use in checking tender offers and equity offerings,*
- *disciplinary proceedings which commenced and concluded, and the court sentences issued in this connection.*

The bulk of the data regarding the CNMV, including this Annual Report, is available free of charge via the Internet.

- 3 *A qualitative change is in evidence in the Annual Report which we present today: the securities markets are becoming increasingly important, not only as a source of corporate finance but also, above all, as an instrument of saving for ever-increasing circles of Spanish society and as an instrument for regulating good governance in the large listed companies.*

The Commission supervises the securities markets, and society places increasing demands on the Commission. Society's expectations are a heavy burden to bear. Good supervision in a time of sharp changes and high volatility, with resources which are always scarce, is a major challenge.

We have responded by modifying our methods of supervision and increasing our resources, within reason. The reader will find exhaustive details of these matters within this Report.

- 4 *The Commission's capacity to respond to rapid changes in the financial markets has been hindered by the slow pace of legislative reform. In 1997, only one Royal Decree and three Ministerial Orders were issued with regard to the securities markets. Spain is the only country in Europe which has yet to incorporate the Investment Services Directive into its domestic legislation, despite the fact that the deadline expired years ago.*

In view of this situation, the CNMV placed particular emphasis on drafting Interpretative Letters which interpret current legislation; eleven Interpretative Letters were issued in 1997, some of particular importance. The Commission also issued a number of recommendations to the financial sector, and it has opted for a more flexible interpretation of the regulations wherever possible, provided that this is not detrimental to the overall security of the markets or to investor protection.

- 5 *Looking back on 1997, we had some successes and some difficult times.*

The Commission sought to reduce red tape (and, therefore, costs) without thereby impairing the overall security of the system; the transparency and responsibility of the market players have been increased considerably, major areas of investment have been liberalized, and access by unlisted companies to market finance has been facilitated.

There have also been unpleasant events. I refer to the penalties which the Commission, acting with its legal authority, imposed on companies and persons which breached the regulations and jeopardized our markets' efficiency and credibility. This is the painful duty of all regulators, but it serves to improve transparency, the system's efficiency and investor protection.

- 6 *At the same time, the CNMV set itself two challenges: to help to improve governance in listed companies, and to reform the financial and mercantile regulations.*

The commission of experts appointed by the Government to draft the Code of Corporate Governance, chaired by Prof. Olivencia and with our Vice-President, Luis Ramallo, representing the CNMV, has worked hard to produce a magnificent result which is about to be published. The next step will be to disseminate information about the Code's virtues so as to encourage the companies listed on our markets to adopt it voluntarily.

A second commission of experts, appointed by the CNMV, has already started work on identifying and proposing changes to the financial and mercantile regulations. This Commission, chaired by Prof. Javier García Enterría, with the assistance of the Treasury and the Bank of Spain, is taking the first step of drafting a proposed reform of the mercantile legislation governing securities; we expect the first results to be available in mid-1998.

- 7 *There are still considerable challenges ahead. Monetary Union will raise competitiveness and undoubtedly trigger changes in the structure of our securities markets. Domestic securities markets in Europe are merging, and there is an increasing number of cross-border interconnections and integrations. The sector has the unlimited support of the CNMV in any decision which strengthens Spain's position as a financial center.*

The Sociedad de Bolsas and the CNMV have a permanent working party which has already designed a new trading system for the electronic market in equities. The fixed-income markets must adopt a single trading platform to prevent dispersion from triggering relocation of this business in

other more efficient markets. The Securities Clearing and Settlement System must improve its interconnections with the Bank of Spain's system in order to achieve an agile system enabling private securities to play a role in monetary policy. Investment services firms must enhance their provision of loyal advice to customers, as they are bound to do, particularly within that process. And we must all make our contribution to increasing our country's financial culture and wealth.

Those are the challenges facing us in the year ahead.

Madrid. 25 February 1998

Juan Fernández-Armesto

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ABBREVIATIONS

ANNA :	Association of National Numbering Agencies
AV:	Agencia de valores / Broker
AVB:	Agencia de valores y bolsa / Broker-dealer
CNMV:	Comisión Nacional del Mercado de Valores
ISD:	Investment Services Directive
FIAMM:	Money market fund
FII:	Real estate investment fund
FIM:	Securities investment fund
IIC:	Collective investment institutions
ISIN:	International Securities Identification Number
MEFF RF:	Fixed-income financial future market
MEFF RV:	Equities financial futures market
MOU:	Memorandum of understanding
IOSCO:	International Organization of Securities Commissions
OTC:	Over the counter
SCLV:	Securities clearing and settlement service
SGC:	Portfolio management company
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 & market member
UVM:	Market Monitoring Unit

1

STRUCTURE OF THE CNMV

Organization structure

The CNMV has modified its organization structure to discharge its duties more efficiently in a context of growth in the sector under its supervision and to face the challenges posed by new Europe-wide developments. The restructuring took place in two stages.

The first stage, culminated in February 1997, involved the following steps:

- Creation of the Securities Market Development Division with the mission of supporting the creation of new investment services companies and collective investment institutions and of developing rules and initiatives for promoting the securities market.
- Assignment of the monitoring of all investment services companies and collective investment institutions to a single division - Supervision – in order to concentrate the inspection of all finance groups in a single unit.
- Creation, within the Inspection Division, of a Market Monitoring Unit to strengthen resources for detecting illicit practices in connection with price formation, improper use of inside information and money laundering.

The second part of the restructuring took place in early 1998 and was based along the following lines:

- The basic supervision and development activities were grouped into four Directorates-General: 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.
- The new Strategy Division's primary purpose is to implement a strategic plan for the Spanish markets and develop regulation for them with a view to the new situation which will prevail after 1 January 1999, when the third phase of Monetary Union commences.
- The Supervision Division centralizes all the functions of on site inspection, monitoring of secondary markets and prudential supervision of investment services companies and collective investment institutions.
- Area Departments were created within certain Divisions: Market Monitoring (under Supervision), International Relations (under Strategy), and Official Registries and Documentation (under General Secretariat).

Table 1.1

STRUCTURE OF THE COMISION NACIONAL DEL MERCADO DE VALORES

	DIVISION	FUNCTIONS
BOARD	Strategy	Strategic planning. Regulatory implementation. International relations of the CNMV.
	Development	Creation and monitoring of securities firms and collective investment institutions. Institutional relations with securities market companies and the SCLV. Office in Catalonia: provision of all the CNMV's services in Barcelona.
	Primary Markets	Security issues and equity offerings. Admissions to listing. Information to the market. Significant holdings. Treasury stock. Tender offers.
	Supervision	Supervision, inspection and intervention of firms. Supervision of secondary markets. Exclusion and suspension of trading.
	Inspection	Proposal and processing of disciplinary proceedings. Market Monitoring Unit: inside information, price manipulation and money laundering.
	Board Secretariat and Legal Department	Secretariat to the Board and the Consultative 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 and research on the financial system.
	Communications	Relations with the media.

Resources

The last year was characterized by a considerable increase in supervision activities. Trading on the stock market doubled, the amount placed through public placements (privatisations and IPOs) multiplied nine-fold and the funds in collective investment institutions increased by 37%. The increase in the activities under supervision logically multiplied the number of supervisory actions and required the CNMV to make a considerable effort to match its human and technical resources to the needs of the services it must provide.

The current framework of budget austerity in the public administration, which is very necessary for the Spanish economy as a whole, makes it difficult to rapidly adapt the CNMV's human and technical resources. Certain restrictions on hiring and on acquisition of material and equipment hindered rapid coverage of needs in particularly sensitive areas such as collective investment institutions, whose growth has led to the CNMV supervising assets totaling over 27 trillion pesetas owned by over six million investors.

Financial data

The increase in activities under supervision was reflected in both revenues and expenses during the year.

Revenues amounted to 3.898 billion pesetas, of which 3.406 billion pesetas were from fees. This item increased by 54% with respect to the previous year even though the authorized rates remained unchanged. There were particularly significant increases in fees for registration of collective investment institutions (101%), issue prospectuses (30%) and admission of securities to listing (26%). There was also a sizable increase in fees for monitoring of secondary markets (82%) and of collective investment institutions (53%).

In contrast with fee revenues, interest revenues fell 25% due to declining interest rates and to a resolution by the Spanish Cabinet which reduced the CNMV's cash balance by 5 billion pesetas (3.957 billion pesetas by reduction of reserves and 1.043 billion pesetas by appropriation of 1996 income). This amount was paid into the Treasury during 1997.

Operating expenses amounted to 1.978 billion pesetas, 8.3% higher than in 1996. Personnel expenses accounted for 73% of the total. Within this caption, wages and salaries increased by 2.2% (1% if the effect of hiring technicians under training contracts as part of the *Programa 2000* is eliminated), due entirely to seniority bonuses, since wages remained frozen. There were noteworthy increases in expenditure on personnel training (+70%), provisions for CNMV Board Member termination indemnities (which are concentrated in the first two years of each mandate), rentals and other expenses relating to the expansion of premises in Madrid, attendance at international meetings and security expenses.

Acquisitions of *tangible fixed* assets totaled 125 million pesetas in 1997, of which 103 million pesetas were for computer hardware as part of a broad infrastructure update plan. Of that amount, 58% was allocated to upgrading and acquiring workstations, 35% to upgrading servers and network facilities and 7% to replacing basic software.

Income for the year totaled 1.92 billion pesetas. Based on the revenue and expenditure trends, the Board of the CNMV resolved on 21 October 1997 to propose that the Government

CNMV's office in Catalonia

The CNMV opened its office in Catalonia on 17 April 1996. The Catalonia office was initially opened to boost the efficiency of supervision of Catalan firms subject to prudential supervision and to facilitate access to the public registries and compliance with reporting obligations for firms registered and securities issuers domiciled in Catalonia.

In view of the results obtained in over one year of operation, it was decided to expand the scope of the Catalonia office's brief in order to contribute to promoting Barcelona as a financial market.

Consequently, since 1 July 1997, the Catalonia office has been staffed with the necessary qualified technical personnel and information systems to enable it to conduct all the relevant tasks relating to the analysis of applications and subsequent modifications of collective investment institutions, IIC managers, portfolio management companies and broker-dealers and brokers, the analysis of issue and equity offering prospectuses and any subsequent admission to listing. The processing of applications through the office reduces transactions costs and greatly simplifies compliance with procedural formalities for firms domiciled in Catalonia.

Since it opened, the Catalonia office has processed 53 incorporations and 55 registrations of collective investment institutions, i.e. one-fifth of the total nationwide. It has also processed 28 applications in connection with issues and admissions to listing, i.e. 16% of the total, including most notably an IPO.

The Catalonia office is open to investors and provides a personalized response to investor queries and complaints. Its offices house a query department with the electronic media to provide convenient access to the CNMV's official registries and to other databases available at the head office.

reduce the fees it collects for its services. The new reduced fees are expected to come into force in the next few months.

Human resources

Management of human resources proved to be very complex in 1997. As part of the general restrictions imposed on the public administration, Spain's General Budget Law for 1997 limited the number of positions which could be offered and made a major change in the recruitment process by including the CNMV within the Public-Sector Employment Program. These measures complicated hiring at a time when the needs of the service were expanding. For example, until the last quarter of the year it was not possible to undertake the selection process to fill vacancies created in the first quarter.

The climate of austerity was also reflected in compensation which, as stated before, was frozen in 1997. In view of the current compensation levels at the CNMV, the high qualifications required to carry out most of the functions and the trend in remuneration in the area under supervision, the salary restrictions did not make it easy to recruit qualified new personnel.

To overcome these problems, in 1997 the CNMV introduced two interesting new initiatives in the human resources area:

- Hiring of technical personnel under training programs. As part of a program called "Técnicos 2000", the CNMV hired 14 recent graduates with brilliant academic records under 2-year on-the-job training contracts, after strictly screening over 11,000 applicants. The program involves rotating these employees so that they spend six month periods in four different divisions. The goal is to provide a source of qualified personnel available in 1999 if the CNMV needs to take on more staff or fill vacancies. However, these programs will not prevent the hiring of highly qualified or experienced technical staff, which will always be done through open selection processes.
- Greater opportunities for internal promotion. The CNMV considers it necessary to increase the scope for promotion within the internal career path. For this purpose, it appointed new deputy directors and created positions of Area Director, who will have considerable responsibilities within their respective divisions.

Table 1.2
CNMV STAFF
BY PROFESSIONAL CATEGORY

Category	Number of employees	
	1996	1997
Services	9	9
Administration	43	45
Technical	113	108*
Management	16	16
Total	181	192

* Does not include 14 technicians hired under on-the-job training contracts in 1997.

Information systems

Computers are essential for the CNMV's supervisory duties. All the information channelled to the CNMV is processed – as data or images – and flows in computer-readable format, depending on the procedure involved, from the workstation to the central systems, enabling it to be linked to other information, retrieved and disseminated both internally and externally.

Various improvements were made to the information system in 1997, including most notably the following:

- Development of a new system for *monitoring transactions* in the market based on dynamically inter-relating all the information.
- Creation of a *World Wide Web site* which can be freely consulted and provides access to the data contained in the public registries, all the legislation on securities markets, the CNMV's principal publications, documentation describing the CNMV's organization, powers and activities, forms for applying for services, press releases and access to the services of the National Securities Numbering Agency. The site (approximately 3,000 pages) is used by an average of 350 users per day (including Saturdays and Sundays) via 7,000 hits. The entire staff of the CNMV has been equipped with *Internet-based e-mail*.
- Development of telematic applications for the CIFRADOCC/CNMV system to allow the electronic interchange of documentation between the CNMV and any finance entity which requests this facility, while providing fully validity and legal efficacy to the transactions.

CIFRADOCC/CNMV system for processing administrative procedures and exchanging information ("electronic signature")

On 19 December 1997, the CNMV's Board established the conditions for using the Internet and the Bulletin Board System (BBS) to process administrative procedures within its brief and for the exchange of information. This development is aimed mainly at intermediaries and issuers, but it may also be used by any individual or legal entity wishing to enter into a formal relationship with the CNMV. All those parties may use the system, called CIFRADOCC, and benefit from the advantages of the new technology in terms of cost and speed. The CNMV itself will also benefit from widespread use of the system since it will expedite procedural processing and facilitate data processing.

The system incorporates various legal and technical safeguards for ensuring the authenticity, confidentiality, integrity, conservation and appropriate use of the documents. The CNMV will authorize its use to individuals or legal entities, which must designate specific persons to operate the system on their behalf. The technical security of transmissions is guaranteed by message encoding, electronic signatures and public key encryption.

This resolution of the CNMV's Board, which is in compliance with article 45 of Law 30/92, dated 26 December, on the Legal Regime for the Public Administration and the Common Administrative Procedure and with Royal Decree 263/1996, dated 16 February, regulating the use of electronic, computer and telematic techniques by the State's General Administration, is the first of its kind in the Spanish administration.

The CNMV's official registries

The CNMV's official registries channel all the information which issuers and intermediaries in the securities market are obliged to make public. Consequently, they are a valuable source of information for investors and, generally, for any person or company interested in that market.

Aware of the importance of this service, the CNMV has sought to make it increasingly accessible and to facilitate processing of the information. In addition to the basic forms of query on-screen or from optical disk at head office and obtainment of hard copies, users now have new possibilities:

- A new front-end at the Catalonia Office of the CNMV.
- Storage of certain information on computer-readable media (CD-ROM and diskette).
- Access to much of the information via the Internet.

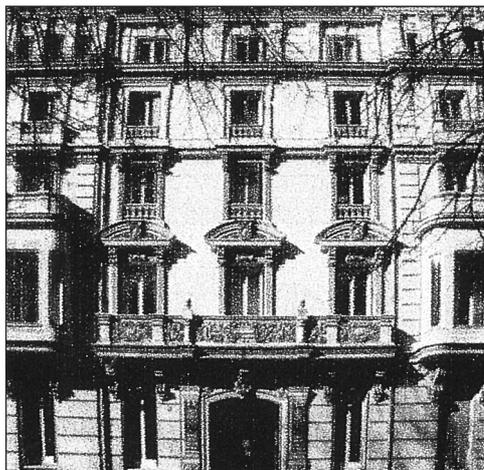
New technologies facilitate information processing and dissemination, and the CNMV will continue to use them to make the securities market more transparent. The major challenge in this field today involves making full use of the possibilities for remote information access provided by the Internet. All the registries will be available on the Internet shortly.

Comisión Nacional del Mercado de Valores

Pº Castellana 19
28046 Madrid
Spain
Telephone: 34 91 5851500
Fax: 34 91 3193373
BBS: 34 91 5852286

Office in Catalonia:
Pº Gracia 19
08007 Barcelona.
Spain
Telephone: 34 93 3047300
Fax: 34 93 3077310

Internet: www.cnmv.es
Public Attention Department:
dap@cnmv.es
Official Registries and Documentation:
rod@cnmv.es
National Numbering Agency:
ancv@cnmv.es
International: International@cnmv.es



2

THE CNMV AS A PUBLIC SERVICE

Table 2.1

HOW TO CONSULT THE CNMV'S OFFICIAL REGISTRIES

	Direct queries at the CNMV			Internet	Diskette & 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 memorandum inscriptions	Since 1989	Since 1989	(*)		
Inscription of broker-dealers and brokers	Since 1989	Since 1989	Since 1989		
Audits:					
Issuers	Since 1986	Since 1986	Since 1986	Since 1986	Since 1990
IIC	Since 1989	Since 1989	Since 1993		
Market subjects	Since 1988	Since 1988	Since 1993		
Market subjects and consolidable groups	Since 1993	Since 1993			
Market management companies	Since 1989	Since 1989			
Special reports	Since 1991	Since 1991			
Financial information:					
Issuers	Since 1989	Since 1989		Since 1995	(**)
IIC	Since 1991	Since 1991	Since 1993	Since 1997	
Tender offers	Since 1989	Since 1989	In preparation		
Book-entry deeds	Since 1989	Since 1989	In preparation		
Intermediary fees	Since 1993	Since 1989			
Significant holdings	Since 1990	Since 1990		Since 1989	(***)
Significant events	Since 1990	Since 1989		Since 1989	
Intermediaries' standard 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.

(*) Prospectuses registered with the CNMV's Catalonia office.

(**) ASCII and Windows formats.

(***) ASCII.

Complaints Department

Functions

The complaints department handles complaints and claims from investors against persons or firms which are supervised by the CNMV. The department's purpose is to provide investors with all possible legal protection and advice within the scope of its powers, which differ from those of the courts of justice and do not include, for example, the power to judge or evaluate the scope of disputes arising from mercantile relationships between investors and supervised firms.

The CNMV resolves complaints in writing, remitting its conclusions with regard to the case to the claimant and the entity to which the complaint relates.

Where it is evidenced that a firm's conduct did not conform to good securities market practices, the necessary measures are taken to rectify its behavior. Additionally, if evidence of punishable offenses comes to light, the CNMV takes the matter into consideration and investigates it.

Many complaints arise due to lack of information on regulations or procedures or to ignorance of the data or reports generally available in the official registries. In these cases, the

CNMV provides the complainant with the necessary information or advises on how to obtain it. It also provides guidance as to the steps to be followed where the complaint relates to matters outside the scope of its powers.

Some complaints relating to matters of general interest

- **Stock splits.** As a result of complaints, the CNMV issued a letter on 21 August 1997 – see CNMV’s web site – addressed to the presidents of firms engaging in securities deposit or administration activities warning that it was not correct to double deposit and administration fees because of stock splits and reminding them that fees can only be charged for this type of transaction if specifically indicated on their rate sheet.
- **Participation by agents of broker-dealers and brokers in portfolio management.** Because of the serious nature of the complaints, the CNMV issued Interpretative Letter 11/1997 clarifying the legal definition of representation and reminding agents that they are not authorized to manage portfolios.
- **“Accordion” transaction at Huarte, S.A.** Numerous investors filed complaints in connection with this transaction, since it involved reducing their investment to zero. Most of the complainants had acquired their shares at the end of 1996 and were not aware that the transaction was due to take place, despite the fact that the CNMV had disseminated detailed information on the matter. Complainants were supplied with the information existing in the CNMV’s official registries and were informed that there had been no irregularities in the transaction. Nevertheless, since there were cases in which the firms which processed the share purchase orders had not sufficiently informed their clients of the risks of their investment, the CNMV reminded those firms of this obligation.
- **Incomplete publicity.** These claims related to the issue of mortgage-backed securities, where the issuer’s publicity made no mention of the fact that it reserved the right to early redemption. Although this matter was indicated in the prospectus filed, the CNMV considered that the publicity constituted an important source of information for investors and notified the issuer accordingly; as a result, the latter offered a compromise to the complainants.
- **Confusing publicity.** The placer of an issue of mortgage bonds issued initial publicity (which was later corrected) suggesting yields much higher than those actually being offered; this led to numerous complaints when the bonds matured. The CNMV considered that, to the extent that an investor based his/her decision on the advertising issued in the first place, he/she was covered by the General Advertising Law and the General Law for the Defense of Consumers and Users and, consequently, was entitled to take the appropriate legal action under that legislation.
- **Inspection.** Complaints led to the initiation of disciplinary proceedings against the companies Delta Focus S.L., Dinamica Directiva S.L. and B.S.C. Asesores S.L. for providing financial services without authorization (“unlicensed intermediaries”). The Inspection Division was also informed of various complaints relating to Aurium S.A. and Rentcapital S.A. (which were eventually excluded from the market in November 1997) for breaches of reporting obligations.

