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Quarter IV
2007



CNMV Bulletin

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Table of contents

I Reports and Analyses	9
Market survey	11
Profitability of listed companies. Developments from 2004 to June 2007 Antonio Cano Muñoz	35
Developments in collective investment funds in Spain Francisco Castellano Cachero	49
II Studies	63
Analysis of price movements ahead of the announcement of takeover bids M ^a Victoria Villanueva Fresán	65
The results of mutual fund management Marián Ruiz Martín	81
Financial activism and innovation: implications for corporate governance Ramiro Losada López	101
III International Reports	113
European initiatives in clearing and settlement Íñigo de la Lastra	115
Target2-Securities Susana Núñez and Montserrat Jiménez	129
IV Regulatory Novelties	147
Novelties in the MiFID in relation to investment services firms Mario Marchiandi Alberdi	149
The Markets in Financial Instruments Directive. An analysis from the perspective of the Spanish securities market Enrique Alonso Alonso	165
V Statistics Annex	183
VI Legislative Annex	201

Acronyms

ACGR	Annual Corporate Governance Reports
AIAF	Asociación de Intermediarios de Activos Financieros/Spanish Brokers' Association
ASCRI	Asociación Española de Entidades de Capital-riesgo/Spanish association of venture capital firms
BME	Bolsas y Mercados Españoles
CEBS	Committee of European Banking Supervisors
CESR	Committee of European Securities Regulators
CNMV	Comisión Nacional del Mercado de Valores
DAC	Directive on Capital Requirements
DSI	Directive on Investment Services
EBITDA	Earnings Before Interests, Tax, Depreciation and Amortization
EC	European Commission
EFAMA	European Fund and Asset Management Association
ESI	Investment services company
ETF	Exchange Traded Funds
EU	European Union
EVCA	European Private Equity & Venture Capital Association
FIAMM	Money market fund
FIM	Securities investment fund
FRA	Forward Rate Agreement
GDP	Gross Domestic Product
IGBM	Índice General de la Bolsa de Madrid/Madrid Stock Exchange General Index
IIC	Collective Investment Schemes
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offerings
LMV	Ley del Mercado de Valores/ Securities Markets Law
MAB	Mercado Alternativo Bursátil/Alternative Stock Market
MEFF	Mercado Español de Futuros y Opciones Financieros/Spanish market in financial futures and options
MFAO	Mercado de Futuros del Aceite de Oliva/Olive oil futures market
MiFID	Markets in Financial Instruments Directive
OECD	Organization for Economic Co-operation and Development
PER	Price Earnings Ratio
RD	Royal Decree
RDL	Royal Decree Law
ROE	Return On Equity
SENAF	Sistema Electrónico de Negociación de Activos Financieros/An electronic trading platform for Spanish public debt
SGIIC	Collective investment scheme management company
SIBE	Sistema de Interconexión Bursátil Español/Spanish electronic market
SICAV	Open-end investment company
UCITS	Undertakings for Collective Investment in Transferable Securities

I Reports and analyses

Market survey (*)

(*) This article has been prepared by the staff of Studies and Statistics Directorate of CNMV.

1 Overview

Concerns about the crisis unleashed by the U.S. sub-prime debacle dominated trading on international financial markets in the final months of 2007¹. Liquidity restrictions in the interbank market amid fears about institutions' exposure to the instruments worst hit by the mortgage crisis resumed with force in December after apparently easing off in the two previous months. The result was a widespread revise-down in growth expectations. Against this backdrop, the Federal Reserve cut its official rates twice, in November and December, by a total of 50 basis points. In what was an unprecedented move, the Fed also hooked up with four other central banks to arrange a coordinated injection of liquidity.

Medium and long rates headed lower once more in the wake of this intervention. The falls were especially sharp in the United States, where bond yields dipped below the euro-zone average in the five- and ten-year maturities. Credit risk premiums continued to climb to new century highs, in a context of scarce cash and rising risk perceptions in private fixed-income markets.

Main international stock markets stayed largely bearish through the fourth quarter of 2007. Worst performing of all was the Japanese market, where the Nikkei 225 dropped 10.4%, though Italian and North American stocks also fared badly, with the Mib 30 down by 5.4% and the Dow Jones by 4.7%. Euro-zone markets clawed back some of their third-quarter losses thanks to a price rally initiated at the end of November. Spain's IBEX 35 performed particularly well with a gain of 3.9% (see table 1). Both the U.S. and Japanese markets continued strongly volatile, while the euro-zone exhibited a more settled profile.

In the Spanish market, the run-up in prices boosted year-long gains to 7%, taking the Ibex 35 into second place behind only Germany's Dax 30, with an increase of 19.3%. The Telefónica share continued powering higher, while "Banks" and "Construction" returned to positive territory after third-quarter losses. "Real estate and others" continued its slide, though cumulative losses are still far from reversing the bull run of 2006. Q3 2007 earnings reports evidenced further growth in the pre-tax profits of Spanish listed firms, albeit with some tailing-off versus the first half period.

¹ The data available at the time of preparing this report run to 7 December. Hence mentions of the fourth quarter refer in fact to the period from 28 September to 7 December.

Summary of financial indicators

TABLE 1

	Q1 07	Q2 07	Q3 07	Q4* 07
Short-term interest rates (%)¹				
Official interest rate	3.75	4.00	4.00	4.00
Euribor 3 month	3.89	4.15	4.74	4.82
Euribor 12 month	4.11	4.51	4.73	4.74
Exchange rates²				
Dollar/euro	1.33	1.35	1.42	1.43
Yen/euro	157.32	166.63	163.55	162.30
Credit risk premiums: BBB-AAA spread (basis points)³				
Euro zone				
3 year	32	28	50	67
5 year	45	43	75	101
10 year	71	62	100	124
U.S.				
3 year	70	65	95	124
5 year	80	70	103	167
10 year	98	90	147	211
Equity markets				
Performance of main world stock indices (%) ⁴				
Euro Stoxx 50	1.5	7.4	-2.4	-1.5
Dow Jones	-0.9	8.5	3.6	-4.7
Nikkei	0.4	4.9	-7.5	-10.4
Other indices (%)				
Merval (Argentina)	0.6	4.2	-0.1	-2.2
Bovespa (Brazil)	3.0	18.7	11.2	2.1
Shanghai Comp (China)	19.0	20.0	45.3	-9.2
BSE (India)	-5.7	15.5	17.9	16.4
Spanish stock market				
Ibex 35 (%)	3.5	1.7	-2.1	3.9
P/E of Ibex 35 ⁵	14.0	13.91	12.67	13.45
Volatility of Ibex 35 (%) ⁶	14.6	17.2	19.0	27.7
SIBE trading volumes ⁷	6,497.8	7,091.4	5,698.7	7,239.4

Source: CNMV, Thomson Datastream, Reuters, Banco de España, Bolsa de Madrid, MEFF and AIAF.

* Latest available data at the time of preparing this report.

na: not available.

¹ Monthly average of daily data. Data for first quarter 2007 correspond to March, data for the second to June, those for the third to September and those for the fourth to December up to 20/12. The official interest rate corresponds to the marginal rate at weekly auctions.

² Data at period end. Data for the fourth quarter 2007 correspond to 20 December.

³ Monthly average of daily data. Data for the fourth quarter 2007 correspond to one month up to 20 December.

⁴ Cumulative quarterly change in each period; up to 20 December in the case of the fourth quarter.

⁵ Price-earnings ratio. Data for the fourth quarter 2007 correspond to 20 December.

⁶ Implied at-the-money (ATM) volatility on nearest expiry. Data for the fourth quarter 2007 correspond to 20 December.

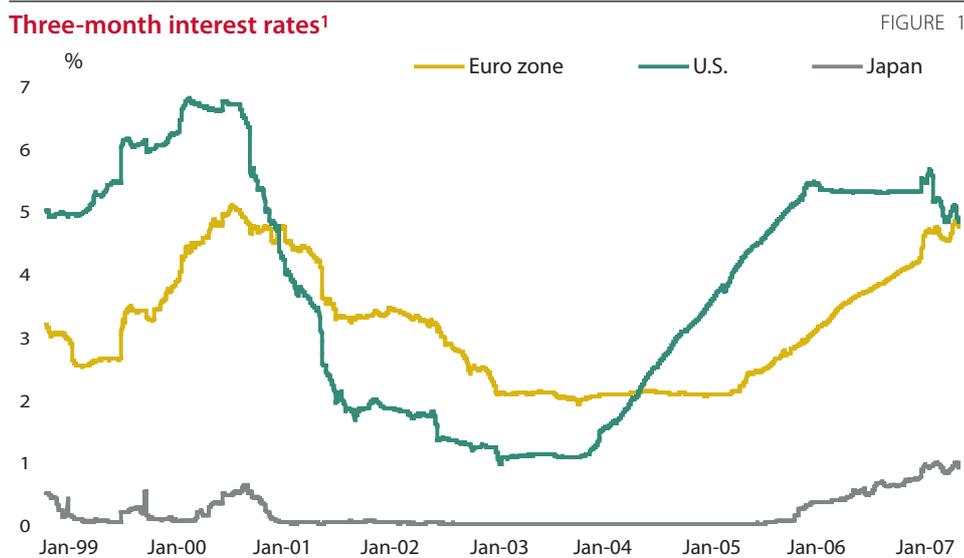
⁷ Daily average in million euros. Data for the fourth quarter 2007 correspond to October and November.