Complaints received in 1997

The growth in securities market activity and, particularly, the influx of new investors was evident in the number of complaints filed in 1997. A total of 609 written complaints were received, i.e. 38% more than in 1996, and 72% of complaints related to financial intermediaries, mainly banks and saving banks.

Many complaints evidenced considerable ignorance of the conditions and characteristics of the securities which had been acquired, of investors' rights vis-à-vis intermediaries and of the workings of the securities markets.

The largest group of complaints related to the execution of buy and sell orders. A large number of complaints evidenced deficiencies in the information provided by firms to their customers regarding the characteristics and workings of the markets where the securities they sought to buy are traded. Others related to deficiencies in execution of orders due to lack of knowledge by the investor or the firm about the basic data to be indicated on the related forms.

A second major group of complaints related to subscription of fixed-income securities and of initial public offerings, generally due to ignorance of the contents of the prospectus. In some cases there was evidence that the information provided to customers at the time of subscribing the securities was incomplete or unclear, and the CNMV has adopted measures to remedy the matter.

The third group of complaints in order of importance related to mutual funds, generally due to the fact that the investor was not aware of the applicable liquidating value or of the characteristics of the mutual fund.

Another sizable number of complaints related to the commissions charged for stock splits, securities custody and administration, changes of ownership and transfers of securities. The CNMV informed the complainants of its position on the matter and reminded intermediaries that they are obliged to place their rate sheet at customers' disposal and to provide customers with settlements of transactions performed or of charges made, with clear, detailed breakdowns of the commissions charged on each transaction.

Claims were solved in an average of less than two months; the shortest times were obtained in complaints which could be resolved merely by remitting information contained in the CNMV's public registries, and the longest times were obtained in complaints where matters had to be checked with the respondent.

Of the complaints resolved in 1997, 91% led to information being provided to the claimant, as indicated in table 2.4. This section included 38 claims resolved in favor of the complainant due to evidence of malpractice. These claims also led to subsequent action by the CNMV: letters, Interpretative Letters, modification of procedures, inspections, etc. Of the remainder, the respondent offered to reach a settlement in 32 cases.

Table 2.2
RESPONDENTS IN COMPLAINTS

Respondent category	No. of complaints		%	
	1997	1996	1997	1996
Market Supervisory and Management Bodies and the CNMV	3	5	-	1
Finance entities	441	303	72	69
Issuers of listed and unlisted securities	163	131	27	30
Other	2	1	-	-
Total	609	440	100	100

Table 2.3

FINANCE ENTITIES AGAINST WHICH COMPLAINTS WERE FILED IN 1997

FIRM	COMPLAINTS
BANKS AND SAVING BANKS	325
CAJA POSTAL, SA	41
BANCO SANTANDER, SA	36
BANCO BILBAO VIZCAYA, SA	31
BANCO CENTRAL HISPANO, SA	21
BANCO DIRECTO ARGENTARIA	16
CAJA MADRID	14
BANCO EXTERIOR DE ESPAÑA, SA	11
LA CAIXA	11
BANCO ESPAÑOL DE CREDITO, SA	11
CITIBANK ESPAÑA, SA	7
BANCO SANTANDER DE NEGOCIOS, SA	6
BANCO PASTOR, SA	6
DEUTSCHE BANK, SA	6
BANCO ATLANTICO, SA	5
CAIXAVIGO	5
IBERCAJA	5
BANCAJA	4
BANCO HERRERO, SA	4
BANCO HIPOTECARIO DE ESPAÑA, SA	4
BANCO POPULAR, SA	4
BANKINTER, SA	4
BNP ESPAÑA, SA	4
CORPORACION BANCARIA DE ESPAÑA, SA	4
BANCO DE COMERCIO, SA	3
BANCO DE ALICANTE, SA	3
CAJA DE AHORROS DE CATALONIA	3
BANCO URQUIJO	3
BANCA CATALANA	2
BANCO DE LA PEQUEÑA Y MEDIANA EMPRESA	2
CAJA DE AHORROS DE GALICIA	2
CAJA DE AHORROS DE LA INMACULADA	2
CAJA DE AHORROS DE SAN FERNANDO	2
OPEN BANK, SA	2
CREDIT LYONNAIS ESPAÑA, SA	2
UNICAJA	2
CAJA ESPAÑA DE INVERSIONES	2
OTHER	35
BROKER-DEALERS AND BROKERS	64
AB ASESORES, SVB, SA	8
BENITO Y MONJARDIN, SVB, SA	5
GESTIDINER, AV, SA	5
ADEPA AGENCIA DE VALORES, SA	4
GAESCO BOLSA, SVB, SA	3
GENERAL DE VALORES Y CAMBIOS, SVB, SA	3
IBERAGENTES ACTIVOS, AV	3
RENTA 4, SVB, SA	3
HERMES 90, AVB, SA	2
INVERBAN, SVB, SA	2
INVERBOLSA, AVB, SA	2
INVEST IBERICA, AV, SA	2
MAPFRE INVERSION, SV, SA	2
OTHER	35

Table 2.3 (Cont.)

FINANCE ENTITIES AGAINST WHICH COMPLAINTS WERE FILED IN 1997

FIRM	COMPLAINTS
FUND AND PORTFOLIO MANAGEMENT COMPANIES	29
GESBANSANDER, SGIIC, SA	6
IBERAGENTES FONDOS, SGIIC, SA	3
BBV GESTINOVA, SGIIC, SA	2
GESINCA INVERSIONES, SGIIC, SA	2
OTHER	16
UNREGISTERED FIRMS	23
TRANSWORLD FINANCIAL SERVICE, SL	6
B.S.C. ASESORES	3
EXCOM GmbH ESSN/OST EUROPA, SL	2
OTHER	12

Table 2.4

OUTCOME OF CLAIMS FILED IN 1997

Outcome	Firm	Number
Settlements		34
	A.B ASESORES SVB S.A.	2
	ACTIVOS EN RENTA A.V., S.A.	1
	BANCO ATLANTICO	1
	BANCO BILBAO VIZCAYA S.A.	2
	BANCO CENTRAL HISPANO	2
	BANCO DEL COMERCIO S.A.	1
	BANCO ESPAÑOL DE CREDITO S.A.	1
	BANCO EXTERIOR DE ESPAÑA, S.A.	1
	BANCO GALLEGO	1
	BANCO HIPOTECARIO DE ESPAÑA S.A.	3
	BANCO SANTANDER	2
	CAIXAVIGO	1
	CAJA DE AHORROS DE CATALONIA	1
	CAJA DE SALAMANCA Y SORIA	1
	CAJA POSTAL S.A.	7
	CREDIT LYONNAIS ESPAÑA S.A.	1
	HERMES 90 AVB,S.A.	2
	IBERAGENTES ACTIVOS S.A.,S.V	1
	IBERAGENTES FONDOS SGIIC,S.A.	2
	LA CAIXA	1
Information supplied to complainant		479
of which result favorable to complainant		38
	AB ASESORES SVB,S.A.	1
	BANCO BILBAO VIZCAYA S.A.	2
	BANCO CENTRAL HISPANOAMERICANO	1
	BANCO DIRECTO ARGENTARIA S.A.	11
	BANCO ESPAÑOL DE CREDITO S.A.	1
	BANCO EXTERIOR DE ESPAÑA S.A.	2
	BANCO HIPOTECARIO DE ESPAÑA S.A.	1
	BANCO POPULAR ESPAÑOL S.A.	2
	BANCO SANTANDER	4
	BANKINTER	1
	CAJA DE ARQUITECTOS SDAD.COOP	1
	CAJA POSTAL S.A.	6
	CORPORACION BANCARIA DE ESPAÑA	3
	GESBANSANDER SGIIC,S.A.	2
Lapsed		8
Outside CNMV jurisdiction		4
Withdrawn		1
Pending		83
Total		609

National Securities Numbering Agency

In line with the resolutions of the Association of National Securities Numbering Agencies (ANNA), the Spanish Agency was one of the first in the world to include in its data base (in January 1997) the new international CFI code (Classification of Financial Instruments), a six-letter alphabetical code where the first letter indicates the classification (called “category”) – variable-income, fixed-income, warrants, options, futures, etc. The second letter indicates the specific group within each category; e.g. in the case of variable-income: common stock, preferred stock, stock funds, money market funds, etc. The last four characters indicate the principal attributes of each group; for example, in the case of shares: voting rights, restrictions on transfer, whether they are fully or partially disbursed, and how they are represented.

Also noteworthy is the commencement, in May 1997, of numbering the underlying instruments and derivatives traded on organized markets, whereby Spain joined the small number of countries which have implemented this numbering.

The number of variations in the Agency’s data bases increased in 1997 due to greater activity by Spanish issuers, the large number of matador issues and the numbering of derivatives. There were a total of 5,406 changes (additions, removals and modifications). The Agency handled 9,001 queries about domestic and foreign securities (an average of 37 queries per day). Using GIAM (Global ISIN Access Mechanism - a communications network linking 27 agencies worldwide), the Agency distributed a total of 5,730 ISIN codes to other agencies which have requested systematic updates of Spanish codes.

The Agency’s data base was made available at the CNMV’s web site in April 1997. There is also a page containing weekly news about the Agency, which reports on new admissions to listing, equivalences, changes in par value, early redemptions and additions, deletions or modifications of codes in its securities file. This new electronic dissemination system is in addition to the pre-existing BBS-based access to the data base.

3

MARKET DEVELOPMENT

The Spanish securities market has developed considerably in recent years. One of the most dynamic sectors has been that of collective investment institutions (IIC), which apparently still have considerable scope for growth. The Market Development division focused most of its activity on this sector in 1997, with a view to simplifying the procedures for creating them and to expanding their scope for investment. In short, the aim was to create a suitable framework for the creation and operation of these institutions within the new Europe-wide scenario of competition, by retaining domestic operators in Spain and attracting foreign operators.

Measures taken with regard to collective investment institutions

Simplification of procedures

The following measures were taken in 1997:

- *Establishment of a “one-stop shop” for authorization of applications to create collective investment institutions and to amend the regulations or bylaws of existing ones.* This measure has had an evident effect despite the short time elapsed since it was implemented: the average period for resolving an application (clearance by CNMV and authorization by the Ministry of Economy and Finance) fell from 48 days in 1996 to just 12 days in 1997.

“One-stop shop” for processing new collective investment institutions

In order to expedite the procedures for authorizing collective investment institutions, an agreement was reached with the Directorate General of the Treasury and Finance Policy (DGTPF) in November 1996 under which the CNMV was authorized as the sole interlocutor for promoters or managers of investment companies and funds effective 1 January 1997.

Under this agreement, the documentation required to obtain authorization to create a new IIC or modify the management rules or bylaws of an existing IIC are filed and processed directly with the CNMV which, after checking that the application meets the regulatory requirements, issues an obligatory report and remits it to the DGTPF with the application for approval.

- *Agreement with the management companies of the four securities markets to establish a procedure to expedite the creation and subsequent admission to, and continued listing of the shares of securities investment companies (SIM).* This new procedure, plus an interpretation of the regulations to the effect that open-end investment companies (SIMCAV) do not need to comply with the publicity requirement in order to be admitted to listing and remain listed on the stock exchange, favored the creation of a large number of these companies in 1997 and thus slowed the trend which had arisen in previous years of establishing them in other European countries with more lenient formal requirements.

- *Implementation of standard forms for mutual fund management rules and for the prospectuses which IIC must file when applying for inscription.* Outlines are also supplied for the content of the application to create a IIC; all this information has been available to the public since 1 January 1997.
- *Simplification of the obligation to update the explanatory memoranda of IIC each year in order to include the audited financial statements.* This obligation is deemed to have been discharged by merely filing the financial statements with a declaration indicating that the sole purpose of the annual update of the memorandum is the inclusion of the financial statements.

Investment in derivatives and unlisted securities

Two regulations issued in 1997 (the Ministerial Order dated 10 June 1997 and Royal Decree 1094/97, dated 4 July) expanded the scope of operations of IIC and allowed them to invest in derivatives which are not traded on organized markets and in unlisted securities, respectively. The CNMV subsequently implemented these regulations in the form of circulars:

- *Circular 3/1997*, dated 29 July, regulates the content of the information to shareholders and investors and implements the internal control obligations imposed on IIC management companies and on investment companies which wish to operate in the derivatives markets. Reporting requirements also extend to foreign IIC which are marketed in Spain, in order to ensure that their investors or shareholders enjoy the same transparency as the investors and shareholders of IIC domiciled in Spain.
- *Circular 4/1997*, dated 26 November, governing the valuation methods and conditions for investment by IIC in unlisted securities, regulates the formal requirements in order to ensure transparency in the data furnished to shareholders and investors, the limits on IIC operations with these investments, the accounting treatment and the valuation methods applicable to calculate the daily liquidating value of the IIC. It also regulates certain specific requirements regarding internal control and rules of conduct.

Other measures

- *Funds with a guarantee of return granted by a third party to the fund.* Anticipating that funds of this type might be created under the Ministerial Order dated 10 June 1997, the CNMV decided to admit applications for the creation of mutual funds whose management regulations and prospectus expressly envisage the establishment of a maximum volume of units per investor after the placement period during which there would be no such restriction. This would enable fund management companies to ascertain in advance the likely size of the fund and, consequently, structure their portfolio appropriately in line with the target return and the planned investment policy.
- *Investment by Spanish IIC in foreign IIC.* The CNMV issued its Circular 1/1997, dated 26 February, which provides a new interpretation of the existing regulations. Consequently, domestic funds can invest in foreign IIC subject to the general requirements and limits established for other marketable securities. Also, since February 1997, Spanish funds are allowed to denominate their units in currencies other than the peseta and may take and reimburse investments in such other currency.

Table 3.1
NUMBER OF REGISTERED FIRMS

	Situation at 31/12/96	Additions	Removals	Situation at 15/12/97
FIM	788	473	3	1.258
FIAMM	181	21	1	201
SIM	217	2	2	217
SIMCAV	68	64		132
SGIIC	136	4	7	133
SGC	57	2	1	58
DEPOSITARIES	159	8	3	164
OICVM	87	23	2	108
SV	45	2	2	45
AV	58	4	2	60
Agents	4.980	963	461	5.482

Community passport for investment services companies

Directive 93/22/CEE (Investment Services Directive - ISD) enables investment companies authorized in other European Union member states to provide investment services in Spain without restrictions and without the need to open a branch.

An authorization granted in any EU member state allows an investment services company to freely provide services in any other EU country, the only requirement being notification to the supervisory body in its home country so that the latter can notify the host country.

Making use of this possibility, various firms from other EU countries (see table below) have notified the CNMV of their intention to provide services in Spain.

COUNTRY	No. of firms
Denmark	5
France	2
UK	270
Ireland	10
Italy	1
Holland	1
Norway	1
Sweden	3
TOTAL	293

A total of 347 applications were received prior to 1 January 1996, of which 305 (almost all from the UK) wished to directly apply article 30.3 of the DSI (Grandfathering clause) i.e. continued provision of services in Spain after January 1996 by firms which had been providing services in Spain before that date. These applications were rejected since they did not fall under that heading.

- *Marketing in Spain of IIC not subject to Directive 85/611/CE.* Circular 8/1997, dated 21 June, considered the possibility of two forms of marketing: either aimed at the general public or at institutional investors. In the latter case it is not necessary to file a prospectus and the requirement regarding equivalent protection of investors is considered to be complied with if the home country's regulations afford reasonable protection in the opinion of the CNMV.
- *New opportunities for investment in foreign markets.* NASDAQ (USA) and the stock markets of Sao Paolo and R o de Janeiro (Brazil) have been recognized as being eligible for investment by Spanish IIC.
- *Queries.* In 1997 the Market Development Division issued written replies to numerous queries and published the most relevant replies on the CNMV's web site in the area covering securities market legislation.

Measures with regard to credit entities and securities firms

The priority granted to IIC did not prevent efforts with regard to other financial intermediaries. These focused principally on codes of conduct, with a view to ensuring effective compliance and enhancing the quality of our market. One example is the Interpretative Letter 10/97, regarding the establishment of «chinese walls», to avoid the dissemination and improper use of inside information in a firm's different areas of business, as discussed elsewhere in this Report (see box in chapter 6 - "Investor Protection").

4

PREPARING FOR THE EURO

A major challenge

Based on Spain's economic performance, it is a likely candidate for inclusion in European Monetary Union (EMU) from 1 January 1999. If this is the case, the euro will become Spain's official currency and the peseta will adopt an irrevocable fixed equivalence to the euro until it ceases to be legal tender in mid-2002.

These developments pose major challenges for Spain. At a "macro" level, our economy must continue to grow in order to converge in terms of wealth, employment and standard of living with the more developed countries of the Union. At a "micro" level, companies and generally all players in the economy will be obliged to operate in a more competitive environment.

The challenges facing the securities markets are even more demanding. Spanish investors and issuers will have greater possibilities of investing and obtaining finance, respectively, but they must learn to operate in a more complex environment in order to seize these opportunities. The main challenge facing financial intermediaries is that of satisfying the new demands which users of financial services will undoubtedly make in the new framework while competing openly with other European operators.

Regardless of changes in the market players' strategies to adapt to this new situation, all involved must necessarily prepare for the transition to operating in the new monetary unit. The reception of this move by the public will depend greatly upon the financial institutions' efficiency in the transition process. In short, the change must take place without unnecessary interruptions in the normal working of the institutions and markets and while avoiding any detrimental effects for investors.

The transition in the securities market

Aware of the importance of a smooth transition, the CNMV invited the industry to analyze the implications of the transition process and to anticipate the changes required in their internal organization and procedures. Consequently, at the end of 1996, various working groups involving the management companies of the organized markets, investment services companies and collective investment institutions were set up under the coordination of the CNMV. The first results were published in July 1997 in a volume entitled "*Los efectos del euro en los mercados de valores y en las instituciones que en ellos operan*" ("*The effects of the euro on the securities markets and on the institutions operating in them.*").

That document analyzes the effects of adopting the euro on intermediaries and market institutions in areas such as operations, accounting, relations with customers and reporting to the public and the regulators. It also contains some decisions, such as that of the organized markets and the Securities Clearing and Settlement Service (SCLV) to adopt a "big bang" approach and conduct all transactions exclusively in euros starting on the first business day of 1999. The SCLV will also have converted all positions pending settlement at the date into euros.

Investment services firms and collective investment institutions also expressed their preference for operating and accounting in euros from day 1. The CNMV will foster the early use of the euro by these institutions by accepting re-

porting in that currency for supervisory purposes from the beginning of 1999. Nevertheless, the working groups pointed out the advisability of continuing to provide information to customers in pesetas.

The working groups will continue to operate until mid-1998. In the second half of 1997 they focused on identifying the operating procedures requiring revision and a new group was created to study the problems which may arise in redenominating securities. The conclusions from this period were published in two documents entitled “*Manual Operativo para la implantación del euro en las sociedades y agencias de valores. Manual operativo informático del euro*” (“*Operating manual for implementing the euro in broker-dealers and brokers. IT operating manual for the euro*”) and “*Introducción al euro en los mercados de valores españoles*” (“*Introduction to the euro in the Spanish securities markets*”). The second semester of 1998 will be devoted to operational testing and coordination between the various entities and the markets.

Table 4.1

INTRODUCTION OF THE EURO IN THE SECURITIES MARKETS

Stage	EMU	Securities market
Preparation (1998)	<ul style="list-style-type: none"> • Selection of member states • Creation of the European Central Bank <ul style="list-style-type: none"> - Strategy and operating framework for monetary policy - Operational organization and development of the TARGET system • Preparation of the financial community 	<ul style="list-style-type: none"> • Working groups continue (1st half of 1998) • Operational testing and coordination regarding the measures which are adopted
Transition period Establishment of EMU (1/1/1999)	<ul style="list-style-type: none"> • Fixed, irrevocable peseta-euro exchange rate • Commencement of operation by the system of European Central Banks and euro monetary policy • Issuance of government debt securities denominated in euros • Voluntary redenomination of private securities 	<ul style="list-style-type: none"> • “Big-bang” in the Spanish markets (measures already decided): <ul style="list-style-type: none"> - Trading in euros - Settlement in euros - New issues of government debt securities in euros - Redenomination of outstanding government debt securities • CNMV: Intermediaries may file information in euros from day 1.
End of 2001	<ul style="list-style-type: none"> • Issuance of euro notes and coinage 	
Change-over period (1/1/2002)	<ul style="list-style-type: none"> • Withdrawal of domestic notes and coinage • Obligatory redenomination of private securities. 	
Culmination (1/7/2002)	<ul style="list-style-type: none"> • Domestic notes and coinage cease to be legal tender 	

5

PRUDENTIAL SUPERVISION

Prudential supervision of securities firms (broker-dealers and brokers), fund managers and collective investment institutions is one of the CNMV's activities which is of greatest importance for investors. Its purpose is to ensure compliance with capital requirements and other regulatory requirements and, as far as possible, anticipate and provide for correction of situations which may be detrimental to investors or may negatively affect public confidence in intermediaries.

In this area the CNMV combines two tools of proven efficiency: "distance" supervision and on-site inspection. The former consists mainly of analyzing the economic information filed regularly by the supervised firms themselves or their auditors, as the case may be, as required by current regulations. The CNMV has developed a powerful data processing system and an analysis methodology which enable it to closely monitor firms' financial situation and detect most possible risk situations sufficiently in advance.

The CNMV routinely supplements distance supervision with on-site inspections. In 1997, the Supervision Division conducted a total of 58 inspections at securities firms and fund managers (9 broker-dealers, 11 brokers, 24 fund managers and 14 portfolio managers). The inspections of registered dealers in government securities were conducted in coordination with the inspection services of the Bank of Spain.

There was a major change in the approach to supervising groups on a consolidated basis in 1997. Both distance supervision and on-site inspections now analyze the entire group's portfolio, paying particular attention to intra-group transactions, the goal being to avoid breaches of the regulations through transfers of risk among group companies.

Also in 1997, the CNMV stepped up its supervision of compliance with the legal obligations binding financial intermediaries with regard to preventing money laundering.

Supervision activities in 1998 will be carried out in accordance with the pre-set plans. The main objective will again be to anticipate possible crises at firms which might be detrimental to customers or other firms.

Solvency of registered intermediaries

Spain's securities firms have always amply exceeded the minimum equity requirements. The same is true of management companies since the CNMV has been their regulator. Although there have been breaches in this connection, they have been few and of scant importance.

The general trend in the market in 1997 further enhanced the equity position of the securities firms as a whole. The increase in trading on the securities markets in 1997 had a positive effect on service revenues which, coupled with stable structural expenses and rising earnings on trading for the house account, led to pre-tax earnings which were double the 1996 level. The annualized return on equity before taxes of the securities firms as a whole was 58% in 1997 (30% in 1996).

Other indicators which improved in 1997 were capital adequacy (which rose due, among other reasons, to the good results attained by the firms in 1996) and computable equity (over 116 billion pesetas at 1997 year's end, i.e. 14% higher than in 1996, whereas the number of firms increased by approximately 2%). The mem-

bers of the stock exchanges were of particular importance in this connection since their computable equity accounted for 65% of the total.

Growth in equity boosted the surplus over requirements to over 81 billion pesetas, 18% more than in 1996. As in 1996, 80% of the firms calculated their equity requirements as a percentage of the legally established minimum capital stock, rather than as a percentage of their risk positions. This generally indicates that the securities firms maintained a prudent policy of investment. At 31 December 1997, there were no securities firms with an equity shortfall and 25% of firms had a surplus of over 700 million pesetas.

Reporting and internal control obligations

The greater regulatory flexibility regarding operations with derivatives and the increased scope afforded to IIC management firms also entail an increase in the potential risks assumed by collective investment institutions and, in the final instance, by investors. In order to maintain the level of investor protection, these firms are required to establish a high level of internal control and to give detailed information to investors both in their prospectuses and in their quarterly reports.

Prospectuses must at least state the purpose for which the collective investment scheme will use derivatives, the type of transactions it will perform and the maximum limits of risk which it will bear. Particularly noteworthy is the fact that a number of obligatory notices must be included, depending on the projected operations, in order to inform potential investors of the risks which the fund might assume.

Minimum contents have been established for quarterly reports in order to ensure that investors are aware of the results obtained, the open positions, the counterparty and market risk, the bilateral transactions arranged with group entities and a general description of the policies applied during the period.

Following are the key internal control obligations imposed on firms operating with derivatives:

- a) Involvement by the board of directors in establishing the general policy regarding risks and the allocation of the necessary control resources.
- b) Appropriate segregation of functions to reduce potential risks; firms must have a control unit permanently responsible for reviewing internal control procedures and systems.
- c) Evaluation of risk on a daily basis, to allow fair treatment of investors who operate from day to day.

Firms operating with derivatives must file a report with the CNMV describing the internal control systems which they have established plus an annual report on the degree of compliance, approved by their board of directors. Both the level of controls to be established and the resources to be assigned to internal control must match the level of risk which firms wish to assume.

The equity structure of the collective investment institutions management companies (SGIIC) is also quite satisfactory. Their solvency is evidenced by the fact that their aggregated computable equity exceeds the minimum equity required in the sector by 30% (116 billion pesetas). Only one management company of the 134 (Gesconsor) breached the minimum equity requirements in 1997, and this was because it was in a period of liquidation.

The portfolio management companies' computable equity amounted to approximately 7 billion pesetas in 1997, i.e. 4 billion more than the minimum equity required in this segment.

Investment by funds in derivatives

The Ministerial Order dated 10 June 1997 governing the use of derivatives by collective investment institutions eliminated one of the principal competitive limitations on the Spanish mutual fund industry. The regulation which it revoked prohibited OTC transactions, which was a clear obstacle to the development of guaranteed funds and limited investment in assets denominated in foreign currencies since there were no appropriate instruments for hedging the exchange rate risk.

The approach adopted was to provide as much freedom as possible to collective investment institutions, considering the difficulties of evaluating the risks associated with derivatives. The regulation also takes account of the special nature of funds, whose owners are not directly in control of their investment and have no power over the fund manager's decisions; consequently, the right to adequate information is essential.

The new Ministerial Order offers very broad possibilities and allows Spanish fund managers to use instruments like those in the most advanced European countries. The regulation expressly envisages all the instruments with an underlying financial instrument which exist in the market and also provides for extending the list as new products appear. Such instruments may be used for any possible purpose.

However, the regulation contains specific safeguards governing transactions conducted outside organized derivatives markets: they must be arranged with sufficiently solvent counterparties, liquidity must be guaranteed on a daily basis, risk diversification limits are applicable and, with certain exceptions, they may only be used for hedging or for attaining a specific target return.

One of the fields where managers are afforded greatest freedom of action is that of funds with an internal guarantee, i. e. those in which derivatives are used to hedge a yield goal. They are allowed to exceed the established limits and they are not subject to the credit risk diversification limits provided that the guarantor meets certain requirements and the guarantee ensures recovery of at least 75% (in present value) of the initial investment.

The commitments in derivatives transactions and the conditions in which various positions may be offset for the purpose of meeting the established limits have yet to be defined exactly. The CNMV is currently drafting a Circular on these matters.

Investment by funds in unlisted securities

The provision of alternative sources of finance for small and medium-sized enterprises is one of the basic goals pursued in making the regulations more flexible by allowing collective investment institutions to invest in unlisted assets. Other legislation is also being prepared in this connection, including the regulation of asset securitization funds and the admission to listing, for the first time, of venture capital companies.

However, unlisted securities do not conform to some of the standard characteristics of mutual funds – the need to ensure that investors can buy and sell their units on a daily basis. The illiquidity which characterizes unlisted securities could pose operational problems for IIC in the event that they had to liquidate these investments at short notice to attend to investor requests for reimbursement. Moreover, the difficulty in valuing these assets is a potential source of conflicts of interest between savers. Any deviation from the correct valuation would be detrimental to some investors and beneficial to others, i.e. the principle of equity would be breached.

The regulation seeks to respond appropriately to these problems. It establishes stricter diversification requirement than prevail for the rest of the portfolio in order to minimize the credit and liquidity risk of these assets. The valuation methods, particularly relating to equities, seek to establish objective, conservative criteria to reflect the realizable value at all times. Additionally, a number of specific rules of conduct are included to avoid, as far as possible, the use of such investments for purposes other than to maximize investor's returns.

Given the current situation, in which investment in listed private issuers' assets (both fixed-income and equities) by IIC is far from buoyant (despite the considerable increase in the last year, particularly in equities) and considering the operational problems involved in the acquisition of unlisted assets by open-end IIC, it is unlikely that there will be massive investment in these instruments in the short term. At 31 December 1997, no scheme had yet availed itself of this possibility.

6

INVESTOR PROTECTION

The purpose of all supervisory action is to protect investors, in the broadest sense of the term. This chapter highlights two areas of the CNMV's activities which are particularly relevant because of their direct impact on investors: relations with intermediaries, and takeover bids and public offerings of sale of securities.

Intermediaries are the cornerstone of the securities market. It is essential that they adhere to good market practices, and the CNMV supervises that they do, particularly when dealing with small investors, who often do not know the applicable procedures and rules.

Takeover bids can lead to major changes in a company's control and future outlook and they can have a particular impact on small investors, who are often unable to exert influence on the management of the companies. The regulation in this area grants broad powers to the CNMV for protecting this investor group.

The enormous success of privatisations and other equity offerings in the last year has made it advisable to recommend caution in the design of public offerings of sale and to develop, at the same time, new methods for disseminating relevant information to the public.

Intermediaries' relations with customers

Securities firms

When it was issued, Royal Decree 629/199, on the rules of operation in securities markets and obligatory records, marked a new departure for broker-dealers and brokers by requiring them to adapt to a framework of greater transparency and service quality in their relations with their customers. Broker-dealers and brokers were required to create and maintain internal rules of conduct, implement procedures for the reception, transmission and recording of orders, establish computerized records of transactions and provide a more comprehensive structure for relations with their customers.

In order to comply with that decree, securities firms had to develop new IT applications (both for recording transactions and for preparing information for remittal to customers) and adapt the contracts governing their services. The result of these efforts was quite satisfactory and the firms currently have reasonable internal and external transaction reporting systems and use a broad scope of normalized contracts to formalize their relations with the customers.

However, further progress needs to be made in certain areas in order to fully adapt the firms to the obligations deriving from the rules for operating in the securities markets. In the opinion of the CNMV, the firms must:

- Increase the quality of information included in their computerized transaction records.
- Complete the process of obtaining contractual coverage for their relations with customers.
- Increase the transparency of the information about commissions which is supplied to their customers.
- Enhance control over the actions of their agents and maximize compliance with the rules of conduct and the protection afforded to customers obtained through agents.
- Watch to ensure that the contractual instruments used with their customers respond to the true nature of the services which the firms provide to them.

“Chinese walls” and conflicts of interest

Banks and securities firms generally provide services in various areas of business relating to the securities markets: processing and executing orders for customers, custody and administration of securities, portfolio management, corporate services, design, placement and underwriting of issues, etc. Additionally, many firms trade for their own account and some (banks and thrifts) have long-term investment strategies and hold stakes in various sectors of the economy.

While carrying out these activities, the professionals involved gain access to information of great economic value which, because of its origin, may not be used for their own benefit or for the benefit of their employer or its customers. To ensure the market's integrity and protect investors, it is essential to establish effective barriers – “chinese walls” – which limit the flow of information among a firm's various areas of business.

In July 1997, the CNMV issued Interpretative Letter 10/1997 providing criteria for the establishment of «chinese walls» in firms which operate in the securities markets. Addressed to the presidents of credit entities, securities firms, portfolio management companies and IIC management companies, this Interpretative Letter reminded them of the need to comply with this obligation and provided some useful criteria for this purpose. The Letter proposed essentially the following:

- a) Defining the following as separate business areas: investment banking, third-party portfolio management (including IIC), intermediation for customers' account, trading for the house account, and long-term holdings in listed companies.
- b) Establishing barriers to the flows of “reserved” or “privileged” information between the various areas of business, ensuring that the activities carried out in each area are conducted in isolation and avoiding potential conflicts of interest.
- c) Establishing systems to check compliance with the contents of the internal rules of conduct to ensure that those rules do not become a mere declaration of intentions.

Collective investment institutions

The IIC generally adhere closely to the regulations which govern them and breaches are quite rare. In particular, breaches have included failure by the depository to discharge certain of its duties, absence of appropriate «chinese walls», minor errors in valuing portfolios and incorrect accruals. No major problems have been observed and the firms involved have always taken all the measures required to overcome them.

Regarding conflicts of interest and «chinese walls», the CNMV issued Circular 10/1997 providing criteria for the establishment of «chinese walls» in firms which operate in the securities markets and proposing the inclusion of certain measures in the firms' internal rules of conduct.

Takeover bids

Fourteen bids were launched in 1997 for a potential total of 108 billion pesetas which led to transactions for a total of 91 billion pesetas. Half of the tender offers were launched with the intention of acquiring control of the target and aimed at attaining over 50% of the capital. Of the others, two were for the purpose of consolidating a shareholding between 25% and 50%, one was to increase control in the target in order to take it private and the other four were by companies wishing to acquire their own shares in order to go private (three cases) or reduce capital by amortizing the shares thus acquired (one case).

Table 6.1
TAKEOVER BIDS

Amounts in billions of pesetas

	1993	1994	1995	1996	1997
Launched in 1997 (1)					
Number	29	17	22	20	14
Potential amount (2)	137.292	136.676	285.442	292.457	107.829
Carried out (3)					
Number	29	17	22	19	13
Amount	97.232	71.068	212.231	268.604	91.183

(1) Presented and authorized in the year.

(2) Not including the potential amount of transactions which were canceled.

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

In processing takeover bids, the CNMV focused on two aspects which are vital for small shareholders:

- *Analysis of the consideration offered* in tender offers whose price must be expressly authorized by the CNMV, because their goal is to take the firm private (four bids in 1997). In these cases, the regulations provides the minimum criteria to be taken into account in setting the price: underlying book value, liquidating value, average share current market price in the last six months, and price, where appropriate. Additionally, an independent appraisal must be provided which values the company as a going concern using generally accepted methods: discounted cash flow, analysis of comparable companies or other valuation methods for the specific sector in which the company operates.
- *Treatment of all shareholders on equal terms.* The CNMV devotes particular attention to tender offers triggered due to the transfer of significant holdings (four in 1997) or due to certain shareholders exceeding the legally established threshold (three in 1997). In the first case, the CNMV verifies that the other shareholders are not being discriminated against, i.e. that the consideration paid to the shareholders which are party to the agreement is equivalent to that offered in the tender offer. In the second case, and particularly in partial takeover bids, the bidder is required to clarify when it became its intention to attain the announced percentage of ownership and what is the nature of its investment. The regulator focuses on the possibility of prior purchases from certain shareholders which would thereby have eluded a possible pro-rating in a partial bid.

Following are some of the main features of certain tender offers made in 1997:

- *Large bids:* the largest tender offers were that made by Glencore Investments B.V. for Asturiana de Zinc, S.A., in which 27 billion pesetas in shares changed hands, and that by Asland, S.A. for Cementos Molins, S.A., which totaled approximately 20 billion pesetas.
- *Bids by foreign companies:* there were five such bids, for a potential total of approximately 82 billion pesetas, in which 74 billion pesetas ultimately changed hands.
- *Competing bids:* Caja Rural Vasca launched a bid for Bankoa, in which it already had a small stake; the French Crédit Agricole group launched a competing bid for a higher price and the first bidder withdrew.

- *Bids with an impact on the stock market:* i.e. which directly or indirectly led to the target company being taken off the market. A direct consequence was that two companies (Banco Exterior de España and BNP España) were taken off the market before the end of the year and a third (BP Oil España) will be taken private shortly. Two other companies (Santana Motor and Sociedad Española de Alimentos) were the targets of tender offers and subsequently taken private. Moreover, four companies which were targets of tender offers in 1997 must regularize their market situation in the coming months either to meet the requirements regarding diffusion of the stock or to go off the market.

Table 6.2
TAKEOVER BIDS IN 1997

Target	Bidder	% capital to which the offer referred	Result, as % of initially targeted stake
Promociones Eurobuilding	NH Hoteles	100.00% (min.=50%)	90.25%
Banco Exterior de España	Banco Exterior de España	0.76%	49.98%
Mobinversora, S.I.M.	Mobinversora, S.I.M.	20.00% (max.)	99.91%
SEDA	Financière de Café, S.L.	45.98%	98.41%
Santana Motor	Sociedad para la Promoción y Reconversión Económica de Andalucía	16.26%	68.35%
Bodegas Bilbainas.	Ducde	100.00% (min.= 51%)	79.32%
Bankoa	Caja Rural Vasca	87.48%	Offer withdrawn
Asturiana de Zinc	Glencore Investments B.V.	20.00% (max.)	98.10%
Vidriera Leonesa	Vista Desarrollo and Royal Bank Investment Ltd.	100.00% (min.= 50%)	52.32%
Bankoa "Competing bid"	Caisse Régionale de Crédit Agricole Mutuel Pyrénées Gascogne	100.00%	95.57%
BNP España	BNP España	2.60%	63.99%
Comercial de Laminados	Klöckner Ibérica, S.L.	100.00%	100.00%
Cementos Molins	Asland	49.99% (max.) 39.14% (min.)	78.72%
BP Oil España	BP Oil España	6.63%	82.01%

Public offerings of sale of securities

In comparison with previous years, 1997 was particularly active in terms of equity offerings and IPOs. Placements totaled over two trillion pesetas, compared with 400 billion pesetas in 1996 (table 6.3).

Table 6.3

PUBLIC OFFERINGS OF SALE OF SECURITIES IN 1997

Amount in billion pesetas

Company	Amount	Placed
Privatisations	1,858.0	
Telefónica	620.6	
Repsol	178.6	
Endesa	875.1	
Aldeasa	45.6	INITIAL PUBLIC OFFERING
Aceralia	138.1	INITIAL PUBLIC OFFERING
Other	151.5	
Adolfo Domínguez	18.0	INITIAL PUBLIC OFFERING
Guinness (1)	5.0	
Telepizza	0.7	
Catalana Occidente	22.4	
Total	0.4	
Mercapital Inversiones (1)	1.7	
Barón de Ley	12.7	INITIAL PUBLIC OFFERING
CVNE	2.5	INITIAL PUBLIC OFFERING
Bodegas Riojanas	2.6	INITIAL PUBLIC OFFERING
FAES	19.4	
BBV	5.6	
Iberpapel	8.0	INITIAL PUBLIC OFFERING
ACS (2)	35.7	
Dinamia	16.8	INITIAL PUBLIC OFFERING
Total	2,009.5	
Pro memoria:		
Retail tranche	1,188.3	
Institutional tranche	821.2	

(1) Unlisted.

(2) Ginés Navarro – OCP merger.

New system of public information in equity offerings

The so-called “chapter zero” in equity offering prospectuses was consolidated in 1997. This consists of an introduction to the prospectus which summarizes the basic features of the issue, the company’s circumstances, the process of setting the price of the offering, a detail of the company’s risks and various matters which should be considered by investors in making a decision.

At the same time, in association with the development of chapter zero, the «legal sixtych» was created. This is a single folded sheet which summarizes the highlights of the prospectus, including a summary of the principal risks and circumstances for decision-making which are set out in chapter zero. The aim of this document is to facilitate comprehension of the transaction and of the company’s circumstances in the form of a summary which, because of its brevity and style, is more readable than the full text of the prospectus, and to disseminate the most salient information to as many people as possible.