2 International financial background

2.1 Short-term interest rates

The confidence slump that followed the August outbreak of the sub-prime lending crisis in the United States continued to weigh on U.S. and euro-zone money markets over the fourth quarter of 2007.

In the euro zone, three-month interest rates continued to strain higher albeit at a significantly slower pace, adding 8 basis points between September and December compared to the 60 bp of the preceding quarter (see table 2). The Euribor 3-month began to climb in December, after an easing phase that took it from 4.8% in early October to a mid November 4.6%, to spike at a mid-month high of 4.95% (see figure 1). The European Central Bank reacted by pumping liquidity into the banking system (around 350 billion euros) in a two-week refinancing operation priced at 4.21%, ensuring that institutions had cash on tap for their annual accounting close.



Source: Thomson Datastream.

1. Data to 20 December.

In the United States, the Federal Reserve lowered its official rate once more on 11 December, in a bid to stop market turbulence transmitting through to the real economy. The cut this time was 25 basis points, leaving the federal funds rate at 4.25%. This was the U.S. authority's third successive easing move after the 50 basis points of 18 September and the 25 basis points of 31 October.

It followed this up on 12 December with the announcement of a concerted plan with four other central banks (the European Central Bank, Bank of England, Bank of Canada and Bank of Switzerland) to stop credit markets seizing up by means of emergency cash auctions and currency swap facilities.

Short-term interest rates¹

TABLE 2

	Dec 04	Dec 05	Dec 06	Dec 06	Mar 06	Jun 07	Sep 07	Dec 07 ²
Euro zone								
Official ³	2.00	2.25	3.50	3.50	3.75	4.00	4.00	4.00
3 month	2.17	2.47	3.69	3.69	3.89	4.15	4.74	4.82
6 month	2.21	2.60	3.79	3.79	4.00	4.28	4.75	4.78
12 month	2.30	2.79	3.93	3.93	4.11	4.51	4.73	4.74
U.S.								
Official ⁴	2.25	4.25	5.25	5.25	5.25	5.25	5.25	4.25
3 month	2.50	4.49	5.36	5.36	5.35	5.36	5.50	5.05
6 month	2.72	4.67	5.35	5.35	5.32	5.39	5.36	4.88
12 month	3.02	4.84	5.24	5.24	5.20	5.45	5.07	4.47
Japan								
Official ⁵	0.15	0.15	0.25	0.25	0.50	0.50	0.50	0.50
3 month	0.05	0.07	0.56	0.56	0.70	0.74	0.99	0.99
6 month	0.07	0.08	0.63	0.63	0.72	0.84	1.08	1.04
12 month	0.09	0.12	0.74	0.74	0.78	0.98	1.15	1.10

Source: Thomson Datastream.

1 Average daily data except official rates, which correspond to the last day of the period.

2 Average data from 20 November to 20 December.

3 Marginal rate at weekly auctions.

4 Federal funds rate.

5 Monetary policy rate.

Despite recent U.S. rate reductions, the market is expecting more of the same in the coming months. 3-month forward rates (FRAs) point the way of renewed cuts of up to 50 basis points on a three-month horizon and a further 50 basis points within six months (see table 3). In the euro zone, rate expectations remain largely unaltered with respect to September 2007, i.e., with most agents staking on no change in the next few months.

Three-month forward rates (FRAs)¹

TABLE 3

(%)	Dec 04	Dec 05	Dec 06	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07 ²
Euro zone								
Spot	2.16	2.49	3.73	3.73	3.92	4.18	4.79	4.79
FRA 3x6	2.23	2.74	3.94	3.94	4.13	4.40	4.52	4.52
FRA 6x9	2.36	2.91	4.07	4.07	4.21	4.59	4.34	4.43
FRA 9x12	2.49	3.00	4.13	4.13	4.25	4.69	4.28	4.37
FRA 12x15	2.64	3.07	4.13	4.13	4.23	4.76	4.28	4.37
U.S.								
Spot	2.56	4.54	5.36	5.36	5.35	5.36	5.23	4.88
FRA 3x6	2.95	4.81	5.31	5.31	5.25	5.33	4.75	4.26
FRA 6x9	3.22	4.84	5.21	5.21	5.06	5.30	4.42	3.78
FRA 9x12	3.41	4.81	5.06	5.06	4.87	5.25	4.29	3.53
FRA 12x15	3.57	4.76	4.94	4.94	4.74	5.23	4.24	3.42

Source: Thomson Datastream.

1 Data at period end.

2 Data corresponding to 20 December.

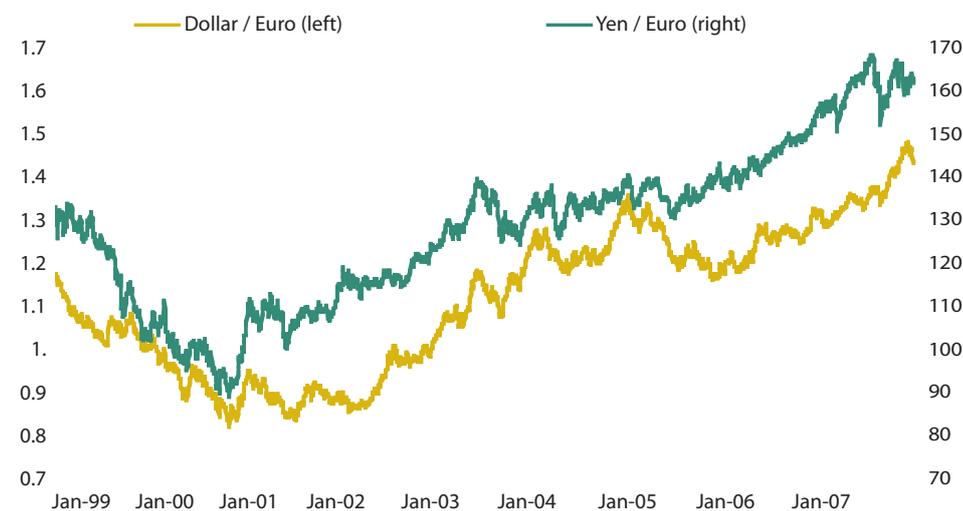
2.2 Exchange rates

The dollar continued to slip back against the euro in the closing quarter (see figure 2). The downward revision of U.S. growth and falling official rates made further inroads into the valuation of the U.S. currency. The exchange rate peaked above

1.48 dollars/euro on 26-27 November before settling back to 1.439 dollars/euro on our end date of 20 December. This equates to a 1.2% depreciation since September and 9% over the length of the year. Meantime the euro sank further against the yen on the way to correcting the June spike. Specifically, the European currency depreciated 0.8% to a 20 December rate of 162.3 yen/euro, though on a year-to-date basis it continued to show a 3.4% gain.

Euro/dollar and euro/yen exchange rates¹

FIGURE 2



Source: Thomson Datastream.

¹ Data to 20 December.

2.3 Long-term interest rates

The fourth-quarter highlights in international medium- and long-term debt markets were a strong decline in government bond yields and the quickening run-up of credit risk premiums.

In the United States, heavy T-bond purchasing sent yields heading sharply lower (see table 4), with declines of 100 basis points in the three-year term and 50 basis points in ten-year instruments. This adds up to a cumulative fall since June 2007 of 1.95% and 1.05% respectively in these two maturities.

Yields also moved down in the euro zone though less markedly than in the United States, with declines of 60 basis points in three- and five-year maturities and 40 basis points in the ten-year term. As a result of this run-down in U.S. medium and long yields, spreads versus the euro zone switched from positive (10 basis points at five years and 25 basis points at ten) to negative (65 and 20 basis points respectively) between end September and 20 December. In the three-year maturity, already negative readings accentuated considerably, from the -15 basis points of end September to -90 basis points on 20 December.

In Japan too investors rushed to purchase government bonds, though with rather more restraint than in the United States and euro zone. The result was a 10 bp decline in yields across all maturities in the fourth quarter of 2007.

Medium and long government bond yields¹

TABLE 4

	Dec 04	Dec 05	Dec 06	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07 ²
Euro zone								
3 year	2.51	2.86	3.75	3.75	3.92	4.49	4.10	3.91
5 year	2.92	3.06	3.77	3.77	3.90	4.52	4.11	3.92
10 year	3.65	3.37	3.80	3.80	3.95	4.57	4.24	4.16
U.S.								
3 year	3.20	4.39	4.59	4.59	4.51	4.99	4.05	3.03
5 year	3.60	4.39	4.54	4.54	4.48	5.02	4.20	3.43
10 year	4.23	4.46	4.57	4.57	4.56	5.09	4.52	4.04
Japan								
3 year	0.24	0.46	0.93	0.93	0.90	1.19	0.92	0.81
5 year	0.57	0.86	1.22	1.22	1.18	1.51	1.18	1.05
10 year	1.40	1.53	1.64	1.64	1.62	1.88	1.60	1.50

Source: Reuters.