The sixtych does not exempt issuers from filing the prospectus, which is the document from which issuer liability arises, nor does it seek to replace investor use of the prospectus. However, the CNMV is aware that investors participating in offerings do not receive the prospectus. The sixtych is a supplement to the prospectus whose purpose is to make the general public aware of the existence of the prospectus and to encourage them to consult it. For this reason, the CNMV considers that issuers and intermediaries are obliged to deliver it to all investors.

Activity in this segment, which is of great importance for securities markets, was increased by various factors:

- Continuation of the government's policy of privatisations, which led to various offerings. In 1997, the State's remaining stakes in Repsol and Telefónica were floated, 25% of Endesa was floated (the State thereby ceased to be the majority shareholder), and Aldeasa and Aceralia were fully privatized by flotation.
- Declining interest rates had a positive impact on the stock market, and the Ibex appreciated 30%. This created a favorable climate for various initial public offerings, including Adolfo Domínguez, Barón de Ley, C.V.N.E., Bodegas Riojanas and Iberpapel.
- The new tax treatment of capital gains on the disposal of marketable securities.
- A more flexible approach to listing requirements. In this connection, the CNMV used the powers granted under a Ministerial Order dated 19 June 1997 which allows it to waive the requirement that companies seeking listing be profit-making if, regardless of the time elapsed since their incorporation, they project obtaining profits in the future or were formed through mergers, spin-offs or business contributions, or in the case of issues arising from economic reorganization or restructuring or privatisation of a State-owned company. Because of this in-

CNMV recommendations and criteria regarding public offerings

Falling interest rates have led investors to seek alternative investment targets and to accept greater risks in the expectation of obtaining higher returns than on fixed-income securities. This trend had a particular impact on the equity offerings launched in 1997 and in some cases the offerings were so heavily oversubscribed that it was impossible to allocate a satisfactory number of shares to retail investors. To address this matter, the CNMV issued recommendations (summarized below) on the retail tranche which were followed in the most recent equity offerings:

Increasing the minimum amount per order, preferably to 200,000 pesetas, although 100,000 pesetas is also acceptable as the minimum order depending on the pro-rata system, in order to ensure that investors can attain a minimum investment which covers the maintenance and other expenses on the shares they acquire.

Reorientation of the base for calculating intermediaries' placement commissions and other measures to avoid artificial inflation of demand and to give priority to the volume allocated over the volume applied for.

Introduction of new systems for allocating shares on a pro-rata basis, e.g. using techniques which are simple and easy to understand, giving priority to smaller orders over larger orders, to individual orders over joint orders, and reduction of the maximum order amount on larger orders depending on the development of demand.

The CNMV also decided to limit free re-allocations of shares from the institutional to the retail tranche in certain situations of uncertainty or considerable volatility in the markets. The CNMV assumes that institutional investors generally have far greater access to information than retail investors and, therefore, have much greater knowledge of the market and the company whose securities are being offered. Consequently, in order to protect investors, the discretionary re-allocation to the retail tranche, with no change in price, of securities initially assigned to the institutional tranche whose conditions were rejected in that tranche, is not always acceptable.

Moreover, calls for greater transparency in corporate governance were reflected in the adoption of certain measures by some of the companies privatized in 1997. In particular, Telefónica, Repsol and Aceralia (and Argentaria, for its offering in 1998) included rules of conduct in their Board Regulations and specified them in their offering prospectuses.

creased flexibility, companies such as Dinamia (Spain's first listed venture capital company), Iberpapel and Aceralia were able to list on the electronic market.

The equity offerings in 1997 aroused considerable investor interest and the CNMV focused particularly on guaranteeing transparency, with special emphasis on two essential objectives: fostering knowledge among investors of the characteristics of the security and the conditions of the transaction and, at the same time, setting acceptable criteria for the conditions governing the retail tranche (see adjoining boxes). Additionally, the CNMV closely monitored the shares from the offerings in their first sessions on the market (see chapter on secondary markets).



The most outstanding development in the Spanish secondary markets in 1997 was the growth of the equities segment. Low interest rates plus rising share prices attracted small investors and collective investment institutions into this segment and encouraged company flotations and the continued process of privatisation of State-owned companies. 1997 was also a good year in the financial futures and options markets, which saw an increase in volume. In contrast, volume declined in both the private debt segment and in the futures on citrus fruits.

Because of the market trends, in 1997 the CNMV devoted particular attention to certain matters such as the formation of the first price in stock flotations, the technical capacity of the trading system to handle a massive influx of orders, the effect of volatility on markets and the increase in private placements.

Additionally, as is customary, routine monitoring of the markets led to many requests for information from market members, management companies of the exchanges, the SCLV and issuers as a result of significant variations in price or volume or of certain events with a possible impact on share prices. The efficiency of the CNMV's supervisory role was enhanced by the creation, within the Inspection Division, of the Market Monitoring Unit (UVM), whose brief and performance in 1997 are discussed in greater depth in chapter 9.

Impact on the market of public offerings

The public offerings of sale with impact on the stock market related to 17 companies and involved the placement of shares for over 2 trillion pesetas (see table 6.3). The bulk of this amount related to partial privatisations of large companies which were already listed, but flotations also made a sizable contribution to dynamizing the market. Eight companies were listed for the first time, all on the continuous market, with a total capitalization of approximately 310 billion pesetas.

Monitoring trading after conclusion of an equity offering is very important for investor protection. The first minutes of trading usually see a large influx of orders seeking rapid gains (sell orders) or to supplement the shares obtained in the offering process (buy orders). The success of most of the equity offerings in 1997 led to a large excess demand in almost all cases, which multiplied the number of buy orders in the first session of trading. The most significant case was the flotation of Adolfo Domínguez, which produced problems of saturation in the continuous market trading system and led to an investigation by the CNMV of the process of setting the initial market price (see adjoining box).

The problems detected in 1997 again highlighted the need to boost the technical capacity of the SIBE, the computerized trading system on which the electronic market relies (see box in this chapter). They also suggested the advisability of certain modifications to the trading rules. In November 1997, the Sociedad de Bolsas – the company who operates the electronic market - adopted a decision to generally allow a variation of at most 50% (formerly 15%) in prices during the pre-opening period, which should enhance the appropriate formation of the initial market price. Once the session has commenced, the maximum variation will still be 15%. Additionally, the pre-opening period has been extended by 30 minutes and now runs from 9 to 10 a.m.; it was also de-

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SECONDARY MARKETS

cided that the reference price in flotations during the pre-opening period will be their public offering price.

It is common practice in equity offerings for a finance entity to be entrusted with stabilizing the stock in its first days on the market, generally in the expectation of sizable sales in that period. The CNMV considers it advisable to establish guidelines on the performance of this function.

Incidents in the Adolfo Domínguez IPO

The retail tranche in the Adolfo Domínguez (ADZ) IPO was 182-times oversubscribed. Because of the pro-rating process, applicants obtained a very small number of shares (a minimum of 3 and a maximum of 15) and many sought to make up their target investment on the market.

During the pre-opening period on the first day of trading (between 9.30 and 10.00 a.m. on 18 March 1997), there was a massive influx of buy orders against a much lower volume of sell orders (2,436,091 and 438,562 shares, respectively). A significant number of the buy orders were entered at very high prices, possibly to favor their execution. As a result, the theoretical price reached 20,000 pesetas at times during the pre-opening period, compared with the IPO price in the retail tranche of 3,007 pesetas. The first matching price was 7,000 pesetas, and a total of 761 trades were executed at that price for a volume of 276,102 shares. The prospects of sizable gains triggered a wave of sell orders and within seven minutes of opening the share had fallen as far as it was allowed – 15% - to 5,950 pesetas. The stock closed at that price. Selling pressure continued in subsequent sessions and the price continued to be corrected downwards.

The massive build-up of orders on ADZ saturated the trading system during the pre-opening period and lengthened the response time to new orders on all traded securities. This situation made it necessary to extend the pre-opening period during the second and third sessions.

The CNMV immediately opened an investigation of the events and collected information on the parties involved in the orders processed during the pre-opening period on 18 March, in addition to conducting inspections. The investigation revealed the following:

- The bulk of buy orders were issued by a large number of small investors seeking to add to their allocations from the offering.
- These orders were processed through practically all of the market members.
- As is usual in these cases, most were market (i.e. “best price”) orders for execution on opening. To ensure immediate execution, the market members entered them at prices well above the price set in the offering process.

After examining the conclusions of the investigation, the CNMV found no reason to institute disciplinary proceedings. Nevertheless, it recommended operators not to process market orders in such a distorting manner during the pre-opening period and recommended investors to use limit orders. Also, reacting to certain practices observed in this event, it notified certain firms that they must modify their internal codes of conduct and improve the keeping of the obligatory records of orders and trades.

As discussed elsewhere in this chapter, this case led to a review of the rules governing trading in the pre-opening period and also highlighted the need for a sweeping renovation of the trading system’s hardware and software.

Private placements

There was increasing interest by institutional investors in the Spanish markets in 1997, as reflected in the rise in the number of private placements, i.e. the sale of significant packets of shares in listed companies to a restricted number of investors. These deals take place without affecting the market price but doubts occasionally arise as to whether they should be subjected to the system for public offerings. Consequently, the CNMV will shortly issue a Interpretative Letter establishing the criteria governing private placements. To avoid application of the system for public offerings, private placements must generally be addressed to a small number of institutional investors, with no prior publicity and without furnishing potential buyers with information which is not simultaneously available to the market as a whole.

Impact of OTC trading on organized markets

There was a considerable increase in OTC trades referenced to the Ibex in 1997, mainly due to the creation of guaranteed mutual funds. The hedging strategies associated with these operations can lead to very large transactions on the organized markets at times which are particularly sensitive in terms of price formation (such as the end of the session) and the CNMV is therefore devoting particular attention to this area. In 1997 a non-resident finance entity was fined 285 million pesetas for distorting prices with trades of this type on 27 December 1995. The CNMV also immediately opened an investigation after the prices of Telefónica and Endesa slumped at the end of the session on 31 December 1997 (see box).

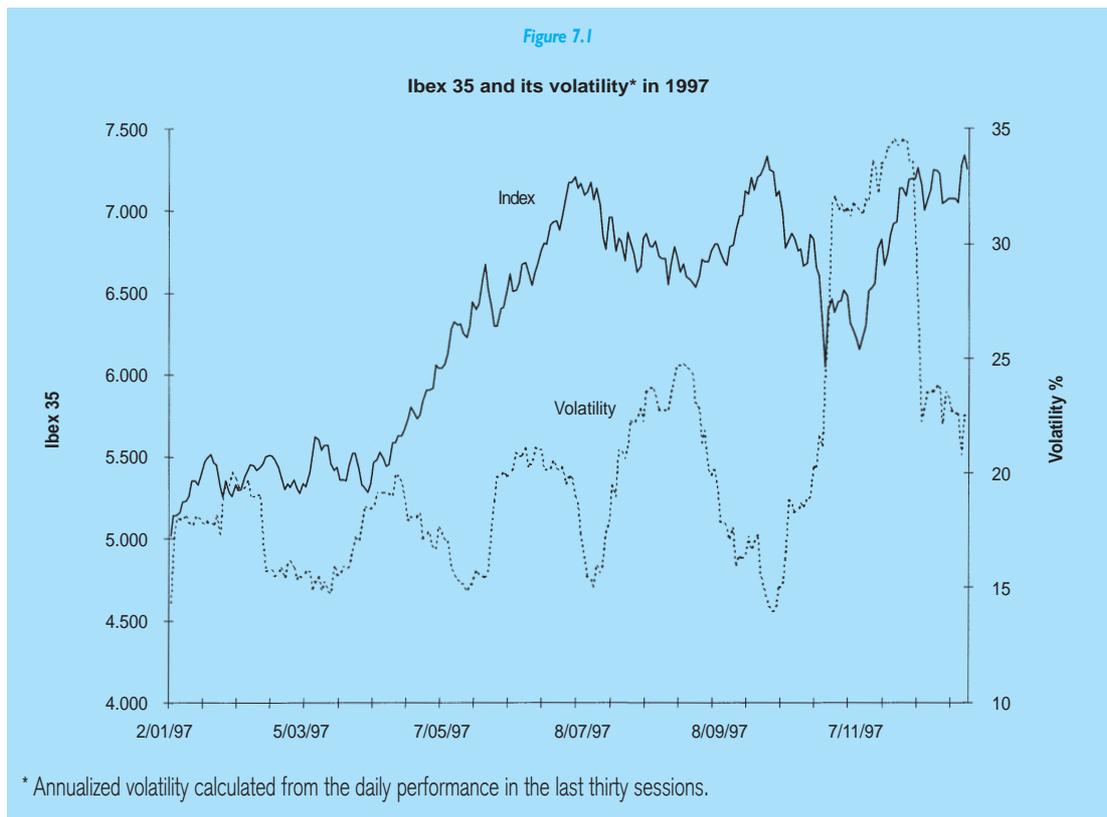
In April 1997, the CNMV warned intermediaries, in its Circular 5/97, that article 80.a) of the Securities Market Law prohibits the creation of artificial price movements for their own benefit or for that of others and that, consequently, they should be cautious when entering orders in the continuous market when their price or amount could seriously perturb the price formation process at that time.

Impact of volatility

The bull market in equities in 1997 was accompanied by considerable volatility, particularly in the first quarter, as shown in the accompanying graph. Additionally, the Asian crisis in October, which triggered a sharp (but temporary) slump in prices practically worldwide, tested the electronic market's trading rules (the various modifications implemented in November by the Sociedad de Bolsas with regard to the pre-opening period have already been discussed) and revealed the limitations of the hardware and software supporting the electronic trading system (see box). The effects of volatility were also felt in the equities segment of MEFF, the financial futures market, as regards the daily margins. Margins had declined in January in line with the other European markets, but in July MEFF was forced to issue an extraordinary margin call for the first

Telefónica and Endesa share price movements at the end of the session on 31 December 1997

Telefónica and Endesa, the two most heavily weighted stocks on the Ibex 35, fell considerably in price during the session on 31 December 1997, in contrast with the index itself. Whereas the Ibex 35 closed down 1.1%, those two stocks fell 5.1% and 4.1%, respectively. In the last minute of trading, Telefónica fell 4.8% and Endesa 1.6%. The CNMV initiated an exhaustive investigation that same day to ascertain the reason for the anomalous variation in the prices of these two stocks.



time in its history. At the end of October, due to the impact of the Asian crisis, it was decided to increase the daily margins.

Working group comprising the presidents of the CNMV, SCLV and the management companies of Spanish exchanges

In 1997, the presidents of the CNMV, the SCLV and the management companies of all the organized exchanges in Spain established a schedule of monthly meetings to discuss matters affecting them. The aim is to exchange ideas and promote initiatives in order to combine forces to favor the Spanish securities market at a time when it must face major challenges such as the massive influx of new investors, increasing competition within the new European framework configured by the Investment Services Directive and Spain's forthcoming entry in Economic and Monetary Union.

Supervision of floor trading by the management companies of the exchanges

The electronic market concentrates 98% of trading in equities and, consequently, the CNMV devotes priority attention to it, but without ignoring floor trading. To supervise floor trading more efficiently, in 1997 the CNMV asked for the active collaboration of the four stock exchanges' management companies, since the stocks traded by open outcry are generally very local and the stock market personnel are present in the pits throughout the session. The market management companies are responsible for organizing and managing trading and, consequently, the securities market legislation (article 12 of Royal Decree 726/1989, dated 23 June, on market management companies and market members) assigns specific supervisory functions to them. In discharging this duty, the market management companies are obliged to notify the CNMV of any events or actions which might constitute offenses and to assist the CNMV in performing its supervisory, inspection and sanction functions.

The need to increase the SIBE's technical capacity

The electronic market's trading system has experienced congestion on several occasions, in particular on 18 and 19 March 1997, on the occasion of the Adolfo Domínguez IPO, on 15 April, due to a massive concentration of orders on Telefónica, and on 28 and 29 October, due to turmoil caused by the Asian crisis.

Aware that the trading system must adapt to the market's present and future needs, the Sociedad de Bolsas is preparing a sweeping renovation of its infrastructure. At the request of the presidents of the management companies of the exchanges and the CNMV, the CNMV's Information Systems Division has analyzed the system's problems and the solutions proposed by the Sociedad de Bolsas. Its main conclusions are summarized below:

- *Problems detected:*

- Trading has outstripped the projections on which the system was designed. It has processed 90,000 orders and 230,000 transactions in a session, but the Sociedad de Bolsas estimates that the market could attain 145,000 orders and 375,000 transactions in the current situation and that, in the coming years, the market's capacity must be more than three times its present level.

- The current system can theoretically process ten orders per second, but response times have never been acceptable above 5 orders per second. Consequently, the system is particularly vulnerable to sharp changes in the market trend which generate a massive influx of orders and a large number of queries, cancellations and modifications.

- The current interface with the systems for routing intermediaries' orders facilitates overloading since up to three transactions may be required to enter an order in the system.

- Improvements in the software could avoid or mitigate the possibility of a single process monopolizing the computers' entire resources, as occurred in the cases of Adolfo Domínguez and Telefónica.

- *The plan proposed by the Sociedad de Bolsas.*

The Sociedad de Bolsas envisages completely replacing its computer hardware, which would quadruple its rated processing capacity, with scope for a 16-fold increase in the future if the need arose. To ensure the continued operation of the system, a backup contract will be arranged with the manufacturer of the computer for the central facilities, hardware and communications. The front- and back-end software will also be revamped. The possibility of modifying the routing interface is being examined, as is the introduction of measures to encourage grouping of orders.

- The innovations will be introduced during 1998, and the new system is expected to fully in place by December. The Sociedad de Bolsas has hardware since January which can be used if necessary before the completion of the implementation schedule.

- *Recommendations.*

- It is necessary to replace the hardware as proposed by the Sociedad de Bolsas. Nevertheless, even taking account of the estimates and calculations which have been made, exhaustive performance tests should be conducted to check whether the new equipment meets the specifications and to ascertain its limits.

- Investors see the routing system as just another part of the trading system. This can lead to false expectations about the overall performance of the system since orders are accepted which have not yet entered the SIBE, encouraging the introduction of new orders in very busy sessions. In addition to reviewing the routing interface, the Sociedad de Bolsas should consider introducing control rules and methods to ensure that systems which are owned by other firms and use different technologies, enhance the management of the SIBE rather than hindering it. It is particularly important that investors should know whether their orders are still in routing or whether they have actually entered the SIBE.

Issuers' transactions with own securities

There are cases where issuers trade with their own securities in order to provide liquidity. It is important to note that these transactions must not artificially affect the security's price and that, for example, it is not admissible for a company related to the issuer to participate at the same time as a counterparty.

Temporary suspension of trading

Suspensions of trading affected a total of 35 issuers in 1997. The most frequent cause was the presentation or announcement of takeover bids and the announcement of relevant events. There were eight suspension due to issuers presenting insufficient financial information to the market. The temporary suspension of a security is a tool to prevent an anomalous functioning of the market in the absence of sufficient information. The CNMV prudently administers suspensions of trading and does not prolong them more than reasonably necessary in order to protect investors and reduce the harm which can be caused by insufficient liquidity.

Table 7.1
SUSPENSIONS OF TRADING

	1996	1997
Number of issuers suspended	28	35
Number of suspensions	39	48
Due to presentation of takeover bid	20	15
Due to dissemination of relevant information	8	16
Due to announcement of forthcoming takeover bid	10	9
Due to insufficient financial information	0	8
Due to technical reasons	1	0

Ex-officio exclusions from listing

In 1997, 10 companies (Coninsa, Baqueira Beret, Colón de Inversiones, Rentcapital, Aurium, Gestiberia, Cointra, Gestión Colectiva, Tipel and Intra Corporación Financiera - all traded by the open outcry system), were excluded from trading by the authorities due to repeated failure to comply with their reporting obligation or because of extraordinarily low trading frequencies. As in prior years, these moves have an indubitable positive effect on the health of the floor trading system, which accounts for a very small proportion of our market's activity. Maintaining on the market companies which do not duly release information or maintain fictional trading activity impairs the overall image of the market and can dissuade investors.

Clearing and settlement

Securities clearing and settlement impact investors and often sway decisions about where to locate trading activity. The growth in the Spanish market and the challenges it faces within Europe in the near future require efforts to be made to improve these services.