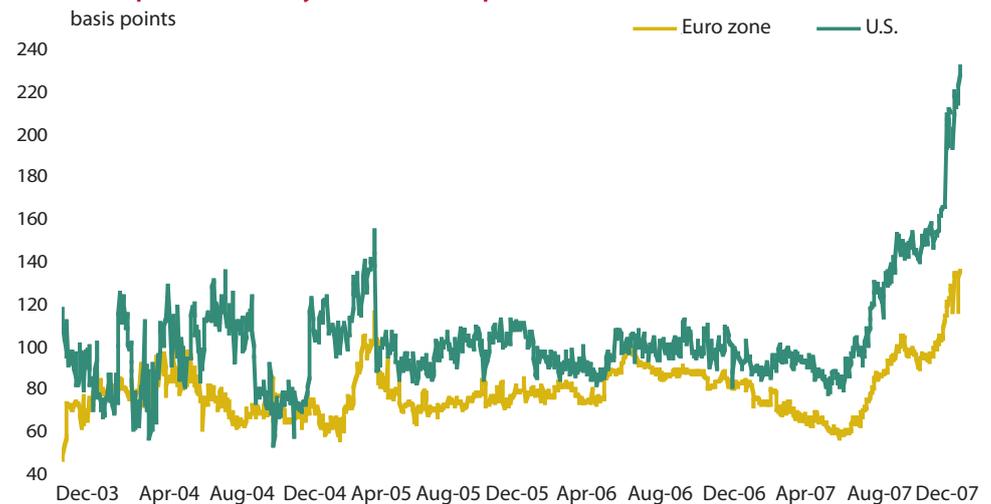
¹ Monthly average of daily data.

² Average data from 20 November to 20 December.

Credit risk premiums continued their steady ascent in the fourth-quarter period (see figure 3 and table 5), to close at an all-century high in both the United States and euro zone.

Credit risk premiums: 10-year BBB-AAA spread¹

FIGURE 3



Source: Reuters.

¹ Data to 20 December.

In the United States, BBB-AAA spreads widened by 30 basis points in the three-year term and 65 basis points at five and ten years. In this last case, premiums soared to over 200 basis points, as against a January 2004 to June 2007 average of 100 basis points. Euro-zone premiums, meantime, rose 15 basis points at three years and 25 basis points at five and ten. Long-term spreads, at 125 bp, were likewise substantially ahead of the January 2004 to June 2007 average of 80 basis points.

Credit risk premiums: BBB-AAA spread¹

TABLE 5

basis points	Dec 04	Dec 05	Dec 06	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07 ²
Euro zone								
3 year	49	43	37	37	32	28	50	67
5 year	61	53	53	53	45	43	75	101
10 year	68	77	84	84	71	62	100	124
U.S.								
3 year	63	37	54	54	70	65	95	124
5 year	71	63	68	68	80	70	103	167
10 year	81	108	96	96	98	90	147	211

Source: Reuters.

1 Monthly average of daily data.

2 Average from 20 November to 20 December.

2.4 International stock markets

Share prices again headed lower on main international markets through the last quarter of 2007, though a mild recovery from end-November kept losses within reason (see figure 4). This negative performance owed to a number of causes, with generally unsettled financial conditions and lower forecasts for world economic growth mixed in with other destabilising factors like the oil price spiral.

Main stock market indices¹

FIGURE 4



Source: Thomson Datastream.

1 Data to 20 December.

The steepest corrections were reserved for Japan, where the Nikkei 225 receded 10.4% in the fourth quarter (see table 6) on the way to year-to-date losses of 12.7%. The Italian market too recorded a 5.4% contraction that took its cumulative fall to 8.1%. In the United States, the Dow Jones dropped 4.7% in what was generally a poor quarter, but managed to stay ahead in year-to-date terms with a positive advance of 6.3%.

The quarter's best performers were the Spanish and German bourses, the only two to stay clear of losses. Specifically, Spain's Ibex 35 gained 3.9% while the German Dax 30 edged ahead 0.1%. The Dax 30 was also the highest earning of all main world markets in 2007, with a 19.3% rise substantially beating the 7% of the second-placed Ibex.

Performance of main stock market indices

TABLE 6

	Index	2006	Q2 07	Q3 07	2007 – Dec ¹		
					% Q	% on Dec 06	% annual
World							
	MSCI World	18.0	5.8	1.9	-4.7	4.9	4.9
Euro zone							
	Euro Stoxx 50	15.1	7.4	-2.4	-1.5	4.7	4.8
	Euronext 100	18.8	7.4	-4.8	-3.5	1.8	2.2
Germany	Dax 30	22.0	15.8	-1.8	0.1	19.3	19.5
France	Cac 40	17.5	7.5	-5.6	-3.6	-0.5	-0.1
Italy	Mib 30	17.5	1.3	-4.4	-5.4	-8.1	-7.9
Spain	Ibex 35	31.8	1.7	-2.1	3.9	7.0	6.6
United Kingdom							
	FTSE 100	10.7	4.8	-2.1	-1.9	2.0	2.4
United States							
	Dow Jones	16.3	8.5	3.6	-4.7	6.3	6.3
	S&P 500	13.6	5.8	1.6	-4.4	2.9	2.6
	Nasdaq-Cpte	9.5	7.5	3.8	-2.2	9.3	8.8
Japan							
	Nikkei 225	6.9	4.9	-7.5	-10.4	-12.7	-11.6
	Topix	1.9	3.6	-8.9	-9.8	-13.3	-12.6

Source: Thomson Datastream.

¹ Data to 20 December. Quarterly change (% Q) corresponds to the period between 20 December and 28 September.

Investor uncertainties were most plainly felt on the U.S. and Japanese exchanges. In both cases, the volatility upswing of the third quarter consolidated in the closing months (see table 7 and figure 6). Specifically, the VIX² indicator of market volatility held at around 22% on average in the fourth quarter (as compared to Q2 07 average volatility of 14%). Euro-zone stock markets performed more evenly in the fourth-quarter period, during which the volatility of the Euro Stoxx 50 eased back to 14%.

Historical volatility of main stock indices¹

TABLE 7

%	1999-2003	2004-2006	2004	2005	2006	Q2 07	Q3 07	Q4 07 ²
Euro Stoxx 50	25.08	12.57	13.36	10.73	13.63	12.40	19.94	13.99
Dow Jones	18.83	9.95	10.52	9.95	9.41	9.05	16.86	17.13
Nikkei	22.95	16.17	17.29	12.14	19.08	13.31	19.49	19.60
Ibex 35	23.09	11.48	12.15	9.86	12.45	14.18	19.58	14.69

Source: Thomson Datastream.

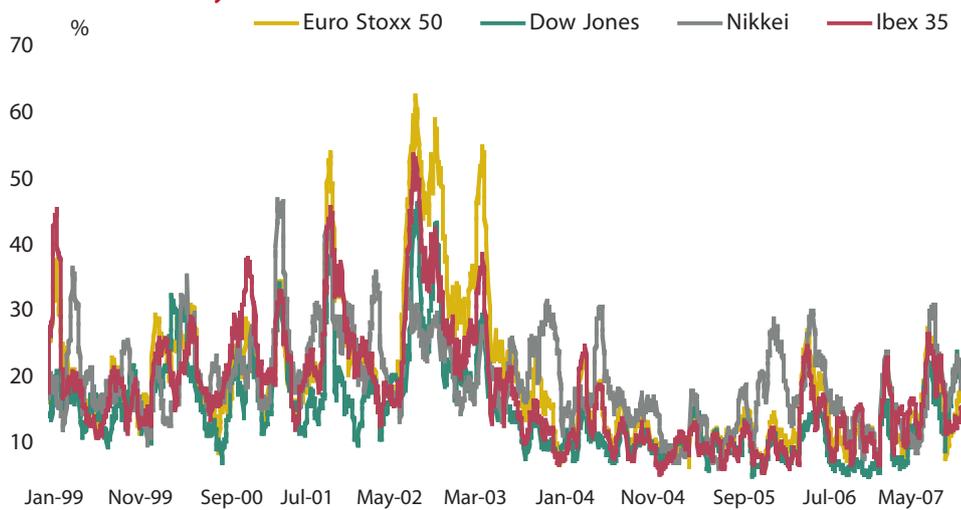
¹ Average daily data.

² Last available data for 20 December.

² Implied volatility of options on the S&P 500 according to the CBOE (Chicago Board Options Exchange), reflecting the market's expectations for the short-term volatility of equities. Considered a benchmark for stock market volatility.

Historical volatility of main stock indices¹

FIGURE 5



Source: Thomson Datastream.

¹ Data to 20 December.

Losses were also the dominant Q4 note in emerging country markets, although without overshadowing a strong year-long performance that easily surpassed those of main world bourses (see tables 6 and 8). Specifically, emerging markets clocked up average gains of 24.5% to 20 December against the meagre 1.6% of leading international indices.

In China, earnings taking was the order of the day after the strong run-up of the past two years. Despite this correction, the market's cumulative advance was a hefty 88.5%. The Taiwan exchange recorded fourth-quarter losses of 16.5%. Conversely, a strong performance by Indian and Indonesian markets boosted their cumulative gains to over 50%.

In Peru, the bull run initiated in 2006 gave way to a steep price correction, with fourth-quarter losses summing 21%. Other Latin American markets experienced moderate slippage in the fourth quarter. The exception was Brazil, which stayed in positive territory en route to a year-long gain of 38.8%.

Eastern Europe markets, with the exception of Russia, turned in a negative Q4 performance. However Croatia and Bulgaria continued to offer attractive gains on the full-year horizon.

Performance of other international stock indices

TABLE 8

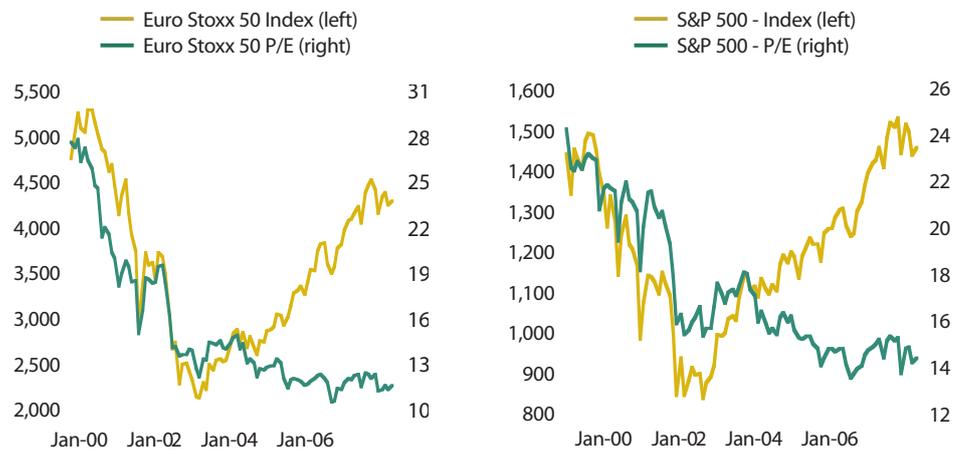
	Index	2006	Q2 07	Q3 07	2007 – Dec ¹		
					% Q	% on Dec 06	% annual
Latin America							
Argentina	Merval	35.5	4.2	-0.1	-2.2	2.4	4.8
Brazil	Bovespa	32.9	18.7	11.2	2.1	38.8	41.9
Chile	IGPA	34.4	13.6	-3.4	-4.9	12.2	12.6
Mexico	IPC	48.6	8.4	-2.7	-3.8	10.2	14.8
Peru	IGRA	168.3	30.4	-2.4	-21.0	33.9	36.4
Venezuela	IBC	156.1	-18.9	-6.1	-0.9	-29.3	-22.5
Asia							
China	Shanghai Comp	130.4	20.0	45.3	-9.2	88.5	112.5
India	BSE	41.0	15.5	17.9	16.4	49.5	55.2
South Korea	Korea Cmp Ex	4.0	20.0	11.6	-5.2	28.6	27.9
Philippines	Manila Comp	42.3	14.3	-2.4	-2.3	17.1	23.4
Hong Kong	Hang Seng	34.2	10.0	24.7	-0.5	35.3	40.4
Indonesia	Yakarta Comp	55.3	16.8	10.3	12.7	47.2	50.4
Malaysia	Kuala Lumpur Comp	21.8	8.6	-1.3	3.8	26.5	28.9
Singapore	SES All-S'Pore	27.2	9.8	4.5	-9.4	12.4	14.9
Thailand	Bangkok SET	-4.7	15.3	8.8	-6.4	16.5	14.5
Taiwan	Taiwan Weighted Pr.	19.5	12.7	6.0	-16.5	0.4	2.7
Eastern Europe							
Russia	Russian RTS Index	70.7	-2.0	9.2	10.2	18.8	22.3
Poland	Warsaw G. Index	41.6	14.9	-8.6	-8.4	9.7	10.3
Rumania	Romania BET	22.2	13.1	-0.3	-0.9	18.6	18.6
Bulgaria	Sofix	48.3	10.4	31.0	-6.4	41.4	42.2
Hungary	BUX	19.5	23.5	-1.8	-10.1	2.8	5.1
Croatia	CROBEX	62.2	14.1	4.2	0.0	57.0	57.5

Source: Thomson Datastream.

¹ Data to 20 December. Quarterly change (% Q) corresponds to the period between 20 December and 28 September.

Stock indices and P/E: Euro Stoxx 50 vs. S&P 500

FIGURE 6



Source: Thomson Datastream.

Price-earnings ratios (P/E) moved in divergent directions in the fourth-quarter period. Falling share prices reduced the earnings multiples of the S&P 500, Euronext 100 and Mib 30 (see table 9 and figure 6). Conversely, P/Es increased in the case of the FTSE 100 (despite a falling index) and the IBEX 35, due to fourth-quarter index gains (see table 6).

P/E of main stock indices

TABLE 9

	2004	2005	2006	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07 ¹
S&P 500	16.36	14.85	15.07	15.07	14.66	15.08	14.69	14.46
Topix	15.68	19.52	17.80	17.80	17.59	18.04	15.59	15.70
Euro Stoxx 50	13.00	12.03	12.15	12.15	11.94	12.35	11.55	11.71
Euronext 100	13.06	12.46	12.93	12.93	13.00	13.68	12.64	12.46
FTSE 100	16.63	12.45	12.41	12.41	12.48	12.65	11.95	12.23
Dax 30	12.96	12.62	12.78	12.78	12.66	13.25	12.35	12.45
Cac 40	12.93	12.14	12.68	12.68	12.55	13.22	12.08	12.00
Mib 30	15.57	13.38	13.07	13.07	12.85	12.87	12.09	11.82
Ibex 35	13.78	12.88	14.29	14.29	14.04	13.91	12.67	13.45

Source: Thomson Datastream.

¹ Data to 20 December.

Dividend yield held up reasonably strongly on main world markets, with European markets retaining their lead (see table 10). Hence while average yields stood at 3.5% on 20 December 2007, the U.S. and Japan again trailed behind with 2.2% and 1.4% respectively.

Dividend yield of main stock indices

TABLE 10

%	2004	2005	2006	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07 ¹
S&P 500	1.84	1.94	1.91	1.91	2.13	2.04	2.11	2.20
Topix	1.11	0.95	1.11	1.11	1.11	1.20	1.37	1.40
Euro Stoxx 50	3.17	3.28	3.52	3.52	3.92	3.61	3.79	3.68
Euronext 100	3.22	3.23	3.32	3.32	3.63	3.52	3.73	3.76
FTSE 100	3.61	3.59	3.77	3.77	3.88	3.82	3.94	3.86
Dax 30	1.96	2.17	2.29	2.29	2.77	2.48	2.50	2.49
Cac 40	3.32	3.43	3.79	3.79	4.26	4.09	4.41	4.27
Mib 30	3.17	3.53	3.67	3.67	3.88	3.47	3.66	3.70
Ibex 35	2.77	3.08	3.02	3.02	3.19	2.99	3.16	2.89

Source: Thomson Datastream.

¹ Data to 20 December.

No fourth-quarter turnover figures are as yet available for main world bourses. The general trend to the third quarter was one of steadily rising trading volumes, with average growth of 55% with respect to the third quarter of 2006. North American markets experienced an activity upswing versus the second quarter, possibly linked to the high volatility prevailing. Conversely, Italian and Spanish markets saw their trading volumes drop by 23% and 16% respectively compared to the quarter before (see table 11).

Trading volumes of main international stock markets

TABLE 11

Billion euros								
Exchange	2004	2005	2006	Q3 06	Q4 06	Q1 07	Q2 07	Q3 07
U.S. ¹	16,813	20,042	27,044	6,091	6,646	7,439	7,740	8,776
New York	9,317	11,410	17,222	3,958	4,232	4,814	5,012	5,807
Tokyo	2,591	3,603	4,617	986	1,049	1,272	1,169	1,192
London	4,149	4,583	5,991	1,340	1,626	2,035	2,128	2,142
Euronext	1,986	2,345	3,006	617	736	948	1,075	1,113
Deutsche Börse	1,238	1,546	2,165	457	545	801	791	827
Borsa Italiana	778	1,051	1,258	231	357	388	509	395
BME ²	646	859	1,154	265	354	419	442	372

Source: World Federation of Exchanges and CNMV.

¹ The sum of New York Stock Exchange (NYSE), Nasdaq and American Stock Exchange.² Bolsas y Mercados Españoles. Not including Latibex.

3 Spanish fixed-income markets

The spread between commercial paper and interbank deposit rates varied little in the period beyond a small decline across all maturities, and accordingly remained within the interval of 15 to 20 basis points (see table 12).

Short-term interest rates¹

TABLE 12

%	Dec 04	Dec 05	Dec 06	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07
Commercial paper²								
3 month	2.25	2.58	3.78	3.78	4.00	4.25	4.87	4.93
6 month	2.30	2.74	3.91	3.91	4.11	4.39	4.91	4.91
12 month	2.39	2.93	4.00	4.00	4.23	4.61	4.91	4.86
Spread³ vs. interbank deposits								
3 month	9	12	11	11	14	12	17	14
6 month	10	15	14	14	18	13	20	16
12 month	10	16	9	9	15	13	20	18

Source: AIAF and AFI.

1 Average daily data. December 2007 data correspond to the average between 20 December and 20 November.

2 Trading on private fixed-income market AIAF.

3 In basis points.

Spanish government bond yields ceded less than their euro-zone counterparts, with three-year yields down just 10 basis points against the 60 basis points of the euro zone. Likewise with ten-year yields, which dropped 15 basis points against the 40 bp of the euro zone. The spread between ten and three-year governments narrowed by 5 basis points to 25 basis points (see table 13 and figure 7).