On 24 February 1997, the Securities Clearing and Settlement System (SCLV) took a step in this direction by establishing the settlement period for stock market at D+3, i.e. shortening it by two days. Although this is considerable progress, the SCLV must make further improvements in this specific area:

Firstly, the committed settlement period must be met, with very few exceptions. The Spanish clearing and settlement system has repeatedly received ratings from the major international depositaries which do little justice to our market's relative importance. The fact that this has occurred repeatedly calls for serious efforts to boost the system's efficiency. The percentage of sales processed late increased in 1997 due possibly to the fact that the shortening to D+3 coincided with a large increase in settlement volumes and with the processing of the large public offerings. Measures had been taken to remedy this matter by the end of the year.

Secondly, international quality standards are increasingly demanding envisage periods shorter than D+3, including the availability of gross settlement services in real time. The SCLV has already undertaken to advance in this direction, and in conjunction with the CNMV, is examining the measures to be adopted.

One important problem which has yet to be overcome is the fragmentation of the system for settlement of private fixed-income securities, which is a brake on the development of this segment of the Spanish market. Whereas equities are entirely dematerialized and are settled by the SCLV, the securities traded in the AIAF are still mostly represented by physical securities and are settled by a different system (Espa-clear).

Another important matter is the management of private securities which collateralize liquidity transactions by the banks in the future European System of Central Banks. At the initiative of the CNMV, a working group (comprising the Directorate General of the Treasury, the Bank of Spain, the SCLV and the CNMV) has been set up to examine alternatives in this area.

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MARKET TRANSPARENCY

Transparency is a quality which is intimately linked to the availability of sufficient accurate, exact and timely information, enabling investors to make sound decisions. A market which is not transparent favors certain agents over the majority and is always inefficient. The CNMV took various steps in 1997 to ensure that our markets maintain a high degree of transparency.

Periodic reporting by listed companies

Listed companies are obliged to provide information to the market on a regular basis. Each quarter they report details of sales, earnings and employees; they present their balance sheets every six months and their audited financial statements, annual report and other related reports once per year.

In this area, the CNMV devotes particular attention to the quality of the information filed on the progress of business. Such information must include explanations of the seasonal or cyclic nature of the business, the nature and amount of the factors affecting assets, liabilities, equity, net revenues or cash flow and those considered as extraordinary by their nature or amount. If the company has this information, it should also provide a breakdown of revenues and earnings by line of business.

To this end, the CNMV is considering modifying the bases of presentation and valuation methods for the half-yearly report so that this report specifically discusses any significant events in contingent assets and liabilities, qualifications, uncertainties and limitations expressed in the auditors' report on the last audited financial statements and any transactions by the company with related parties. The form in which this information must be structured has been included in the instructions for completing the half-yearly filing.

Use of new technologies in disseminating and reporting information

Recently filed prospectuses (such as those of Iberpapel and Dinamia) were made available on the CNMV's web site.

The CNMV will continue to encourage the use of computer media to facilitate the process of verifying applications and, insofar as the market has the requisite resources, will increasingly make prospectuses available on the Web (www.cnmv.es) so that users may not only view them but also make use of their contents.

Financial statements and auditors' reports

The presentation of financial statements and the related auditors' reports has improved considerably in recent years. As shown in table 8.1, the percentage of auditors' reports being filed with exceptions and the number of disclaimers of opinion and adverse opinions have all declined.

Table 8.1

AUDITS OF ISSUERS FILED WITH THE CNMV (*)

	1996		1995		1994	
	Number	%	Number	%	Number	%
1. AUDITORS' REPORTS FILED						
- Individual financial statements	421	64,1	452	64,7	467	66,0
- Consolidated financial statements	236	35,9	247	35,3	241	34,0
Total auditors' reports filed	657	100,0	699	100,0	708	100,0
- Special reports under Ministerial Order 30/9/92	102		152		172	
2. AUDITORS' OPINION						
- Clean opinion	517	78,7	504	72,1	484	68,4
- Qualified opinion	140	21,3	195	27,9	224	31,6
3. TYPES OF QUALIFICATION						
- Number of auditors' reports with exceptions ...	65	46,4	98	50,3	93	41,5
- Number of auditors' reports with uncertainties, etc.	100	71,4	145	74,4	172	76,8
- Number of auditors' reports with limitations	20	14,3	27	13,8	29	12,9
Total qualified auditors' reports	140	100,0	195	100,0	224	100,0
4.1. EFFECT OF EXCEPTIONS ON RESULTS						
- Number of auditors' reports with positive effects	17	26,2	18	18,4	28	30,1
- Number of auditors' reports with negative effects	41	63,1	69	70,4	51	54,8
4.2. EFFECT OF EXCEPTIONS ON NET WORTH						
- Number of auditors' reports with positive effects	11	16,9	24	24,5	20	21,5
- Number of auditors' reports with negative effects	26	40,0	38	38,8	32	34,4
Total auditors' reports with exceptions	65	100,0	98	100,0	93	100,0
5. NATURE OF UNCERTAINTIES, ETC						
- Going concern	35	35,0	32	22,1	48	27,9
- Tax contingencies	39	39,0	55	37,9	60	34,9
- Recovery of assets	35	35,0	81	55,9	96	55,8
- Assets revalued under Basque Country regulations	2	2,0	16	11,0	18	10,5
- Litigation	21	21,0	29	20,0	25	14,5
- Denial of opinion or adverse opinion	12	12,0	18	12,4	19	11,0
- Other uncertainties	43	43,0	43	29,7	41	23,8
Total auditors' reports with uncertainties, etc.	100	100,0	145	100,0	172	100,0

(*) Auditors' reports on financial statements and special reported filed with the CNMV through 6 October 1997.

This trend is due essentially to two factors: the realization by issuers of the importance of filing financial statements on which auditors can issue a clean opinion and the insistence by the CNMV on improvements in the quality of information supplied by issuers in their financial statements.

The change in attitude by issuers is due to many reasons, such as the development of the securities market, investors' greater knowledge (leading them to demand information which is increasingly more reliable and transparent) and the access by Spanish companies to international

markets, where a qualified auditors' report can pose a considerable obstacle to the placement of securities. The change in the economic cycle, now in the upswing, means that there is less use of creative accounting to distort the actual figures.

Nevertheless, most issuers could still improve the quality of the information provided in their annual reports and management reports by not merely fulfilling the requirements of company law but providing added value and giving investors more data and information on which to base investment decisions (risks, growth potential, etc.). For example, some companies do not even state which markets their securities are traded on and little or no information is provided regarding off-balance sheet and related-party transactions. Issuers would contribute to increasing the market's transparency if they adopted some of the CNMV's recommendations in this connection, which include the following:

- Companies should not file abridged accounts.
- Exceptions to reporting should be confined to those allowed by company law.
- Management reports should discuss in detail the balance sheet items and the factors which might affect the company's future performance.

Action taken by the CNMV to improve the information furnished by issuers includes most notably the following:

- Demands to companies that they furnish their auditor with sufficient information to avoid scope limitations. The result is that the number of auditors' reports with scope limitations fell from 53 in 1993 to 20 in 1996.
- Contacts with the main audit firms to notify them of matters which the CNMV considered to be in need of improvement and to inform them of the criteria which the CNMV uses in reviewing auditors' reports and financial statements.
- Demands to companies with qualified 1996 auditors' reports to explain the reasons for the qualification and their plan to eliminate them. Specifically, in 1997 100 demands were issued to 59 companies. As shown in table 8.2, most of these companies had already remedied the matter which gave rise to the qualification or had filed a plan for that purpose by the end of 1997. Only three companies had failed to reply or complete their reply by that date.
- Suspension of trading in securities whose issuers had not filed the auditors' report by the established deadline or whose auditors' report contained qualifications, uncertainties or limitations requiring the provision of additional information. Trading in eight companies were suspended for this reason, of which only one (Urbas) was listed on the electronic market. The other companies (traded by the open outcry method) were Cartemar, Urbi, Dalt, Jumberca, Ucem, Pbsa-Pesquerías Españolas del Bacalao and United Dutch.

Significant holdings and boards of directors

The information contained in the public records on listed companies' shareholder structure and board of directors has been expanded to include a comments field containing such additional information as: concerted action, options, clarifications about notifications which have not been updated, etc. Moreover, the record of directors includes a new field indicating the director's position. All this information is now available on the Internet, making it significantly easier to consult.

Table 8.2

**DEMANDS ISSUED TO LISTED COMPANIES IN 1997
IN CONNECTION WITH THE AUDIT OF THE 1996 FINANCIAL STATEMENTS**

Continuous market	Open outcry	Second market
1.- Companies which had failed to file the consolidated audit and which have remedied the matter.		
AGROMAN	GESTIBERIA*	BARCELONESA INVERS. MOBILIAR.
	GRES DE NULES	COMERCIAL SALGAR
	ZAYER	CROMOGENIA UNITS
		EDITORIAL GUSTAVO GILI
2.- Companies with qualified auditors' reports which have remedied the situation or filed a plan to remedy it.		
CORPOR. FINANCIERA REUNIDA	ALMACENES GENERALES INTERN.	INMOBILIARIA CARROGGIO
CORTEFIEL	ANDRES RUIZ DE VELASCO	KERABEN
FILO	BOLSANOR	
HORNOS IBERICOS ALBA	CIA. DE INVERSIONES CINSA	
HUARTE	CIA. LEVANTINA EDIF. Y OBRAS P.	
INDO INTERNACIONAL	COINTRA*	
MARCO IBERICA, DIST. EDICIONES	COMERCIAL DE LAMINADOS	
NICOLAS CORREA	DALT	
	FOMENTO INMOBILIARIO CENTRAL	
	FORUM INMOBILIARIO CISNEROS	
	GRAND TIBIDABO	
	HULLAS DEL COTO CORTES	
	INMOBILIARIA ALCAZAR	
	INMOBILIARIA SANBOAL	
	JUMBERCA, S.A.	
	MANUFACTURAS ANTONIO GASSOL	
	NAARDEN INTERNACIONAL	
	NATRA	
	RENFILA	
	S.A.PLAYA DE ALBORAYA	
	S.A. NOBO	
	UNION CATALANA DE VALORES	
	UNION GENERAL INVERSIONES	
	XEY	
3.- Companies with qualified auditors' reports which state they will not take any measures to remedy the matter.		
MINERO SIDER. DE PONFERRADA	GLOBAL STEEL WIRE	CORPORACION IB-MEI
	I. E. G.	
4.- Resolution of qualifications depends on future events or cannot be overcome in the short term.		
SNIACE	ESPAÑOLA DEL ZINC	CARTEMAR
URBANIZACIONES Y TRANSPORTES		
5.- The Company will decide how to handle and overcome the qualification in the 1997 financial statements.		
LA SEDA	ERCROS	
NUEVA MONTAÑA QUIJANO	PROMOCIONES Y CONCIERTOS IN.	
RADIOTRONICA	TUBOS FORJADOS	
6.- Companies which had received demands and failed to respond or complete their initial response.		
	INBESOS	URBI
	VICINAY	

* Excluded from listing.

Relevant events and their communication to the market

Dissemination of relevant news by listed companies is an essential factor in the working of the securities market. The Securities Market Law defines relevant events as those which “have a noteworthy influence” on the share price. Given the diversity of the business world, it would not be useful to draw up a closed list of events in order to delimit the scope of this legal definition. Rather, the CNMV considered it advisable to provide issuers and their legal counsel with a number of guidelines to help them correctly apply the current legislation.

Consequently, in July 1997 the CNMV issued Policy Statetment 9/1997 on significant events and their notification to the CNMV, which includes, for guidance purposes, a list of the events and decisions which it feels fall within this category, and makes the following comments and recommendations, among others:

- *Scope of obligation.* Any event or decision which might modify or has modified the profitability or solvency of the issuer or the level of efficiency which the market attributes to it based on the previously distributed information can be considered a material event.
- *Secrecy phase.* This is the phase which normally precedes the adoption of decisions. All information produced during this phase is defined as “reserved” (article 81.1 of the Securities Market Law) and maximum confidentiality is required so as not to create confusion or false expectations in the markets. The CNMV recommends that issuers minimize the number of people who are aware of the matter, that they keep a record of their names, require participants which are not related to the issuer to sign a confidentiality agreement and keep strict control over documentation. To detect leaks, the issuer must monitor the share price and, if leaks occur, it must confirm or deny the news about the leaked information. The issuer should be particularly cautious in meetings with analysts, shareholders or investors so as not to reveal to them information, which has not been previously released to the market as a whole.
- *Time of notification.* In the case of decisions by the issuer, notification to the CNMV must be made immediately after the related resolution by the competent governing body (Board of Directors or Shareholders’ Meeting, generally). If execution is conditional, e.g. on the obtaining of administrative authorization, this must be stated in the notification. In the case of economic and financial results or other data, the information must be released immediately after it becomes known or is evaluated and approved. The issuers may also voluntarily inform the CNMV of their plans during the secrecy phase, requesting confidential treatment from the CNMV. However, the CNMV may oblige them to release the information or may publish the information itself if it considers that the news has been leaked.
- *Form of notification.* The CNMV must be notified first, by the fastest and most efficient route and, whenever possible, when the market is closed, in order to avoid distorting market trading. Where very significant news is released while the market is open, the CNMV may temporarily suspend trading in the stock in order to enable all operators to be aware of and evaluate the development. The CNMV makes all notifications immediately available to professional reporters and news agencies as well as including them in its public registries.
- *Internal policies and procedures.* All issuers must establish internal policies and procedures covering at least the following: (i) a code of conduct on the control and use of reserved information within the firm, (ii) criteria for identification, internal use and notification to the market of “reserved” and “sensitive” information and (iii) designation of persons responsible for notifying significant events to the CNMV.

Code of Corporate Governance

On 28 February 1997, the Spanish Cabinet approved the creation of a Special Commission which it commissioned to draft a report on the performance of the boards of directors of companies which use the financial markets, by broad consultations with the agents and firms operating in the markets and with their most representative organizations and, based on the results, to draft an “code of corporate governance” which could be adopted voluntarily by such boards of directors in the future.

On March 1997, by an Order of the Second Vice President of Government and Minister of Finance, the Special Commission was formed with Mr. Manuel Olivencia Ruiz as President, Mr. Luis Ramallo García as Vice-President, and Mr. José María López de Letona y Núñez del Pino, Mr. Enrique Piñel López, Mr. Eduardo Bueno Campos, Mr. Víctor Pérez Díaz, Mr. Pedro Ballvé Lantero, Mr. Jesús Platero Paz and Mr. Cándido Paz-Ares Rodríguez as ordinary members. Mr. Antonio Alonso Ureba, the Secretary of the Board of the CNMV, was appointed Secretary of this Commission, since the CNMV had been entrusted with providing the Commission’s operational secretariat and the necessary administrative support using its own personnel.

The Special Commission worked throughout 1997 and held regular meetings in the CNMV’s offices.

This is a very important initiative since, as pointed out in the resolution which created the Commission, it responds to demands by broad professional sectors and by the markets themselves, which will benefit from greater investor confidence if the boards of directors of the companies obtaining finance on the markets are more directly involved in corporate governance and act in a more responsible manner.

Other developed countries have already drafted codes of corporate governance, all of which are voluntary. Publication of Spain’s code will help to fill the gap in our business culture with regard to transparency in management, and will consequently benefit shareholders and the investment community in general. This initiative is also particularly timely given the rapid expansion of share ownership in Spain.

Once the Special Commission’s proposal has been completed and remitted to the Cabinet, the CNMV will publish it and it expects listed companies to adopt the Code’s recommendations and thereby enhance the quality of our securities markets.

9

MARKET INTEGRITY

Market Monitoring Unit

Objectives and Resources

The CNMV created the Market Monitoring Unit (UVM) in February 1997. Reporting to the Inspection Division, the UVM's fundamental aim is to pursue the following practices:

- Improper use of inside information.
- Price manipulation.
- Money laundering.

The detection and punishment of these offenses have been priorities of the CNMV since it was founded. Now, with the creation of the UVM, the goal is to entrust this work to a highly specialized unit equipped with the best human and technical resources.

The new unit was formed with experienced personnel transferred from other divisions in the CNMV. Consequently, the unit has in-depth knowledge of the various areas of supervision, as is required to efficiently discharge its duties. The procedures and technical resources are similar to those used by supervisory bodies in the London and New York stock exchanges.

The UVM is gradually coming up to speed. However, in its short period of existence it has already perfected some of its investigation systems and it will fine-tune them on the basis of future experience.

Detection of offenses

The UVM has various tools for detecting the possible commission of the offenses which it was created to pursue:

- Systematic review of trades preceding certain events: takeover bids and other corporate transactions, notifications of significant events preceded by an alteration in the trend in trading volumes or prices, etc.
- Analysis of the information provided by the area in charge of monitoring secondary and derivatives markets (alarm systems). Particular attention is given to unusual variations in volumes or prices.
- Coordination with other institutions in the framework of the Commission for the Prevention of Money Laundering.
- Complaints filed with the CNMV's Public Attention Department.

Standard steps in an investigation

a) *Possible use of inside information:* Once an investigation is under way, it generally follows the following pattern:

1. Delimitation of the period under investigation and of possible insiders. The goal is to determine from what point the insider information existed and who had access to it.
2. *Identification of the parties engaging in transactions during the period under investigation.* The basic data are held by the finance entities which were involved in the transactions or which act as depositories or which keep the book entries for the stock. Evidently, the information involved may be copious and

a large number of entities may be involved. One of the UVM's priorities since it was formed has been to expedite the treatment and transmission of this information.

3. *Use of the information.* The information obtained in the preceding two phases is checked to determine whether any of the persons who were in possession of the reserved information conducted transactions during the period under investigation or whether they have any links with buyers or sellers. This step may require additional information from data bases or obtained under subpoena. Information is often requested from the supervisory authorities in other countries to ascertain the true owners of the transactions being scrutinized. Throughout this process, the CNMV strictly observes the regulations of the data protection legislation. Data can only be demanded for the purposes of the investigation and must be either destroyed or offered to the interested parties once the investigation has concluded.

b) *Possible price manipulation.* The market behavior of the asset in question is examined, the general procedure being as follows:

1. *Determination of the trading interval to be analyzed* and selection of the market members which were most actively involved during in the period.
2. *Selection of the transactions which had the greatest impact on prices* and identification of the related owners.
3. *Analysis of links* between price behavior and events which affected the stock, product or index.

Consequences of an investigation

Once the UVM has concluded an investigation, the CNMV makes one of the following decisions on the basis of an overall appraisal of the events and actions which are observed:

- *Closure of the investigation*, if no conduct or practices which breach the securities market regulations are detected.
- *Remittal of a notification to the interested person or firm indicating*, as appropriate, the existence of organizational deficiencies or of conduct which departed from good securities market practices. In these cases, the addressee is asked to read the notification at the Board of Directors (if it is a company) and report to the CNMV, by a given deadline, of the measures adopted to remedy the deficiencies which were detected.

The most noteworthy actions in this connection during 1997 were as follows:

- Two broker-dealers and a banking entity were found to have deficiencies in the obligatory records referred to in Royal Decree 629/1993 on rules governing action in the securities markets and obligatory records.
- A banking entity, three broker-dealers and a broker were recommended to modify their internal codes of conduct to establish a specific system for the acquisition and disposal of securities acquired by their personnel. The goal was to prevent operators from trading in securities where their firm either traded with those securities or played a role in tender offers or equity offerings in them. This would also ensure compliance with certain basic principles of the securities markets (priority of customers' interests, prohibition on the use of privileged information, etc.) while bringing the codes of conduct applicable to those firms into line with those of others which, due to their greater responsiveness in this connection, already had similar internal rules since the entry into force of Royal Decree 629/1993.

- One securities issuer which had a controlling holding in another listed company was asked to adopt internal measures in order to avoid future cases of the issuer directly transferring part of its stake in that subsidiary to that subsidiary itself, since that transaction immediately generated treasury stock for the latter (which was amortized after acquisition in this particular case). The market member which had intervened in the transaction was also asked to adopt measures to prevent this practice from recurring.

- *In particularly serious or complex cases, remittal of a notification to the person or firm involved, setting out the events or actions observed and the CNMV's evaluation of same. Once the addressee person or company's reply has been received and analyzed, a decision is made whether or not to commence disciplinary proceedings.*

Table 9.1

ACTION BY THE MARKET MONITORING UNIT IN 1997

	Number
Investigations conducted	38
Inside information	20
Price manipulation	14
Other	4
Demands for information ¹	1,025
Identify investors	909
Identify circle of insiders ²	41
Obtain information	58
Letter of recommendations	17
Visits ³	51
Declarations obtained ⁴	35

¹ Requests to the SCLV, associated entities, market members and foreign regulators.

² Requests to issuers, legal and financial advisers and other participants in corporate transactions.

³ Visits mainly to market members, associated entities and issuers.

⁴ To individuals and to agents of market members, finance entities and issuers.

Action by the Inspection Division

In 1997 a total of 23 disciplinary proceedings were processed, of which nine had commenced in previous years, covering a total of 45 offenses.

The CNMV made considerable efforts to expedite processing of these procedures, responding to a target set at the end of 1996, while scrupulously respecting the guarantees and time periods for the interested parties to exercise their right to defense. This target was reasonably attained since, at the end of 1997, only 8 proceedings remained open, the oldest of which had commenced in July 1997.

The number of disciplinary proceedings was lower than in 1996, due mainly to two reasons. Firstly, offenses in the area of solvency, liquidity and accounting at investment services companies, which had been the subject of priority attention in the past, had practically disappeared, reflecting both the good market climate and increased professionalism of their administrators.

Secondly, the CNMV itself has decided to focus on the codes of conduct to be observed by firms and persons operating in the securities markets. Respect for codes of conduct ensures effective protection for investors and is an essential quality factor for enhancing the image and competitive position of our securities market.

The greater importance of breaches of codes of conduct led to greater diversity in the offenses processed in 1997. Of the 45 proceedings, 18 related to price rigging, privileged or reserved information, absence of «chinese walls», provision of incorrect information to the market and violation of the principle of customer priority. The number of these (14) which were included in proceedings opened during the year was greater than in previous years due to the contribution made by the new Market Monitoring Unit.

Criteria of interest in the resolution of disciplinary proceedings

I: Price manipulation. Practices covered by article 99.i) vs. those covered by article 80.a) of the Securities Market Law.

I.a. Items covered by article 99.i).

The CNMV is extremely concerned about practices which might distort the correct formation of prices in the securities market, as such prices should respond exclusively to free market supply and demand in order to be true, correct and fair. In short, the aim is to defend a market which is free and open (and, hence, efficient) where prices are set based on the consensus of buyers and sellers acting in good faith.

Unlicensed intermediaries

In 1997, the CNMV continued to detect and repress the activities of unregistered intermediaries, which are extremely detrimental to investors and to the good image of our securities market.

A total of 40 firms were discovered in 1997 which were conducting activities presumably subject to CNMV supervision. It is noteworthy that in the vast majority of cases, the mere initiation of the inspection led to cessation of illegal activity by these firms. Since this is the most beneficial possible outcome for investor interests, the CNMV has stepped up its efforts to detect such companies as soon as they begin to operate.

As a result of the investigations, charges were presented against four firms and their directors for illicit activities. Another four firms and their directors were fined. In ten of the cases inspected, evidence was found of criminal offenses which were notified to the police unit which liaises with the CNMV and to the judicial authorities, to which the CNMV continued to provide support.

In the course of inspections, certain firms were found to be offering high-yield products other than securities which any prudent investor should examine very cautiously before acquiring. These included alleged short-term currency transactions, investment in the commercial exploitation of animals such as emus and ostriches and one-off mortgage finance transactions.

The inspectors also detected firms not registered in Spain which claimed to be authorized to market in Spain options and futures traded on foreign markets by exhibiting alleged contracts for representation or marketing with brokers authorized in those countries. This fact is not in itself a guarantee that the firm is legally authorized to operate in Spain.

Table 9.2

ACTION BY THE INSPECTION DIVISION IN 1997

	1997		1996	
1. Demands	2,054		1,456	
2. Offenses leading to opening of proceedings				
-Very serious	18		20	
-Serious	3		9	
-Minor	-		2	
3. Proceedings concluded				
-Very serious offenses	25		82	
Dating from 1995	4		73	
Dating from 1996	16		9	
Dating from 1997	5		-	
-Serious offenses	6		45	
Dating from 1995	1		38	
Dating from 1996	2		7	
Dating from 1997	3		-	
-Minor offenses	1		3	
Dating from 1995	-		2	
Dating from 1996	1		1	
Dating from 1997	-		-	

	Opened		Closed	
	1997	1996	1997	1996
I. Price manipulation	5	-	2	-
II. Failure to report significant holdings	-	1	6	1
III. Illicit activities	4	6	5	12
IV. Simulated transfers	-	1	5	5
V. Insider information	6	1	1	-
VI. Breach of coefficients	-	1	1	3
VII. Concealment of significant events	1	0	1	1
VIII. Breach of Company Law	2	0	2	3
IX. Breach of general securities market regulations	-	4	1	26
X. Breach of general CIS regulations	-	-	1	-
XI. Elusion of tender offer	-	2	-	2
XII. Accounting offense	-	2	-	25
XIII. Obstruction of inspection	-	-	-	1
XIV. Unregistered issues	-	-	-	1
XV. Breach of authorization requirements	-	-	-	2
XVI. Filing false information	-	2	-	-

	Opened		Closed	
	1997	1996	1997	1996
I. «Chinese walls»	1	-	1	-
II. Accounting irregularity	-	1	1	3
III. Violation of the "customer first" principle	-	1	2	3
IV. Breach of regulations on orders and transaction records	1	2	1	1
V. Reserved information	1	-	1	-
VI. Illicit activities	-	-	2	-
VII. Breach of coefficients	-	2	-	5
VIII. Failure to report treasury stock	-	-	-	1
IX. Breach of general securities market regulations	-	3	-	30

	Opened		Closed	
	1997	1996	1997	1996
I. Breach of code of conduct	1	1	-	-
II. Breach of general securities market regulations	-	1	-	3

	1997			1996		
	Number	Amount	Period	Numer	Amount	Period
I. Fines	37	1,195,834,954 pts.	-	179	901,931,415 pts.	-
II. Disqualification of officers	6	-	30 years	20	-	154 years
III. Limitation of activities	1	-	1 year	-	-	-
IV. Reprimands	2	-	-	8	-	-
V. Withdrawal of authorization	2	-	-	7	-	-

In the difficult field of defining what constitutes price rigging, considerable progress was made in 1997 both through disciplinary proceedings and through the issuance of Circular 5/1997.

One essential factor is distinguishing between conduct under article 99.i) and that under article 80.a) since, although they are similar, the penalties are very different. Whereas “development of practices aimed at distorting the free formation of prices in the securities market” (article 99.i)) is pursued as a very serious offense, “provoking an artificial change in prices for own or third-party benefit” (article 80.a) is only a serious offense.

In the CNMV's view, in order for action to fall under article 99.i), there must be a deliberate process to alter the mechanism by which prices are freely set. Accordingly, offenses under article 99.i) should logically also involve actual impairment of the market.

The Ministerial Order dated 23 October 1997

The Ministerial Order dated 23 October 1997 punished a foreign firm for carrying out massive sales of securities in the Ibex-35 index in order to reduce the closing price as much as possible, which events took place in the final seconds of the session on 27 December 1995. The firm in question had to settle a swap transaction which it had arranged to hedge the return on a guaranteed fund referenced to the Ibex-35 index; once it had sold during the session the bulk of the stocks which it had acquired to hedge the risk of the transaction, the firm engaged in practices (massive sale of securities at the end of the session in defiance of all economic logic) with the intention of lowering the closing value of the Ibex-35 index as much as possible.

The Ministerial Order found that there had been an offense under article 99.i) in that there was a causal relationship between the firm's actions (sales of spot baskets on the Ibex-35) and the sizable drop in the closing value of the index and that said linkage was due to action by the firm which did not respond to a legitimate divestment strategy but, rather, was aimed at lowering a given price to enable it to maximize its gain from the spread between the price obtained on the prior sale of the stocks held to hedge the swap transaction and the settlement of the latter. In short, the events revealed a clear intention to fix a given price in search of individual benefit in the settlement of an off-market transaction.

The position of the Court (“Audiencia Nacional”)

The specific intention and especial gravity required under this type of offense were also admitted, in the terms proposed by the CNMV, in the Court judgments issued on 16 April, 29 September and 21 October 1997. The first two judgments related to the manipulation of an issuer's share prices by the issuer itself and by companies in its finance group; the third judgment related to manipulation of the prices of a specific stock by a broker-dealer which controlled 100% of trading in one of the markets and 60% in another and set the price using individuals and legal entities related to it and to its officers. The Court confirmed that, for an offense under article 99.i) to exist, it is not necessary that there be an illicit purpose but, rather, that the “performance of practices aimed at distorting the free formation of prices, so that the fact that prices are distorted for an ulterior motive which is not an offense is not an exonerating circumstance. Consequently, the offense is consummated when the practices in question manage to form a price for the security in breach of the free interplay of supply and demand.”

The aforementioned judgments considered as evidence of intentionality the massive intervention by the issuer in trading in the stock, actually exceeding 50% of trading in the stock on certain days of the period which was analyzed, which managed to create a false price insofar as the

issuer, by its deliberate action to this end, managed to neutralize and reverse the natural trend of the market.

Also, in line with the CNMV criteria, those court judgments also considered that the fact that the issuer acted without the market's knowledge by trading through instrumental companies which at no time revealed the issuer's intention was proof of deliberate malice, and stated that those events "created an artificial appearance in the market at the same time as it generated an artificial price which encouraged others to trade in the security at that price."

1.b. The components of article 80.a)

The CNMV considers that the consummation of actions under article 80.a) has different characteristics from those described above. Firstly, this precept is in the section on rules of conduct and, consequently, it would clearly appear to be aimed basically at intermediaries and other market professionals and not at other entities which may act in the market (e.g. listed companies) – unlike article 99.i) which is applicable across the board.

Also, in contrast with the intentionality required under article 99.i), article 80.a) seeks to punish negligence when measured against the yardstick of the special diligence required of qualified professionals. In short, the aim is to punish actions which, though not carried out with the intention to artificially alter market prices, were performed by persons or firms which, by virtue of their special qualifications, should have known that the undesired result could ensue and, therefore, should have acted differently.

Therefore, article 80.a) is part of a chapter which seeks to prevent negligent behavior in the markets by the professionals operating in them and the offense is the creation of a risk, and no actual result is required for consummation of the offense.

In this line, CNMV Interpretative Letter 5/97, dated 3 April 1997, was a reminder that certain practices, such as entering orders either during the pre-opening period and at the close of session, might affect the process of price formation of certain stocks and be considered as serious offenses under article 80.a). In short, these are practices which should be shunned by those obliged to place the interests of their customers and of the market in general above their own interests.

II. Liability of individuals

II.a. General principles

The Securities Market Law, whose original text was inspired by the principles underlying the Credit Entities Supervision and Control Law, considered legal entities to be the offenders and only provided two cases where individuals could be punished: where they had acted for their own account and, exceptionally, for the account of a supervised entity, in which case the individual's liability was derived from the primary liability of the legal entity. This scheme was subsequently modified by Law 3/1994, dated 14 April, which placed individuals and legal entities on an equal footing as regards the application of the disciplinary system.

In view of this new situation, the CNMV has sought, through various disciplinary proceedings, to establish criteria for determining when the burden of an offense should be borne by an individual and when by the legal entity involved. The general principle is that where both are liable, there is no need to accumulate penalties and, consequently, depending on the circumstances of the case, the punishment may fall on one or other, or on both. Since it is not necessary to accumulate penalties, the CNMV feels it is logical to maintain the principle enshrined in the original wording of the Law, i.e. first punish the legal entity, and proceed against individuals when special circumstances arise.

II.b. Variation in liability depending on the seriousness of the offense

The special circumstances entailing individual liability relate to particularly serious offenses and to criminal intent. This means that when an offense is minor or serious, there will generally be no punishment for individuals and it will be confined to the legal entity only unless particularly criminal intent was observed. Conversely, a very serious offense will generate individual liability in addition to liability for the legal entity unless it can be proven that there was no criminal intent.

II.c. Application in specific cases

The question arose in the Resolution dated 21 May 1997 where, in a case of filing of incorrect information with the CNMV (a serious offence where there was no criminal intent), it was decided that no additional liability should be imposed on any individuals. The events to which the Resolution referred arose in the context of rumors in the media about a major securities transaction. The CNMV asked the issuer involved to release relevant information about the transaction and to confirm or deny the rumors. The company released information which proved to be incomplete, creating a dangerous and irregular situation of asymmetry of information among the market agents. Nevertheless, it was also proven that the provision of incomplete information arose without any intention to deceive on the part of the company's directors or officers who, forced to choose between transparent reporting and confidentiality (so as not to jeopardize the transaction), opted for the latter. It was decided that, apart from the firm's institutional liability, the executives' behavior involved a minor lack of due diligence which did not merit punishment.

The Ministerial Order dated 23 October 1997

In the same line of argument as in the preceding paragraph, the Ministerial Order dated 23 October 1997 decided not to impose liability on individuals because, although the offense in question was classified as very serious, the circumstances of the parties involved showed no signs of criminal intent. In the case which concluded with that Ministerial Order, although the offense was classified as very serious since it involved manipulation of prices on the securities market, no charges were brought against the directors and executives of the firm involved on the grounds that they had not acted with criminal intent. The events constituting the offense were attributable directly and exclusively to the firm's operators who, by their actions, had generated the firm's institutional liability.

III. Reporting by issuers and the securities markets

III.a. General principles

Many of the legal obligations and duties arising from the securities market regulations revolve around the ideas of "*reporting*" and "*publicity*." Under the principle of "*reporting*", all issuers which offer securities to the public for trading on the markets are obliged to provide information which is true, sufficient, effective and up to date so that it may serve as an instrument of investor protection and ensure that they assume the risks inherent in their investments in securities with full knowledge.

Additionally, the information must be equal and simultaneous for all parties in order to avoid discriminatory treatment. In this way, the reporting principle links with the principle of equality and, specifically, with its most notorious consequence: the prohibition on the use of inside information and the obligation to prevent and avoid situations where there is a risk of such

use. It is evident that failure to report and incorrect information can generate situations of potential use of inside information for those in possession of the actual information, thus jeopardizing the operation of the securities market in conditions of loyalty and honesty.

These reporting obligations are not mere formalities; they are essential and they cannot be evaded nor can they be discharged in appearance only by furnishing information of minimal quantity or quality or outside the established deadlines.

III.b. Relevant events. Need for the notifications to be complete and accurate

Relevant events play a major role in the context of the financial information to be supplied to the market by securities issuers. In the life of any company there can be facts or events which substantially affect its financial statements, profitability prospects or even the orientation of its business plans. Since these events impact the market's view of a company, they consequently impact the price of listed securities.

The CNMV considers, as expressed in the Resolution dated 21 May 1997 (referred to in II.c.), that securities issuers must report extensively and punctually to the market and seek to ensure that all agents have the same information at the same time, and prevent such events from becoming the subject of rumor or being used for individual interests. Additionally, where events which might have an influence on a share's price cannot be divulged yet since they form part of strategic plans or projects which have not yet been approved or finalized, the Law establishes that anyone who is party to that information must keep it confidential.

However, as stated in the Resolution dated 21 May 1997, once a relevant event ceases to be confidential, for whatever reason, the CNMV may use its powers under the Law to request additional information and the recipients of such request cannot invoke the duty of confidentiality to deny the request; rather, they must furnish full information and notify the CNMV of all the information and data which are necessary to enable the CNMV to decide, in the light of the circumstances, whether the information should be made public. This is so because the decision as to whether information should be made public lies with the CNMV and not with the securities issuers.

III.c. Application in specific cases

In exercising its powers to sanction, the CNMV has traditionally considered that acts and omissions by securities issuers which breach the reporting rules are liable to be classified basically as either very serious offenses under article 99.ñ) of the Securities Market Law or as serious offenses under article 100.j) of that same law.

In this respect, the CNMV's position, based on a literal interpretation of the regulations, is to classify as a very serious offense any conduct evidencing malice and manifest intention to deceive the recipients of the information supplied, and as a serious offense any conduct where the blame arises only through negligence.

Consequently, in the aforementioned Resolution dated 21 May 1997, it was considered that the issuer company's actions constituted a serious infringement since it was proven that it furnished to the market, at the request of the CNMV, information which proved to be incomplete and insufficiently clear, although there was no criminal intent or desire to deceive but merely inefficient and negligent performance by the management and governing bodies. This arose because, when the company received a demand from the CNMV that it issue a communiqué about its plans and investment decisions, it found itself in a situation which appeared to be a conflict of interests between, on the one hand, those deriving from the demand for immediateness and transparency in reporting under the Securities Market Law and, on the other hand, the need for con-

fidentiality and prudence in the process of taking strategic decisions of public interest. In that context, the company made a decision, which was misguided and inadequate, of not informing the CNMV of plans which actually existed whereas it had been asked to furnish clear, complete information and to notify of any possible conflicts of interest so that the CNMV might decide the best course to follow.

IV. Insider and reserved information. «Chinese walls»

IV.a. General principles

Measures to prevent, avoid and punish the abusive or disloyal use of insider and reserved information in securities markets have always, in all spheres, been essential for guaranteeing seriousness and transparency. At the present time, when Spain's securities markets are facing the challenge of the European Union and the single currency, these measures are more important than ever.

The CNMV's position is that, to attain this objective, securities market professionals must make an active relevant contribution by implementing internal regulations containing rules of conduct which are appropriate to the risks to be covered and by explaining them to their managers and employees and by overseeing their compliance.

The CNMV considers that particular liability lies with those persons and firms which do not take the necessary measures to implement rules of conduct aimed at avoiding and preventing uncontrolled flows or the abusive or disloyal use of information, and with those which fail to observe or enforce such rules.

In 1997, the CNMV had the opportunity to clarify the principles underlying the wording of articles 81, 82 and 83 of the Law, which were issued to safeguard the use of reserved information and to punish any use of insider information. This clarification came in the Resolution dated 11 June 1997 and in CNMV Interpretative Letter 10/97, dated 21 July 1997.

IV.b. Application in specific cases

The aforementioned Resolution reiterated that, as a general principle applicable to all persons and firms involved in the securities market, article 81.2 of the Securities Market Law imposes a duty of totally refraining from certain actions when one is in possession of insider information, defined as any specific information relating to one or more issuers of securities or to one or more securities which has not been made public and which, if made public, may or might have an appreciable influence on the price of that security or securities.

In addition to the general principle established in article 81.2 of the Securities Market Law, which is a prohibition on anyone party to insider information, articles 81.1 and 83 impose broader obligations upon those acting in the markets, particularly credit entities and securities firms, in an attempt to avoid the abusive or disloyal use of reserved information and to guarantee the autonomy of investment decisions by preventing conflicts of interest.

Accordingly, whereas all involved in the securities markets are obliged to refrain from operating when they hold insider information, firms are also legally obliged to establish the necessary measures to avoid conflicts of interest and to prevent the abusive or disloyal use of the reserved information. The concept of reserved information is intimately linked to professional secrecy, which covers all confidential information, i.e. non-public information provided to a securities market professional and deriving from his/her own activities.

Thus, article 81.1 of the Securities Market Law imposes the obligation to safeguard any insider or reserved information to which one has access and to prevent abusive or disloyal use thereof, and it demands clearly positive behavior since it punishes acts of omission

such as failure to notify cases of breach or to adopt measures to correct the consequences of such a breach.

Moreover, article 83 of the Securities Market Law demands that all firms acting or providing advice on investing in the securities market are obliged to established barriers to information («chinese walls») to prevent the uncontrolled flow, and improper use, of any insider or reserved information between the firm's various lines of business, which must have been separated so that each function is performed autonomously and so that conflicts of interest are avoided. They are also obliged to ensure that the decisions in each sector regarding investments or divestments are taken by managers who are isolated by «chinese walls» and are not contaminated with insider or reserved information.

Consequently, firms must necessarily design and impose rules of conduct which restrict the flow of information between their various lines of business and guarantee that decisions are adopted on an autonomous basis, as set out in the aforementioned CNMV Interpretative Letter 10/1997.

The Resolution dated 11 June 1997

The events discussed in the Resolution of 11 June 1997 relate to a situation in which a credit entity had relevant information about plans for a very significant securities transaction; although this information did not meet the definition of “insider” as it was not concrete, it was reserved since it had been received in the context of the entity's status as participant in the securities markets and, consequently, was subject to the duties arising from professional secrecy. In this case, the entity purchased shares of one of the companies involved in the transaction, and the purchases were ordered by a manager in possession of that reserved information. The CNMV Resolution found that the entity in question did not have the required «chinese walls» to prevent uncontrolled internal flows of relevant information and to ensure that investment decisions were not tainted by such information. It was also found that, while lacking such general procedures, the entity did not apply an appropriate procedure for safeguarding the information which it received, thus paving the way for its improper use. Finally, it was found that the entity did not take the necessary measures to mitigate the adverse consequences of such use.