In contrast, corporate bond yields climbed between 5 and 10 basis points in the three and five year maturities, and 15 basis points in the ten-year term. The result was a sharply widening corporate bond spread vs. the corresponding sovereign instrument, with increases of 20 basis points at three and five years and 30 basis points in the ten-year segment. This last spread reached a December level of 60 basis points; the highest in at least two years.

Yields of medium- and long-term government bonds and private fixed-income¹

TABLE 13

%	Dec 04	Dec 05	Dec 06	Dec 06	Mar 07	Jun 07	Sep 07	Dec 07
Private fixed-income²								
3 year	2.81	3.15	4.04	4.04	4.17	4.75	4.35	4.43
5 year	3.38	3.48	4.14	4.14	4.21	4.84	4.42	4.48
10 year	4.15	3.89	4.26	4.26	4.39	5.02	4.68	4.82
Government bonds								
3 year	2.61	2.91	3.74	3.74	3.91	4.51	4.09	3.98
5 year	3.00	3.06	3.77	3.77	3.94	4.56	4.20	4.06
10 year	3.64	3.36	3.81	3.81	4.00	4.63	4.37	4.21
Spread³								
3 year	20	25	30	30	26	25	26	45
5 year	37	42	37	37	27	28	22	42
10 year	51	54	45	45	38	39	31	61

Source: Thomson Datastream and AIAF.

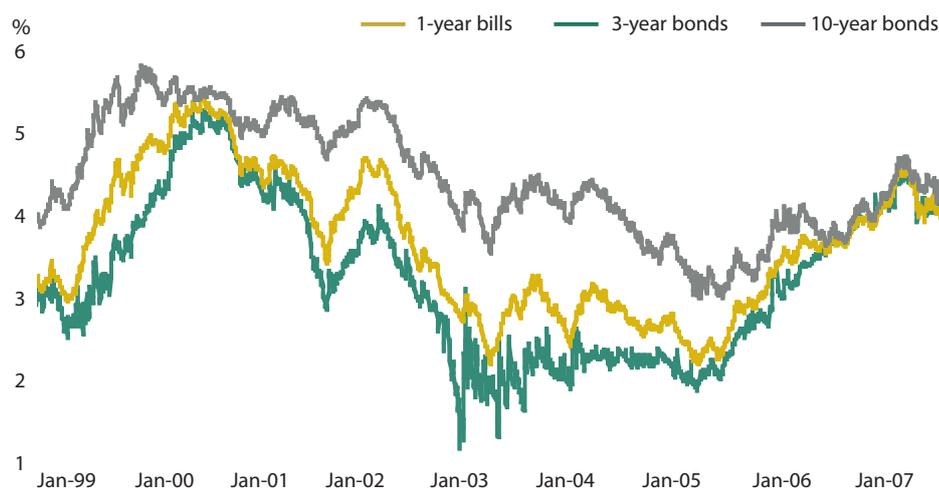
1 Average daily data. December 2007 data correspond to the average between 20 December and 20 November.

2 Bonds and debentures in outright trades on the AIAF market.

3 In basis points.

Spanish government bond yields¹

FIGURE 7



Source: Thomson Datastream.

¹ Data to 20 December.

The ratings of issues registered with the CNMV and trading on the AIAF fixed-income market experienced no noticeable fall-out from the interbank crisis. Over 90% of covered bond issues conserved their AAA rating (see table 14). Plain bonds and debentures again fell mainly into the AA and A categories. As in previous quarters, preference shares were the lowest rated instruments, with 39% of them BBB.

Credit ratings of CNMV-registered issues trading on AIAF¹

TABLE 14

% total unless otherwise indicated	Mortgage backed securities	Non mortgage asset-backed securities	Mortgage bonds	Territorial bonds	Matador bonds	Plain bonds	Plain debentures	Preference shares	Total
Rated									
Amount (million euros)	24,441.4	292,068.6	147,638.0	15,625.0	1,238.2	84,522.1	40,995.5	21,877.1	628,405.8
Percentage	100.0	100.0	99.0	95.4	100.0	91.7	82.9	94.9	97.0
Investment grade									
AAA	93.9	94.6	98.0	93.6	80.1	4.2	3.5	0.0	72.1
AA	1.4	0.9	1.1	0.0	12.5	47.6	20.6	4.3	9.2
A	3.3	2.3	0.0	1.8	4.9	39.9	53.9	46.6	12.7
BBB	0.7	1.5	0.0	0.0	0.0	0.0	4.9	38.9	2.4
Speculative grade									
<BBB	0.7	0.6	0.0	0.0	2.5	0.0	0.0	5.1	0.5
Unrated									
Amount (million euros)	0.0	0.0	1,442.5	750.0	0.0	7,640.3	8,457.5	1,185.5	19,475.8
Percentage	0.0	0.0	1.0	4.6	0.0	8.3	17.1	5.1	3.0

Source: CNMV.

¹ Outstanding balance as of 30 November 2007.

The most visible effect of the mortgage crisis was the third-quarter contraction in issues of asset-backed securities, whose outstanding balance slumped to 17,898 million euros against the over 30,000 million of previous quarters. There was also some slight deterioration in credit ratings, with a lower proportion of issues in the AAA bracket (see table 15).

However issuance activity picked up strongly in the closing quarter. Volume in issue climbed to over 52,8 billion euros. These issues were almost wholly acquired on the primary market by the originating institutions, which by this means can generate instruments eligible as collateral in Eurosystem monetary policy operations.

Issues of asset-backed securities¹ registered with the CNMV: distribution by credit rating

TABLE 15

% total unless otherwise indicated

	2006	2007			
	Q4	Q1	Q2	Q3	Q4
Amount (million euros)	39,766	39,392	31,518	17,898	52,819
Percentage	100.0	100.0	100.0	100.0	100.0
<i>Investment grade</i>					
AAA	94.2	96.7	94.6	92.9	93.7
AA	1.1	1.2	1.2	0.7	1.0
A	2.3	0.5	1.9	2.9	1.8
BBB	1.4	1.1	1.6	2.0	2.0
<i>Speculative grade</i>					
<BBB	1.0	0.5	0.8	1.4	1.5

Source: CNMV.

¹ Including mortgage bonds and non mortgage asset-backed securities.

4 Spanish equity markets

4.1 Prices

The Spanish stock market was the best performing of all main world bourses in the fourth quarter of 2007. The Ibex 35 moved up 3.9% against average losses of 2.8% in main euro zone markets and the 4.7% fall of the Dow Jones. The Ibex had in fact gained 9.4% to 8 November, when it touched a new record high of 15,945.7. However the losses predominating in the weeks that followed took it down to a 20 December level of 15,140.2., equating to a cumulative gain since the year's outset of 7%. This was the next best performance in the euro zone after Germany's Dax 30, which recorded a cumulative advance of 19.3% (see tables 6 and 16).

Performance of Spanish stock indices

TABLE 16

annual % unless otherwise indicated	2006	Q2 07	Q3 07	2007 – Dec ¹			
				Index	% Q	% on Dec 06	% annual
Ibex 35	31.8	1.7	-2.1	15,140	3.9	7.0	6.6
IGBM ²	34.5	1.1	-2.4	1,640	2.4	5.5	4.9
Barcelona	29.3	1.7	-0.5	1,189	2.8	4.8	4.0
Bilbao	34.1	1.7	-3.6	2,629	1.6	2.0	1.3
Valencia	35.3	1.7	-1.1	1,354	2.1	6.8	6.3
Ibex with dividends	36.0	-1.8	-1.2	25,344	9.2**	15.3	19.2
Ibex-NM ³	34.0	-7.4	-2.3	3,301	-3.8***	-6.0	-8.1
Ibex Medium Cap ⁴	42.1	-0.1	-11.4	17,901	-9.0	-8.9	-10.4
Ibex Small Cap ⁵	54.4	-1.8	-5.2	14,923	-9.1	-3.4	-5.5
BCN-Mid 50 ⁶	51.0	1.7	-8.3	33,502	-10.6	-9.3	-11.2
FTSE Latibex All-share ⁷	23.8	18.0	11.4	3,565	6.8	53.8	57.2
FTSE Latibex Top ⁸	18.2	20.8	2.0	4,989	0.7	32.0	34.8
FTSE Latibex Brasil ⁹	24.3 *	23.0	43.4	13,819	5.1	60.6	64.5

Source: Thomson Datastream, Reuters, Bolsa de Madrid y Sociedad de Bolsas.

1 Data to 20 December except the Ibex with dividends, corresponding to 30 October, and the Ibex-NM, corresponding to 30 November. Quarterly change (% Q) refers to the period between 20 December (30 October in the case of Ibex with dividends and 30 November for the Ibex-NM) and 28 September.

2 Madrid Stock Exchange General Index.

3 Ibex Nuevo Mercado, made up of TMTs (technology, media and telecoms) and discontinued as of 3 December 2007.

4 Index of medium-cap shares made up of 20 companies.

5 Index of small-cap shares made up of 30 companies.

6 Index of the middle segment of the Spanish stock market drawn up by the Barcelona Exchange.

7 Index of all shares quoted on the Latin American market in euros (Latibex).

8 Index of main Latibex shares.

9 Index of main Brazilian shares quoted on Latibex.

* Since the index started, on 26 September.