International cooperation in inspections

The increasing internationalization of the securities business makes it necessary for national supervisory authorities to cooperate ever more closely. This is particularly so in the area of inspection, where international cooperation is becoming more frequent, fostered by the criteria established by the International Organization of Securities Commissions – IOSCO – and by bilateral agreements.

Mutual assistance in this area between the CNMV and the authorities of other countries intensified in 1997, and took the form of exchanges of useful information for inspection proceedings, some of which had commenced precisely because the CNMV had detected irregular actions in Spain by non-resident firms.

International cooperation was particularly fruitful in three areas:

- Pursuit of irregular activities by unregistered intermediaries, some of which were operating simultaneously in several countries.
- Investigation of price rigging and the use of insider information where the alleged offenders were operating in a territory other than that in which the markets were located.
- Cooperation with the authorities entrusted with combating money laundering in connection with firms and persons belonging to international structures.

Table 9.3

OUTCOME OF DISCIPLINARY PROCEEDINGS IN 1997

Reference	Resolutions
(1/97)	<u>CNMV Board Resolution dated 22 January 1997.</u> Resolution regarding alleged breach, by a securities investment company, of the regulations governing investments by collective investment institutions, and failure to report significant holdings by several of its participants. Charges dismissed. (articles 32.4 b) & e) of the Law Regulating CISs)
(2/97)	<u>CNMV Board Resolution dated 29 January 1997.</u> Resolution regarding alleged performance, by several individuals, of fraudulent acts involving the simulated transfer of title to certain shares and the alleged violation by one of them of the principle of placing the customers' interests first. One of the charges was dismissed (article 99 s) of the Securities Market Law). A fine of 20 million pesetas was imposed (art. 100 a) of the Securities Market Law)
(3/97)	<u>CNMV Board Resolution dated 30 April 1997.</u> Resolution regarding alleged breach, by a firm managing government debt securities which are traded by the book-entry system, of the regulations governing the way in which trading orders are to be registered. A fine of 3 million pesetas was imposed (art. 100 c) of the Securities Market Law)
(4/97)	<u>Ministerial Order dated 21 May 1997.</u> Resolution regarding alleged breach, by a firm managing government debt securities which are traded by the book-entry system, in connection with its activities as such, of the regulations governing its relations with the Bank of Spain's money market telephone service log. A fine of 7 million pesetas was imposed (art. 99 g) of the Securities Market Law)
(5/97)	<u>CNMV Board Resolution dated 21 May 1997.</u> Resolution regarding alleged breach, by an issuer, of the obligation to inform the Comisión Nacional del Mercado de Valores of information required under the Securities Market Law. A fine of 300 million pesetas was imposed (art. 100 j) of the Securities Market Law)
(6/97)	<u>CNMV Board Resolution dated 11 June 1997.</u> Resolution regarding alleged breach by a firm through incorrect record-keeping of transactions and filing of order vouchers and through lack of and failure to apply internal procedures and rules to ensure that reserved information deriving from the different activities in the firm's various sectors was not at the disposal of the other sectors ("chinese walls") and failure to prevent, remedy and report the incorrect use of such reserved information. A fine of 85 million pesetas and a limitation of firms pension of one year were imposed (art. 100 c), n) and r) of the Securities Market Law)
(7/97)	<u>CNMV Board Resolution dated 24 July 1997.</u> Resolution regarding alleged breach, by a portfolio management company, of the principle of placing the customers' interests first and of the rules of conduct established by law. Fines totaling 33 million pesetas were imposed (articles 100 n) and 101 of the Securities Market Law)
(8/97)	<u>CNMV Board Resolution dated 29 July 1997.</u> Resolution regarding alleged performance, by a firm, of practices aimed at distorting the free formation of prices in the securities market. Charges dismissed. (article 99.i) of the Securities Market Law)
(9/97)	<u>Ministerial Order dated 1 August 1997.</u> Resolution regarding the alleged performance, by two companies, without authorization, of activities consisting of the reception and transmission of orders from investors. Fines totaling 37 million pesetas were imposed (art. 99 q) of the Securities Market Law)
(10/97)	<u>Ministerial Order dated 4 September 1997.</u> Resolution regarding alleged performance, by a portfolio company, of illicit activities and of transactions with securities which entailed simulated transfers of the title to same. Fines totaling 4.5 million pesetas were imposed and persons were disqualified from holding office or management positions in finance entities for 15 years (articles 99 q) and s) of the Securities Market Law)
(11/97)	<u>CNMV Board Resolution dated 17 September 1997.</u> Resolution regarding alleged breach of a firm's internal code of conduct regarding the securities market by an individual belonging to the firm. Private reprimand. (article 101 of the Securities Market Law)
(12/97)	<u>Ministerial Order dated 23 October 1997.</u> Resolution regarding alleged performance, by a firm, of practices aimed at distorting the free formation of prices in the securities market. Fine of 285 million pesetas (article 99.i) of the Securities Market Law)
(13/97)	<u>CNMV Board Resolution dated 26 November 1997.</u> Resolution regarding alleged breach, by a corporation, of the legal limitation on the acquisition of treasury stock. Fine of 10 million pesetas. (article 89.1 of the Companies Law)
(14/97)	<u>Ministerial Order dated 26 November 1997.</u> Resolution regarding alleged habitual reception and transmission, by a company, without authorization, of orders from domestic investors regarding the purchase and sale of securities traded on foreign markets. Fines totaling 404 million pesetas (article 99 q) of the Securities Market Law)
(15/97)	<u>CNMV Board Resoluion dated 11 December 1997.</u> Resolution regarding alleged breach, by a corporation, of the legal limitation on the acquisition of treasury stock. Fine of 6 million pesetas. (article 89.1 of the Companies Law)

Table 9.4

COURT JUDGMENTS HANDED DOWN IN 1997 IN APPEALS AGAINST PENALTIES*

No.	Date	Court	APPEAL NO.	Appealed order
1	24/2/1997	National Court	1586/93	Ministry of Finance Order dated 19/4/1993 Confirmed the penalties imposed on a director of a broker-dealer, consisting of six years' disqualification for two very serious breaches of article 99 l), in connection with article 71 j), both of the Securities Market Law, (prohibition on trading for one's own account with the owner of securities under management) and two fines of five million pesetas for very serious breaches of articles 99 s) (simulated transfers) and 99 i) (price manipulation).
2	4/4/1997	Madrid Higher Court	983/93	CNMV Board Resolution dated 11/11/1992 Confirmed the penalty imposed on a director of a broker-dealer, consisting of fine of two million pesetas, for a serious breach of article 100 c) of the Securities Market Law (accounting irregularities).
3	8/4/1997	Madrid Higher Court	1438/94	CNMV Board Resolution dated 22/12/1993 Confirmed the penalty imposed on an issuer company consisting of a fine of 50 million pesetas, for a serious breach of article 100 j) of the Securities Market Law (incorrect notification of acquisitions of treasury stock through interposed parties).
4	14/4/1997	National Court	1807/93	Ministry of Finance Order dated 12/7/1993 Confirmed the penalty imposed on a director of a broker-dealer, consisting of five years' disqualification, for a very serious breach of article 99 i) of the Securities Market Law (price manipulation).
5	16/4/1997	National Court	06/0001788/93	Ministry of Finance Order dated 12/7/1993 Confirmed the penalty imposed on a director of a broker-dealer, consisting of five years' disqualification, for a very serious breach of article 99 i) of the Securities Market Law (price manipulation).
6	5/5/1997	National Court	06/0000088/93	Ministry of Finance Order dated 12/2/1991 Confirmed the penalty imposed on a broker-dealer, consisting of fine of 99,614,385 pesetas, for a very serious breach of article 99 s) of the Securities Market Law (simulated transfers).
7	7/5/1997	National Court	06/0000868/93	Ministry of Finance Order dated 11/1/1993 Confirmed the penalties imposed on a director of a broker-dealer, consisting of eight years' disqualification, for two very serious breaches of article 99 l), in connection with article 71 j), both of the Securities Market Law, (prohibition on trading for one's own account with the owner of securities under management), and two fines of five million pesetas for very serious breaches of articles 99 s) (simulated transfers) and 99 i) (price manipulation).
8	7/5/1997	National Court	06/0001598/93	Ministry of Finance Order dated 19/4/1993 Confirmed the penalties imposed on an executive of a broker-dealer, consisting of ten years' disqualification, for two very serious breaches of article 99 l), in connection with article 71 j), both of the Securities Market Law, (prohibition on trading for one's own account with the owner of securities under management), and two fines of five million pesetas for very serious breaches of articles 99 s) (simulated transfers) y 99 i) (price manipulation).
9	19/5/1997	National Court	1787/93	Ministry of Finance Order dated 12/7/1993 Confirmed the penalty imposed on a director of a broker-dealer, consisting of a fine of five million pesetas, for a very serious breach of article 99 t) of the Securities Market Law (resistance to inspection by the CNMV).
10	4/6/1997	National Court	06/0001994/93	Ministry of Finance Order dated 23/9/1993 Confirmed the penalty imposed on an agent of a broker-dealer, consisting of a fine of 25 million pesetas, for a very serious breach of article 99 q) in connection with 71 j), both of the Securities Market Law (illicit activities).
11	4/6/1997	National Court	06/0002124/92	Ministry of Finance Order dated 9/7/1992 Confirmed the penalty imposed on an individual, consisting of a fine of 74,700,000 pesetas, for a very serious breach of article 99 o) of the Securities Market Law (insider information).
12	4/6/1997	National Court	06/0001974/93	Ministry of Finance Order dated 23/9/1993 Confirmed the penalties imposed on two corporations, consisting of fines of 6,778,000 and 704,000 pesetas, respectively, for a very serious breach of article 99 r) of the Securities Market Law (avoidance of tender offer).
13	10/6/1997	National Court	06/0000268/94	Ministry of Finance Order dated 16/3/1994 Confirmed the penalties imposed on a corporation, consisting of a fine of 500 million pesetas for a very serious breach of article 99 s) of the Securities Market Law (simulated transfers), and a fine of 400 million pesetas for a very serious breach of article 99 p) of the Securities Market Law (failure to report significant holdings).

Table 9.4 (Cont.)

COURT JUDGMENTS HANDED DOWN IN 1997 IN APPEALS AGAINST PENALTIES*

No.	Date	Court	APPEAL NO.	Appealed order
14	10/6/1997	National Court	06/0000265/94	Ministry of Finance Order dated 16/3/1994 Confirmed the penalty imposed on a foreign company, consisting of a fine of 200 million pesetas, for a very serious breach of article 99 p) of the Securities Market Law (failure to report significant holdings).
15	19/6/1997	National Court	06/0000552/94	Ministry of Finance Order dated 15/4/1994 Confirmed the penalties imposed on a director of a broker, consisting of a fine of one million pesetas, for a serious breach of article 100 g) of the Securities Market Law (breach of liquidity coefficient), and seven years' disqualification for three very serious breaches of articles 99.k) (breach of solvency coefficient), 99.e) (accounting irregularities) and 99.l) (lack of appropriate resources for the business) of article 99 of the Securities Market Law.
16	19/6/1997	National Court	06/0000648/94	Ministry of Finance Order dated 24/5/1994 Confirmed the penalty imposed on a corporation, consisting of a fine of 65 million pesetas, for a very serious breach of article 99 s) of the Securities Market Law (simulated transfers).
17	15/9/1997	Madrid Higher Court	1277/95	CNMV Board Resolution dated 3/12/1993 Confirmed the penalty imposed on a director of a broker, consisting of a fine of one million pesetas, for a serious breach of article 100 g) of the Securities Market Law (breach of liquidity coefficient).
18	29/9/1997	National Court	1853/93	Ministry of Finance Order dated 12/7/1993 Confirmed the penalties imposed on an issuer company, consisting of two fines of 303 million pesetas each for two very serious breaches of articles 99.s), (simulated transfers) and 99.i) (price manipulation) of the Securities Market Law.
19	29/9/1997	National Court	06/0001780/93	Ministry of Finance Order dated 12/7/1993 Confirmed the penalty imposed on a broker-dealer, consisting of a fine of 35 million pesetas, for a very serious breach of article 99 i) (price manipulation) of the Securities Market Law.
20	21/10/1997	National Court	06/0001592/93	Ministry of Finance Order dated 19/4/1993 Confirmed the penalties imposed on a broker-dealer, consisting of fines totaling 166,888,106 pesetas, for four very serious breaches of article 99 of the Securities Market Law, two of article 99.i) in connection with 71 j) (prohibition on trading for one's own account with the owner of securities under management), one of article 99.s) (simulated transfers) and one of article 99.i) (price manipulation).
21	12/11/1997	National Court	06/0000580/94	Ministry of Finance Order dated 6/5/1994 Confirmed the penalty imposed on a corporation, consisting of fine of 268,231,025 pesetas, for a very serious breach of article 99 i) of the Securities Market Law (price manipulation).
22	14/11/1997	Supreme Court	754/95	Cabinet Resolution dated 13/10/1993 Confirmed the penalties imposed on a de facto administrator of a broker-dealer, consisting of two fines of five million pesetas each, for two very serious breaches of article 99 of the Securities Market Law, one of article 99.l) (legal incompatibility) and one of article 99.e) (accounting irregularities).
23	2/12/1997	National Court	6/687/94	Ministry of Finance Order dated 27/7/1994 Confirmed the commission by an individual of a very serious breach of article 99.o) of the Securities Market Law (privileged information), but reduced the fine (15,283,200 pesetas) to 7,641,600 pesetas.
24	3/12/1997	Madrid Higher Court	1087/97	Ministry of Finance Order dated 3/6/1997 Confirmed the penalty imposed on an operator and agent of a broker-dealer, consisting of a 20 million pesetas fine for a serious breach of article 100.n) of the Securities Market Law (violation of the "customer first" principle).
25	11/12/1997	National Court	6/751/95	Ministry of Finance Order dated 29/5/1995 Confirmed the penalties imposed on a collective investment scheme management company, consisting of fines totaling three million pesetas for two very serious breaches of article 32.4.e) of the Collective investment institutions Law (breach of investment and liquidity coefficients) and that imposed on a credit entity consisting of a fine of 2,500,000 pesetas for a very serious breach of article 32.4.m) of that same law (marketing of an investment fund without meeting the legal requirements).

* The courts confirmed the penalties in all cases but one, where they reduced the penalty. The full text of the judgments will be available shortly at the CNMV's web site.

10

REGULATION

The Constitutional Court judgment dated 16 July 1997

On 16 July 1997, Spain's Constitutional Court issued an important judgment on the following matters:

- Appeal filed by the Basque Government alleging unconstitutionality of Law 24/1988, dated 28 July, governing the securities market.
- Appeal filed by the Executive Council of the Catalan Government alleging unconstitutionality of Law 24/1988, dated 28 July, governing the securities market.
- Appeal filed by the Catalan Parliament alleging unconstitutionality of Law 24/1988, dated 28 July, governing the securities market.
- Positive conflict of powers raised by the Basque Government in connection with Royal Decree 376/1989, dated 22 March, governing broker-dealers and brokers and another dated 28 September of that same year, vis-à-vis Royal Decree 717/1989, dated 23 June, governing the management companies and members of the securities markets, the Sociedad de Bolsas and the collective deposit required from market members.

Because of its interest for the securities market, the doctrine contained in that judgment is summarized below.

Basic nature of Law 24/1988, dated 28 July, on the securities market

The judgment states, subject to the exceptions described below, that the Securities Market Law is a «basic» law, even if this is only expressly stated in connection with its Title VIII. The affirmation of the Law's constitutionality is based on the fact that it was issued in strict exercise of the powers established in articles 149.1.6, 149.1.11 and 149.1.13 of the Spanish Constitution, which give the State exclusive powers to approve mercantile legislation, legislation governing credit, banking and insurance and the bases for general planning of economic activity.

The fact that the Law is declared to be «basic» means that its precepts are binding upon the Autonomous Regions, which may exercise the regulatory and executive powers attributed to them by law while respecting the principles contained in that Law.

Articles with regard to which the Constitutional Court established the correct interpretation in order to conform to the Constitution

These articles are as follows:

- *Articles 31.c) and 59 of the Securities Market Law.* These articles define as official secondary markets those which are State-wide and those created by the Government at the proposal of the Comisión Nacional del Mercado de Valores for securities represented by book entries. The Court held that once the legal framework for such markets had been established – an essential element of which is undoubtedly the very creation of the type of market in question – the Autonomous Regions have the exclusive power to establish the various markets (stock exchanges, government debt securities market, futures and options market, etc.) in their respective territories and to regulate them within the framework of the bases established by the State.

- *Article 34 of the Securities Market Law.* This precept establishes the power of the Comisión Nacional del Mercado de Valores to exclude securities from trading on the official secondary markets. The Court held that when the securities in question are admitted to listing only in a market located in an Autonomous Region with devolved powers in this connection, the regulation ceases to be basic and, consequently, the power to exclude from trading may be exercised by the Autonomous Region in question.
- *Article 47 of the Securities Market Law.* According to the Constitutional Court, this precept of the Law establishes a regulatory common denominator by defining as members of the securities exchanges those broker-dealers and brokers which participate in the capital of the market management companies, but this provision cannot exhaust the regulation governing the organization of the exchanges; consequently, the Autonomous Regions, in exercise of their own powers, may admit other subjects as members of the exchanges located in their territory even if they do not meet the aforementioned condition.
- *Article 78 of the Securities Market Law.* This article empowers the Government or, with its express delegation, at the proposal of the Comisión Nacional del Mercado de Valores, the Minister of Economy and Finance to issue rules of conduct in implementation of the contents of Title VII of the Law. The Court found that the regulations of this title and, specifically, the provision contained in article 78, are basic in nature, but it also recognized that the Autonomous Regions have the power to approve codes of conduct which must be observed by broker-dealers and brokers and, generally, by all persons or firms engaging in activities relating to the securities markets located in their territories.
- *Article 12 of Royal Decree 726/1989 dated 23 June, governing the management companies and members of the securities markets, the Sociedad de Bolsas and the collective deposit.* Article 12 establishes the supervisory functions which, without prejudice to the Comisión Nacional del Mercado de Valores' supervisory, inspection and sanction powers and of the powers of the corresponding Autonomous Region under Title VIII of the Securities Market Law, are attributed to the securities exchange management companies and which include the power to notify, provide assistance, support and raise proposals to the Comisión Nacional del Mercado de Valores. This precept is implemented in article 84 of the Law, in connection with which the judgment states that it is legitimate that an Autonomous Region cannot exercise supervisory, inspection and sanction powers over firms and individuals and legal persons in connection with securities which, in addition to operating in the securities market of its territory, also operate in exchanges located in other Autonomous Regions and even outside the national territory. Consequently, the reference in this article 12 to the supervisory, inspection and sanction powers corresponding, as the case may be, to the respective Autonomous Region should be construed as referring to those powers which may be exercised over firms and individuals and legal persons in connection with securities which only operate in the exchanges in its territory.

Articles declared to be contrary to the Constitution

The Constitutional Court found the following precepts to be contrary to the Constitution:

- *Article 45 of the Securities Market Law.* The requirement of approval from the Government of the Nation to create securities exchanges located in the territory of Autonomous Regions with devolved powers in this area.
- *Article 48 of the Securities Market Law and article 7 of Royal Decree 726/1989 dated 23 June, governing the management companies and members of the securities markets, the Sociedad de Bolsas and the collective deposit.* The approval by the Comisión Nacional del Mercado de Valores of the bylaws of the management companies of exchanges located in the territory of Autonomous Regions with devolved powers in this area, since this power lies with the Region in question.