** To 30 October.

***To 30 November.

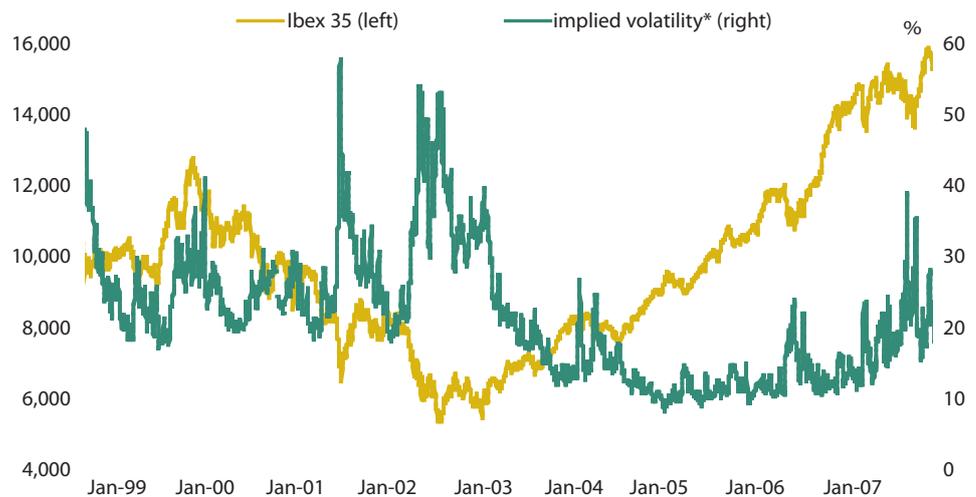
The other main Spanish stock indices all underperformed the Ibex. Specifically, the IGBM managed a gain of just 2.4%, while both the Ibex Medium Cap and the Ibex Small Cap dropped back by around 9%.

The advance of the FTSE Latibex basically reflected the strong performance of Brazilian corporates. The FTSE Latibex All-share rose 6.8% in the fourth quarter with the FTSE Latibex Brazil up by 5.1%.

Volatility eased a little in average terms, but continued moving above the average levels of 2003 onwards (see figure 8). Implied at-the-money (ATM) volatility on the nearest expiry date of Ibex 35 options was an average 20.9% against the 22% of the third quarter. Volatility touched a quarterly peak of 28% on two separate occasions, in mid November and on 20 December. The third-quarter peak was the 35-36% recorded in the trading sessions of 17- 20 September. Average volatility from January 2003 to June 2007 stood at 16%.

Performance of the Ibx 35 and implied volatility

FIGURE 8



Source: Thomson Datastream and MEFF.

* Implied at-the-money (ATM) volatility on nearest expiry. Data to 20 December 2007.

IGBM gains traced predominantly to the “Technology and telecommunications” sector, which managed a quarterly advance of 11.6%. Telefónica’s strong year-to-date earnings performance won it “safe haven” status in the third quarter when it clocked up an impressive gain of 18.7%. The bull run persisted through the fourth quarter with the shared picking up an additional 12.5% (see tables 17 and 18).

The “Banks” sub-sector also continued in positive territory, with a more moderate advance of 3.4%, thanks to the rising prices of institutions like Santander, Banco de Sabadell and Bankinter. The latter was the quarter's star performer with a gain of 28.1%, coinciding with a major reshuffle among its significant shareholders.

Performance of the Madrid Stock Exchange by sector and leading shares¹

TABLE 17

annual % unless otherwise indicated	weighting ²	2006	Q2 07	Q3 07	2007 – Dec ³		
					% Q	% on Dec 06	% annual
Financial and real estate services	38.70	34.9	-2.1	-7.0	2.7	-6.3	-6.3
Real estate and others	1.95	111.2	-21.1	-3.6	-8.6	-36.4	-37.2
Banks	34.81	27.3	-1.3	-7.0	3.4	-4.9	-4.6
BBVA	13.07	21.0	-1.0	-9.7	0.9	-9.0	-9.3
Santander	14.16	26.8	2.5	-0.4	6.0	2.2	2.6
Oil and energy	24.18	33.3	9.1	-3.3	0.4	13.4	12.8
Endesa	4.35	61.2	-0.7	-0.3	-9.3	1.5	3.4
Repsol YPF	4.45	6.2	15.9	-14.4	-3.8	-8.1	-10.5
Iberdrola	9.92	43.4	17.4	-0.8	1.8	26.7	26.3
Basic materials, industry and construction	9.95	61.9	2.9	-10.7	-1.9	-2.7	-4.3
Construction	5.89	61.0	1.8	-17.0	1.4	-9.9	-11.6
Technology and telecommunications.	15.39	28.4	-0.5	17.5	11.6	33.5	32.2
Telefónica	14.54	26.8	0.2	18.7	12.5	37.0	35.6
Consumer goods	7.05	31.9	0.2	-1.6	-6.7	7.6	7.3
Consumer services	4.73	8.6	-5.0	-8.9	-3.2	-6.4	-6.9

Source: Thomson Datastream and Bolsa de Madrid.

¹ Shares capitalising at more than 4% of the IGBM.

² Relative weight (%) in the IGBM as of 2 July 2007.

³ Data to 20 December. Quarterly change (% Q) corresponds to the period between 20 December and 28 September 2007.

The “Oil and energy” sector scraped a small gain in the fourth quarter, with divergent performances between shares: Red Eléctrica de España and Solaria moved up strongly while Endesa finished sharply down due to share price adjustments following the closure of the takeover bid process.

The “Construction” sector made up the ground lost in the third quarter. Leading the pack was Construcciones y Auxiliar de Ferrocarriles (CAF) with a quarterly rise of 13.4%, which lifted its cumulative 2007 gains to 107.4%. Another two sector companies, General de Alquiler de Maquinaria and Acciona also figure among the top performers in the year (see table 20).

The worst performing sector was “Real estate and others” with a further 8.6% losses in the quarter (see figure 9). Among the individual players, Urbas, AISA and Astroc all saw their prices tumble (see table 19). The result was to enlarge the sector's year-to-date losses to 36.4%. Note, however, that this result is still far from annulling the sector's spectacular run-up of 2006, which closed with an annual gain of 111.2%. By company, the more extreme case is undoubtedly Astroc, which followed up its 2006 spurt of 487% with a 80.8% fall to 20 December 2007, placing it at the rear end of the IGBM contingent (see table 20).

Shares with greatest impact on IGBM change¹

TABLE 18

Share	Sector	2007- Dec ²		
		% Q	Jan-Dec 07	% annual
Rise				
Telefónica	Technology and telecommunications	1.82	5.38	5.18
Banco Santander	Financial and real estate services	0.85	0.31	0.37
Bankinter	Financial and real estate services	0.25	0.08	0.08
Banco de Sabadell	Financial and real estate services	0.19	-0.21	-0.16
Iberdrola	Oil and energy	0.18	2.65	2.62
Red Eléctrica de España	Oil and energy	0.17	0.30	0.31
Acciona	Basic materials, industry and construction	0.15	0.65	0.67
Fall				
Endesa	Oil and energy	-0.41	0.06	0.15
Inditex	Consumer goods	-0.18	0.06	0.06
Repsol	Oil and energy	-0.17	-0.36	-0.47
Grupo Ferrovial	Basic materials, industry and construction	-0.15	-0.31	-0.31

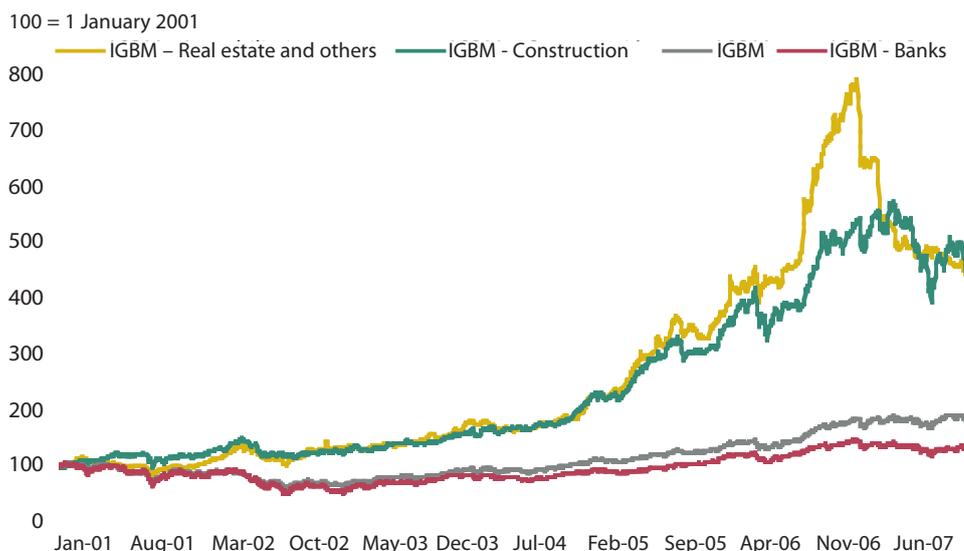
Source: Thomson Datastream and Bolsa de Madrid.

1 The shares listed are those having most impact (equal to or more than 0.15 points) on the change in the IGBM.

2 Data to 20 December.

Performance of Real estate and others, Construction and Banks¹

FIGURE 9



Source: Bolsa de Madrid.

¹ Data to 20 December.