- *Article 64.* The Court held that the legal requirements for membership of an exchange located in the territory of an Autonomous Region with devolved powers in this area should be accredited before that Region and not before the CNMV, as this article currently establishes.
- *1st Additional Provision of the Securities Market Law.* The Court declared that the change of the name of the exchanges existing in the Basque and Catalonia Autonomous Regions was not lawful.
- *Article 15 of Royal Decree 726/1989 dated 23 June, governing the management companies and members of the securities markets, the Sociedad de Bolsas and the collective deposit.* The powers attributed in this article to the Comisión Nacional del Mercado de Valores to suspend or annul certain decisions by the management companies of exchanges located in the territory of Autonomous Regions with devolved powers in this area were held not to be constitutional. Likewise, the power assigned to the CNMV to oversee the application of the legislation by those management companies and, where appropriate, to order modifications to the related resolutions was also held to be unconstitutional.
- *Article 17.2 of Royal Decree 726/1989 dated 23 June, governing the management companies and members of the securities markets, the Sociedad de Bolsas and the collective deposit.* The approval by the Comisión Nacional del Mercado de Valores of the budgets, and modifications to the budgets, of the management companies of the exchanges located in the territory of Autonomous Regions with devolved powers in this area was held not to be constitutional since that power lies with the related Region.
- *Article 23.2 of Royal Decree 726/1989 dated 23 June, governing the management companies and members of the securities markets, the Sociedad de Bolsas and the collective deposit.* The power to establish the total amount of the deposit and the form of distribution envisaged in this article were declared to unconstitutional, although they had already been revoked by Royal Decree 116/1992, dated 14 February.

Regulatory activity

There was intense regulatory activity in connection with the securities market in 1997, much of which was devoted to the Draft Law to reform the Securities Market Law (Law 24/1988, dated 28 July). There is a pressing need for this Law to be approved since it is the regulation which implements the Investment Services Directive in Spain.

The following regulations on the securities markets were approved in 1997:

Comisión Nacional del Mercado de Valores

- *Royal Decree 901/1997, dated 16 June, updating the tax rates and partially amending Royal Decree 647/1994, dated 15 April, governing the rates applicable to the activities and services provided by the Comisión Nacional del Mercado de Valores.* This Decree modified the benchmark for determining the taxable base applicable in registering prospectuses of equity offerings and the supervision of the activities of member of the exchanges and of unofficial secondary markets, and certain fixed rates applicable to trading in the futures and options markets.

Secondary markets

- *Ministerial Order dated 19 June 1997 which modifies the requirement for admission to exchange listing provided in article 32.1.c) of the 1967 Exchanges Regulation.* This Order empowers the CNMV to establish exceptions to the requirement established in point 1.c) – profits over a period of several years – provided that one of the stated circumstances applies.

Broker-dealers and brokers

- *Circular 1/97, dated 8 January, amending Circular 6/1992, dated 30 December, on equity requirements for broker-dealers and brokers and their consolidable groups, regarding the inclusion of trading losses in the calculation of the equity requirements for volume of business.* Circular 1/97 included the provisions of Royal Decree 1343/1992 governing the handling of losses for the purposes of calculating minimum equity requirements, and maintained uniformity in the provisions governing equity requirements for broker-dealers and brokers. Moreover, it clarified which firms are covered by the new minimum equity calculation system by virtue of engaging in the mediation activity referred to in the Royal Decree.
- *Circular 2/97, dated 12 February, amending Circular 6/1992, dated 30 December, on equity requirements for broker-dealers and brokers and their consolidable groups, regarding the counterparty risk in interest and exchange-rate derivatives.* This Circular amended Circular 6/1992 regarding the treatment of the risk and commitment accounts relating to interest and exchange rates and introduced the possibility, for the purposes of determining the minimum equity requirements, of taking account of the existence of bilateral clearing contracts and the possibility of firms hedging their counterparty risk by a system of marking to market.

Collective investment institutions

- *Royal Decree 1094/1997, dated 4 July, implementing Royal Decree Law 7/1996, dated 7 June, on urgent tax measures and others to foster and liberalize economic activity, regarding the conditions for investment by collective investment institutions in unlisted securities.* This decree implemented the measure envisaged in article 21 of Royal Decree-Law 7/1996, dated 7 June, on urgent measures to deregulate economic activity, by expanding the scope for securities investment companies, securities investment funds and money market funds to invest in unlisted securities, although it maintained the requirement that investment in unlisted securities should be expressly envisaged in the bylaws or regulations and in the institution's prospectus. One main reason for permitting investment in unlisted securities was to channel part of savings towards small and medium-sized enterprises.
- *Order dated 10 June 1997, governing transactions by financial collective investment institutions in financial derivatives.* Article 21 of Royal Decree-Law 7/1996, dated 7 June, on urgent tax measures and others to foster and liberalize economic activity, placed Spanish collective investment schemes on an equal footing with their European counterparts by allowing them to invest in derivatives which are not traded on an organized secondary market. From a formal standpoint, the new legal framework for investment in derivatives made it necessary to update the existing legislation and it was considered that the most appropriate solution was to issue this Order which make up the new regulatory provisions with the existing ones.
- *Order dated 3 November 1997 amending the Order dated 20 December 1990, which partly implemented the Regulation of Law 46/1984, dated 26 December, governing collective investment institutions,* by empowering the Comisión Nacional del Mercado de Valores to issue provisions regarding reporting and accounting regulations for collective investment institutions. This Order was a consequence of Royal Decree 1094/1997, whose approval created the need to amend the Order dated 20 December 1990 for two purposes: to adapt its content to the amendments in the Regulation of Law 46/1984, dated 26 December, governing collective investment institutions, and to empower the CNMV to issue provisions governing the accounting of investments in unlisted securities.
- *Circular 3/1997, dated 29 July, on the reporting obligations of financial collective investment institutions and implementing the Ministerial Order dated 10 June 1997 on trading in derivatives.* This Circular 3/1997 amended the system of reporting transparency for investors and partici-

pants in collective investment institutions. It also specified the internal control requirements which must be accredited by collective investment scheme management companies and securities investment companies which seek to trade in derivatives, and the requirements for exceeding the general limits on market and counterparty risk. Lastly, it extended the use of certain structured instruments which are not traded on organized markets to uses other than hedging risks or attaining specific target returns.

- *Circular 4/97, dated 26 November, on valuation methods and conditions for investment by collective investment institutions in unlisted marketable securities.* This Circular regulates the general formal requirements for guaranteeing transparency and information to investors or participants in collective investment institutions which wish to invest in unlisted securities, including those representing the capital stock or net worth of venture capital companies or funds, and the accounting treatment, valuation methods and criteria for setting the maximum investment percentages and the effective value of such securities.
- *Circular 5/97, dated 26 November, amending article 13 of Circular 4/1994, dated 14 December 1994, on the accounting standards, reporting obligations, determination of liquidating value and investment and operating coefficients and system for appraising property of real estate investment companies and funds.* Since investments in real estate require significant amounts of funds and the purchase of a property takes longer than marketable securities, this Circular establishes a system which allows a longer time period, enabling real estate investment companies and funds to comply with their coefficients while selecting the investments which may best serve their investors' interests.

CNMV Interpretative Letters

The CNMV issued numerous Interpretative Letters in 1997, most of which related to rules of conduct and collective investment institutions.

Primary securities market

- *Interpretative Letter 9/1997, dated 16 June, on “significant events and their notification to the Comisión Nacional del Mercado de Valores”.* This Letter contains a number of instructions which may be of use to issuers and their advisers in correctly applying the current legislation on significant events – see box in chapter 8 – “Market Transparency”.

Broker-dealers and brokers

- *Interpretative Letter 11/1997, dated 18 November, on “portfolio management and agents of securities firms”.* This Letter defined the scope of the term “representation”, which appears in article 9.2 of Royal Decree 276/1989, dated 22 March, on broker-dealers and brokers, in connection with the portfolio management business. The CNMV considers that the representation of a broker-dealer or broker, a credit entity or a portfolio management company by third parties may not in any event involve the direct management of the portfolio by the agent.

Rules of conduct

- *Interpretative Letter 5/1997, dated 3 April, regarding the “prohibition on creating an artificial movement in prices for own or third-party benefit.”* The CNMV is concerned about bids entered during the pre-opening period which bear no relationship with the share's intrinsic value and about orders entered in the instants prior to the end of session which, by their

price or amount, might trigger an artificial movement in share prices, and it considers that both cases may involve breaches of article 80.a) of the Securities Market Law, which forbids securities firms from generating artificial movements in share prices for own or third-party benefit.

- *Interpretative Letter 7/1997, dated 22 May, relating to the “powers granted by debenture-holders to the issuer”.* It is frequent practice for debenture-holders to grant proxies to the issuer itself, and this raises serious conflicts of interest, particularly when the proxy-holders are employees of, or are related to, the issuer. For this reason, the CNMV advises that the internal rules of conduct should include clauses preventing such persons from acting in defense of the debenture-holders’ interests or, at least, guaranteeing that the proxies are exercised correctly.
- *Interpretative Letter 10/1997, dated 10 July, on the “criteria for establishing information barriers in firms which operate in the securities markets”.* In view of the difficulties evidenced by firms operating in the securities market with regard to implementing the mandate in article 83 of the Securities Market Law, which obliges them to establish information barriers to prevent the uncontrolled flow and improper use of privileged information, commonly referred to as “chinese walls”, the CNMV proposes a number of measures whose inclusion in each firm’s internal code of conduct will contribute to effective compliance with this obligation.

Collective investment institutions

- *Interpretative Letter 1/97, dated 26 February, regarding “investment by Spanish collective investment institutions in shares or units issued by other collective investment institutions”.* In response to the interest expressed by certain promoters of Spanish collective investment institutions in investing in shares or units in other collective investment institutions as a means of more efficiently diversifying their investments, the CNMV, after analyzing article 4 of the Collective investment institutions Law, issued this Letter establishing the criteria to be met by Spanish collective investment institutions which are going to invest in shares or units issued by other collective investment institutions.
- *Interpretative Letter 2/1997, dated 26 February, regarding the “possibility of establishing in Spain securities investment funds and money market funds denominated in currencies other than the peseta”.* This Circular provides a method of operation, which complies with Spanish regulations, for funds seeking to denominate their shares in a currency other than the peseta.
- *Interpretative Letter 3/1997, dated 31 March, regarding the “requirements to be met by open-end securities investment companies for the admission of their shares to listing on the securities market”.* The CNMV and the exchange management companies consider that newly-created open-end securities investment companies (SIMCAV) should not be required to meet the minimum diffusion requirements at the time they apply for listing of their shares on the exchange. This is because the system under which SIMCAVs operate fully guarantees the commitment to attend to all offers of and demand for their shares on a market basis.
- *Interpretative Letter 4/1997, dated 31 March, expressing the “agreement between the Management Companies of the Exchanges of Barcelona, Bilbao, Madrid and Valencia and the Comisión Nacional del Mercado de Valores to expedite the procedures for creation and subsequent admission to listing on the exchanges of securities investment companies (SIM) and open-end securities investment companies (SIMCAV).*
- *Interpretative Letter 6/1997, dated 5 May, regarding the “annual updating of the explanatory memoranda of collective investment institutions”.* This Letter seeks to avoid the duplicate reporting obligations arising from the fact that collective investment institutions must update their prospectus each year once they have the auditors’ report on the previous year. This obligation is

deemed to have been discharged by filing the financial statements and auditors' report with the CNMV together with a statement, within the month following approval of the financial statements, to the effect that the memorandum filed with the CNMV is current.

- *Interpretative Letter 8/1997, dated 12 June, regarding "marketing in Spain of foreign collective investment institutions not subject to Directive 85/611/CEE".* In this Letter, the Comisión Nacional del Mercado de Valores clarifies certain doubts raised regarding the application of the Second Additional Provision of Royal Decree 1393/1990, which regulates the procedure applicable to foreign collective investment institutions not subject to Directive 85/611/CEE (un-harmonized IIC) seeking to market their shares or units in Spain.

CNMV Interpretative Letters

The Interpretative Letters are letters addressed by the Comisión Nacional del Mercado de Valores to all the parties operating in the markets in order to publicize the interpretations and criteria which govern its actions with regard to a given matter.

Their basic purpose is to increase legal security, which is achieved in two ways:

- By publicizing the interpretations and criteria by which the CNMV's actions will be guided.
- By limiting the possibility of discretionary action by the CNMV since the Interpretative Letters express the criteria which the CNMV will follow in applying the rules governing its activity.

Characteristics of the CNMV Interpretative Letters:

- They are not legally binding.
- Their purpose is purely interpretative and informative.
- The process for drafting them is simple, making them a very agile and immediate instrument.
- They are not replies to specific queries raised with the CNMV; rather, they address matters with a broad scope.

They are an expression of the CNMV's informal regulatory activity, in line with the activities conducted by most other securities commissions throughout the world (e.g. "policy statements" and "interpretative releases", in the case of the SEC, and "rescrits", in the case of the COB).

IOSCO

The CNMV played an active role, as member of the IOSCO Technical Committee and of its five Working Parties, in all the initiatives of this organization during 1997.

The Working Parties discussed most notably the following matters:

Multinational securities offerings and accounting

- Progress was made towards the establishment, in 1998, of international accounting standards which can be used by transnational issuers of securities.
- A prospectus was designed for use by such international issuers, which will be released in 1998.

Secondary markets

- The main new development in this area was the preparation of a “*Guide to information exchanges*”, designed to facilitate information flows between regulators and market authorities during times of crisis in the market itself or in any of the companies involved in the market.

Intermediaries

- Coordination with the Basle Committee to determine the conditions in which firms’ internal models can be used as the basis for calculating the minimum equity requirements for the trading portfolio’s market risk. The aim is to have rules which are common to banks and investment companies. Further investigation of credit risk is also under way.

Inspection and exchange of information

- Examination of all the jurisdictions comprising the IOSCO in order to evaluate their level of regulation and their capacity to cooperate with other countries in the area of supervision. Although the situation was satisfactory in general, certain countries presented serious deficiencies in transaction record-keeping and in their capacity to obtain information from market participants and supply it to their counterpart organizations in other countries. Consequently, a resolution was approved which was aimed at improving the applicable standards.
- Report on the implications of the use of the Internet on the securities markets, which analyzed both the problems arising from improper use and the advantages which it can provide to the supervisor.

Collective investment institutions

- Report on the principles applicable in supervising IIC managers, which discussed such matters as the rules of conduct to be observed by these companies, valuation methods and segregation of assets and the disclosure of their fees and expenses.

In addition to the work of the five permanent working parties, the IOSCO launched three special projects. The first is aimed at compiling all the principles developed by the IOSCO in recent years on the various areas of regulation. The second aims at examining the prospects offered by the Internet and its practical im-

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plications for supervisors. The third is to alert the entire financial community about the year 2000 problem in computers, since many computers only use the last two digits of the year, in which case 00 will be identified as 1900, thus creating risks in portfolio valuation, maturities, etc. In this connection, the IOSCO is urging all supervisors to ensure that there are no problems at national level and thereby avoid knock-on effects on the international financial community.

European Union

The two European forums in which the CNMV is involved, namely the Informal Group of Presidents of Securities Commissions and the High-Level Group of Securities Supervisors, which reports to the European Commission, focused on the problems of interpreting and implementing the Investment Services Directive, the introduction of the euro in financial markets and the harmonization of areas not covered by the Directive. In connection with the latter, work was performed on the fitness and suitability of partners and directors of investment firms and on the standards of conduct applicable to companies participating in equity offerings.

In December 1997, the Informal Group of Presidents of Securities Commissions strengthened its institutional character and its ability to communicate with other bodies by transforming itself into the *Forum of European Securities Commissions* (FESCO), which comprises the Securities Commissions of all the European Union member countries plus Norway and Iceland and will have a permanent General Secretariat and a President appointed for two-year terms.

Regarding specific EU regulations on securities markets, 1997 saw the approval of the Directive regulating the investment guarantee fund and progress with projects such as the amendment of the Capital Adequacy Directive, the proposed Directive on firm settlement in the systems of payments and securities settlement, and the proposed Directive on distance contracts for financial services between suppliers and customers. Old initiatives such as the amendment of the Directive on UCITs¹ and the amendment to the Takeover Directive were relaunched in 1997; conversely, the Directive to create a Committee on Marketable Securities appears to have been parked.

Other international matters

- Since early 1997, the CNMV has been a member of the “Joint Forum” comprising representatives of the IOSCO, the Basle Committee and the International Association of Securities Supervisors, whose mission is to develop principles on the supervision of financial conglomerates whose activity extends to banking, securities and insurance. Work in 1997 focused on examining the fitness for partners and directors, calculating capital adequacy requirements for groups as a whole and examining intra-group transactions and risks.
- In the area of information exchange and international cooperation, the CNMV signed new bilateral agreements (Memoranda of Understanding) in 1997 with the following authorities: Germany’s Bundesaufsichtsamt für den Wertpapierhandel (17 June), Ecuador’s Superintendencia de Compañías (4 November), Bolivia’s Superintendencia de Valores (4 November) and Taiwan’s Securities and Futures Commission (7 November). These Memoranda all relate to the provision of technical assistance, except for that signed with Germany, which envisages the exchange of confidential information.
- The Swiss Federal Banking Commission and the CNMV mutually recognized each other as authorities capable of receiving confidential information requested in compliance with the legislation on securities markets in their respective countries.

(1) Unit Collective Investment Trusts.

International organizations of securities commissions: IOSCO and FESCO

The globalization of markets has encouraged international cooperation between the securities market supervisory authorities. The main multilateral forum in this area is the International Organization of Securities Commissions – IOSCO. Formed in 1983, IOSCO has 89 ordinary members (the principal supervisory authorities in their respective countries), 9 associate members (other supervisors with partial powers in their domestic markets) and 44 affiliated institutions (organized markets and other institutions). Its two principal objectives are the development of international cooperation between supervisors and the harmonization of regulations.

The body which formally approves the IOSCO's resolutions is its Presidents Committee, which meets annually. The organization also has a Technical Committee, which is in charge of IOSCO's technical projects, an Emerging Markets Committee, which develops projects in this field, and an Executive Committee, which is in charge of internal organization. It also has five permanent working parties – Issuers, Secondary Markets, Intermediaries, Inspection and Collective investment institutions – which are supplemented by task forces on an ad hoc basis. The presidents of the committees are replaced every two years.

Within Europe, the development of the single market for securities and the forthcoming introduction of the euro have led to the creation of a specific forum of cooperation, the Forum of European Securities Commissions – FESCO. Formed on 8 December 1997 in London, FESCO comprises the principal supervisors from the 15 member states of the European Union plus Norway and Iceland. Its principal goals are to establish principles in areas which are not harmonized, to exchange experiences, foster cooperation and transfer initiatives and opinions to other forums.

FESCO holds three high-level meetings per year and establishes working parties when it sees fit. It has a President, elected by consensus with a two-year mandate, and a permanent General Secretariat.

Annex 1

COMPOSITION OF THE CNMV BOARD

President: Juan Fernández-Armesto

Vice-President: Luis Ramallo García

Commissioners: José Manuel Barberán López
Jaime Caruana Lacorte²
Miguel Martín Fernández³
José M^a Roldán Alegre⁴
Francisco de Vera Santana

Secretary: Antonio J. Alonso Ureba

(2) Director General of the Treasury and Finance Policy.

(3) Appointed effective 13 January 1998 to replace José M^a Gondra Romero, whose mandate terminated on 4 November 1997.

(4) Deputy Governor of the Bank of Spain.

Annex 2

COMPOSITION OF THE CNMV ADVISORY COMMITTEE

President: Luis Ramallo García

Secretary: Antonio J. Alonso Ureba

REPRESENTATIVES

Issuers: Francisco Blanco Balín
Jesús del Pozo Soler
Luis Cortés Domínguez

Investors: Rafael García de la Rasilla y Pineda
Carlos Soroa Castellano

Stock Exchange Members:

Enrique Piñel López
Gregorio Arranz Pumar
Jaime Aguilar Fernández-Hontoria
José Ramón Valcárcel Pérez

Consumers and Users Council:

Manuel Pardos Vicente

Autonomous Regions:

Valencian Government:

José Manuel Uncio Lacasa

Basque Government:

Juan Miguel Bilbao Garai

Catalan Government:

Francesc Xavier Ruiz del Portal i Bravo

ALTERNATIVE REPRESENTATIVES

Issuers: José Alfonso Núñez Boluda
Sebastián Albella Amigo

Investors: Alvaro García de la Rasilla y Pineda
Juan Carlos Guzmán Acha

Stock Exchange Members:

Fernando de Roda Lamsfus
Carlos Orduña Chouraki
José Ramón Valcárcel Pérez
Antonio de Bonilla y Romero

Consumers and Users Council:

Juan del Real Martín

Autonomous Regions:

Valencian Government:

Nicolás Jannone Bellot

Basque Government:

Miguel Bengoechea Romero

Catalan Government:

Jaume Pera i Lloveras