IGBM shares with biggest quarterly change

TABLE 19

Share	Sector	2007- Sep ¹		
		% Q	Jan-Dec 07	% annual
Rise				
Bankinter	Financial and real estate services	28.09	8.64	8.92
Pescanova	Consumer goods	24.51	49.45	46.52
Red Eléctrica de España	Oil and energy	20.47	34.78	36.42
Solaria Energía y Medio Ambiente	Oil and energy	16.98	-	-
Construcciones y Auxiliar de Ferrocarriles (CAF)	Basic materials, industry and construction	13.44	107.35	104.42
Fall				
AISA	Financial and real estate services	-60.36	-	-
Urbas Guardahermosa	Financial and real estate services	-54.43	-75.17	-75.43
Astroc Mediterráneo	Financial and real estate services	-47.44	-86.30	-84.92
Natraceutical	Consumer goods	-32.00	-53.30	-55.96
Fersa Energías Renovables	Oil and energy	-29.77	-	-

Source: Thomson Datastream and Bolsa de Madrid.

¹ Data to 20 December. Quarterly change (% Q) refers to the period between 20 December and 28 September 2007.

IGBM shares with biggest annual change

TABLE 20

Share	Sector	2007- Dec ¹	
		% annual	% Q
Rise			
Construcciones y auxiliar de ferrocarriles (CAF)	Basic materials, industry and construction	104.42	13.44
Grifols	Consumer goods	74.80	-3.48
General de Alquiler de Maquinaria	Basic materials, industry and construction	57.31	-0.26
Acciona	Basic materials, industry and construction	52.86	12.14
Bolsas y Mercados Españoles	Financial and real estate services	52.39	6.22
Fall			
Astroc Mediterráneo	Financial and real estate services	-84.92	-47.44
Urbas Guardahermosa	Financial and real estate services	-75.43	-54.43
Vueling Airlines	Consumer services	-71.13	-16.08
Ercros	Basic materials, industry and construction	-56.41	-19.05
Natraceutical	Consumer goods	-55.96	-32.00

Source: Thomson Datastream and Bolsa de Madrid.

¹ Data to 20 December. Annual change (% annual) corresponds to the period between 20 December 2007 and 20 December 2006, and quarterly change (% Q) to the period between 20 December and 28 September 2007.

Table 21 sets out the 2007 performance of IGBM shares in summarised form. We can see that the index as a whole saw a slight improvement in Q4 2007. The percentage of companies recording losses dropped to 71.7% from the 75.0% of the third quarter, while the percentage gaining between 10% and 25% moved up from 4.7% to 7.9%.

Performance range of IGBM companies

TABLE 21

% total IGBM companies	Q4 06	Q1 07	Q2 07	Q3 07 ¹	Q4 07 ¹
≥ 25%	14,8	12,0	4,9	1,6	0,8
10% to 25%	27,9	37,6	10,7	4,7	7,9
0% to 10%	36,1	33,6	21,3	18,8	19,7
≤ 0%	21,3	16,8	63,1	75,0	71,7
Pro-memoria: total no. of companies					
	122	125	122	128	127

Source: Thomson Datastream.

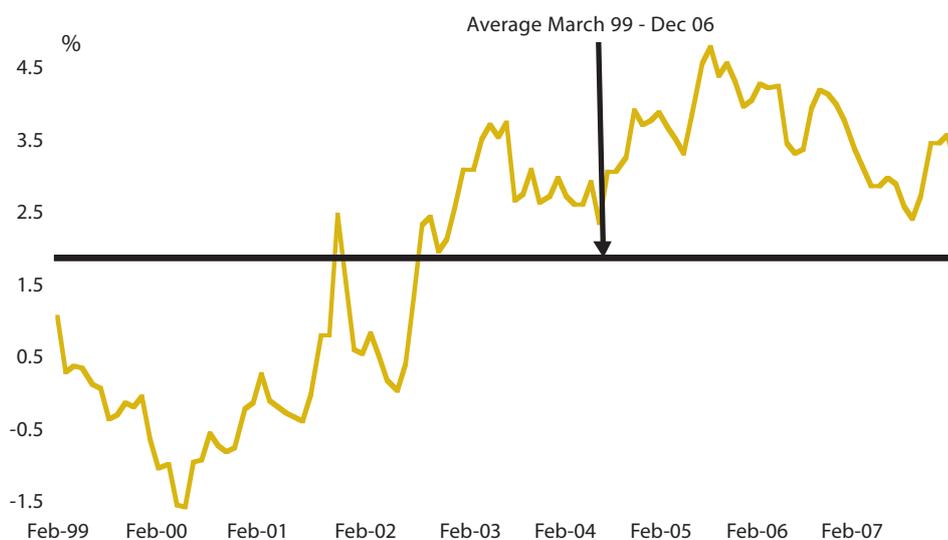
¹Data to 20 December.

As remarked in section 2.4, the P/E of the Ibex 35 climbed to 13.5 in the fourth quarter under the spur of rising share prices. This increase was the highest in the euro zone, keeping the Ibex 35 multiple ahead of the euro-zone average of 12.1 though still short of the 16.4 average recorded between January 1999 and December 2006.

The higher P/E of the Ibex 35 eroded the yield differential on equity investment in comparison to long-term bonds (earnings yield gap) between September and December, despite the interim decline in rates. The result was a December earnings yield gap of 3.2% (3.5% in September). This is still significantly higher than the average in place from early 1999 to December 2006 (see figure 10).

Earnings yield gap¹ of the Ibex 35

FIGURE 10



Source: Thomson Datastream and authors.

¹ Difference between stock market yield, taken as earnings/price, and ten-year bond yields. Monthly data to December.

4.2 Activity: trading and liquidity

Trading on the Spanish market continued brisk over the fourth quarter of 2007. October-November data locate turnover in the period at 327,624 million euros, giving an average daily volume of 7,281 million euros. This figure stands 27% higher than the daily average for the third quarter of 2007 (see table 22). On a first analysis, then, we can say that 2007 has been something of a boom trading year on Spanish exchanges, with average daily volume to 7 December of 6,668 million euros a full 47% higher than the average figure for 2006.

The rise in trading volumes in the electronic market exceeded the increase in market capitalisation to November 2007. The result was that turnover velocity, the ratio between market trading and capitalisation, quickened to 191 from the 187 of last September (see figure 11).

Trading on the Spanish stock market

TABLE 22

Million euros	2004	2005	2006	Q4 06	Q1 07	Q2 07	Q3 07	Q4 07 ¹
All exchanges	642,109	854,145	1,154,294	354,260	418,540	441,725	372,131	327,624
Electronic market	636,527	847,664	1,146,390	351,020	415,857	439,664	370,417	325,775
Open outcry	5,194	5,899	5,318	1,358	574	209	98	247
of which SICAV 2	4,541	4,864	3,980	1,091	258	57	32	12
MAB 3	-	-	1,814	1,705	1,771	1,605	1,369	1,435
Second market	21	26	49	20	122	22	38	10
Latibex	366	557	723	158	217	226	209	157
Pro-memoria: non resident trading volumes (% all exchanges)	57,6	57,1	58,2	59,3	59,3	61,6	na	na

Source: CNMV and Directorate-General of Trade and Investments.

1 Cumulative data for October and November.

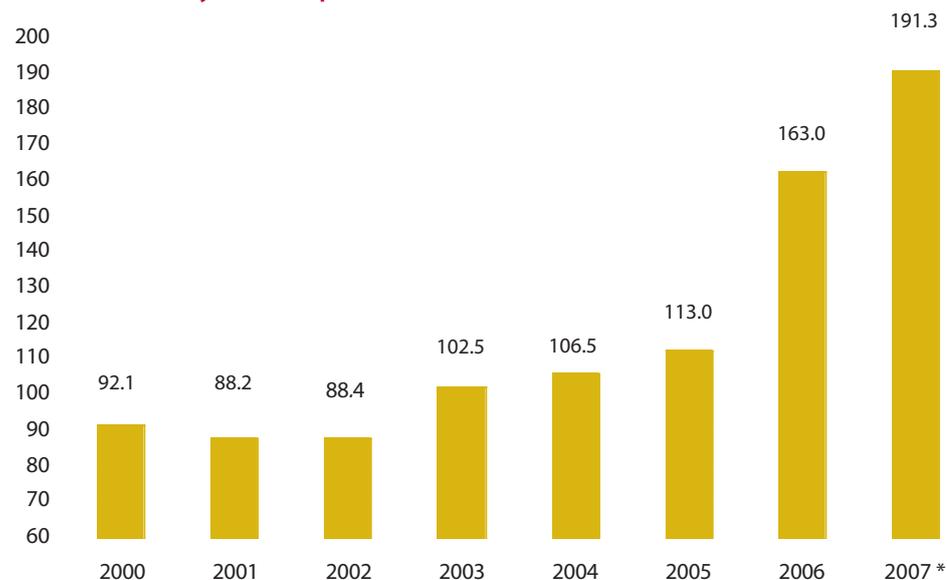
2 Open-ended investment companies.

3 Alternative investment market. Data since the start of trading on 29 May 2006.

na: data not available at the time of preparing this report.

Turnover velocity¹ of the Spanish stock market

FIGURE 11



Source: CNMV and Sociedad de Bolsas.

1 Ratio of cumulative trading volume in the electronic market in the past twelve months and average monthly capitalisation in the same period.

* Data to August.

4.3 Listed company earnings

Companies listed on the electronic market continued to report strong earnings growth despite a generally slower third quarter. Year-on-year growth in pre-tax profits was 8.9%, compared to equivalent increases in the first and second quarters of 16.2% and 23.7% respectively. In nine-month terms, company earnings were up 16.6% versus the equivalent period in 2006 against the 20.3% posted to mid year (see table 23).

Pre-tax profits¹ of IGBM companies

TABLE 23

Thousand euros, unless otherwise indicated	Quarterly data		Cumulative data	
	Amount	% change	Amount	% change
		Q3 07/06		Q3 07/06
Financial and real estate services²	6,398,493	2.0	22,352,971	15.7
Real estate and others ³	75,091	-69.4	1,086,572	8.8
Banks	6,167,983	20.4	19,794,833	22.4
BBVA	1,906,579	22.5	6,607,587	9.5
Santander	2,853,252	21.3	8,813,874	33.6
Oil and energy	4,393,198	-1.1	13,727,621	-1.9
Endesa	1,197,000	0.1	3,500,000	-10.5
Repsol YPF	1,293,000	-17.5	4,150,000	-11.3
Iberdrola	693,346	21.6	2,163,797	17.0
Basic materials, industry and construction	596,659	-55.1	6,128,387	11.8
Construction	1,086,328	16.2	4,895,316	78.6
Technology and telecommunications	4,103,526	84.8	9,373,326	68.7
Telefónica	4,075,415	82.4	9,275,162	65.9
Consumer goods	851,182	15.4	2,144,240	15.5
Consumer services	934,795	8.4	2,531,274	22.7
Total electronic market	17,277,853	8.9	56,257,819	16.6

Source: CNMV and authors.

¹ In the case of companies not belonging to a consolidated group, data are on an individual basis.

A breakdown by sector and individual firm reveals a wide disparity in earnings performance. Firstly, we have the profits surge at Telefónica, with year-to-date growth of 65.9% topping the already impressive 54.9% reported for the first-half period. The construction sector too posted a strong advance in profits, though with clear signs of a fading momentum, especially at Acciona, Sacyr Vallehermoso and Fomento Construcción³.

But where the stall in earnings was most clearly felt was in “Real estate and others”, which reported nine-month growth of 8.8% compared to the 34.2% of the first-half period. The most extreme case was Astroc, which went from posting 76.9 million euros profits between January and September 2006 to 153.5 million euros losses over the same period in 2007.

The “Banks” sector kept up profits growth of 22-23% approximately to the third quarter of 2007, with Bankinter, Banco de Sabadell and Santander all prolonging their good earnings run⁴.

“Oil and energy” was the only sector to experience a third-quarter decline in pre-tax profits (-1.9%). The cause in this case was profits slippage at Endesa, Repsol YPF and Cepsa, while remaining sector firms all reported third-quarter growth.

³ The sector as a whole reported Q2 profits 29.7% up on the prior quarter. Fomento Construcción grew its pre-tax numbers 163.7%, followed by Sacyr Vallehermoso with 89.1% and Acciona with 70.6%. However, these same firms reported third-quarter decreases of 52.2%, 68.7% and 82.3% respectively.

⁴ Year-on-year growth in third-quarter pre-tax profits of 66.9%, 47.7% and 33.6% respectively.

Profitability of listed companies. Developments from 2004 to June 2007

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1 Introduction

This article analyzes developments in profitability in companies listed on Spanish stock exchanges and the main components of profitability on the basis of financial data prepared in accordance with the International Financial Reporting Standards adopted by the European Union, which companies are obliged to submit to the Spanish SEC (CNMV).

Our study groups listed companies by broad sector of economic activity. Accordingly our elucidation of the data obtained is based on an overall, aggregate view. This is continued with a sectoral analysis, but we undertake no individualized or detailed study of listed companies.

Up to and including 2004 the regulatory framework of reference in Spain for financial reporting in the sphere of listed companies was the Standard Chart of Accounts (Plan General de Contabilidad) issued in 1990, and the consolidation regulations adopted in 1991.

However, since 2005, Regulation no. 1606/2002 of the European Parliament and Council provides the obligation for all companies listed on the European stock markets to prepare consolidated annual accounts in accordance with the International Financial Reporting Standards (IFRS), which has posed a considerable challenge to listed companies, their accounts auditors and the regulators that supervise regulatory compliance and oversee market transparency.

With its Circular 1/2005, the Spanish SEC began to adapt its periodic public reporting forms to the new accounting framework provided by the IFRS in the consolidated sphere of securities issuers. Since then financial data have been reported pursuant to the new regulation.

This paper takes as a sample the consolidated figures of the listed companies that have had to apply the IFRS since 2005, including comparative figures for 2004 and thus ensuring that the data do not lose homogeneity as would happen if the analysis were extended to apply to years subject to different accounting standards. We also include figures for the first six months of 2007, duly annualized where appropriate, so as to facilitate comparison with the three previous years and in order to have the most recent data and thus be able to extend the scope of our remarks.

The rest of this paper is structured as follows: the second section describes the data and indicators used, the third section analyses the trend in return on equity in aggregate and by sector of activity, the fourth section remarks on the main components of the profitability indicator, and finally the fifth section sums up our main conclusions.

2 Data and indicators

This analysis is intended to give an overview of the trend in the profitability of listed companies over the period comprising the years 2004, 2005 and 2006 and the first six months of 2007. The accounting data come from public information reported by listed companies, including issuers of shares and other securities tradable on the stock market.

Specifically, the sample consists of the financial statements of companies obliged to periodically report public information prepared according to the IFRS. It excludes foreign firms, public corporations and firms that consolidate their accounts in a controlling company belonging to the same sector. The resulting sample covers 81.3% of all listed companies at the end of the first six months of 2007 and represents 98.5% of listed companies' total tradable capital.

We analyze profitability at both aggregate and sectoral level, distinguishing between the five economic sectors: energy, industry, construction and real estate, services and credit institutions.

Table 1 shows the number of companies considered for each sector:

Number of companies by sector				TABLE 1
	2004	2005	2006	1st half of 2007
Energy	14	14	15	14
Industry	43	43	49	49
Construction and real estate	27	27	28	29
Services	27	27	29	30
Credit institutions	22	22	22	22
Aggregate total	133	133	143	144

Source: Prepared by author.

The key indicator under study is return on equity (ROE). We also identify and analyse its main components: return on investment, income margin, investment turnaround, financial leverage and the trend in the cost of debt.

3 Return on equity

Return on equity (ROE) is one of the most notable indicators in the taking of investment decisions. Table 2 shows the trend in ROE as from 2004 for the sample as a whole and for each sector.

ROE

TABLE 2

	2004	2005	2006	1st half of 2007
Energy	15.15%	20.63%	18.58%	17.33%
Industry	16.50%	16.01%	20.56%	20.63%
Construction and real estate	17.27%	19.42%	29.77%	26.28%
Services	19.96%	25.39%	27.57%	28.49%
Credit institutions	13.10%	17.23%	19.09%	20.55%
Aggregate total	15.19%	19.40%	21.38%	21.59%

Source: Prepared by author.

As we see, in the years in question there was a sustained increase in return on equity, exceeding 20% in the first six months of 2007. This trend is due to favourable performances in business results, for a significant parallel increase is observable in the equity of listed companies as from 2004, even reaching two digits in 2005 and 2006, prompted by the financing of certain corporate expansion operations with own funds. By sector the most notable events are as follows:

- **Energy:** The trend observed is influenced by the high capital gains recorded in 2005 by two electrical utilities, from non-recurring transactions. This exceptional data for 2005 caused ROE to decrease in 2006. And the low figure for the first six months of 2007 is largely due to the financing of investment abroad with shareholders' equity. Finally, in some companies in the oil industry, ROE growth slowed in 2006 due to the drop in refinery margins relative to the high margins in 2005, and in the first six months of 2007 due to the US dollar's loss of value against the euro.
- **Industry:** It is worth noting the increase of 4 percentage points in ROE between 2005 and 2006, up to 20%, and the maintenance of this rate in the first half of 2007, chiefly due to the favourable trend in this variable in metal transformation and base metal companies due to growth in the steel market. This offset the less expansive results from listed chemical companies.
- **Construction and real estate:** A sustained rise in demand allowed profitability to increase over almost all of the period analyzed. But the high debt acquired in recent years to finance the diversification of investments, its greater cost and the first signs of slowdown in construction growth explain the deceleration observed in the first six months of 2007, and generate some uncertainty as to the industry's foreseeable results in the next few years.

Moreover, real estate companies' results for 2006 were favourably influenced by the change in accounting treatment, permitted by the IFRS, consisting of the valuation of real estate investments at fair value. These are accounting entries that do not generate cash flow but that affect a company's results. Finally, the more recent stock market performance of some listed securities seems to anticipate a change of trend in the real estate sector that might entail adjustments in the valuations currently used in accounting records.

- **Services:** This sector achieved very high returns on equity, up to 28.5% in the first half of 2007. This was contributed to by the favourable trend in results in the mobile telephony industry and by positive results from the companies acquired over the last few years.

- **Credit institutions:** The growth of profitability in this sector corresponds to sharp growth in results, over 29% in 2005 and 30% in 2006. This was based in part on the steady improvement in the efficiency ratios of banks and savings banks. In 2006 it is also worth noting certain non-recurring items (sale of subsidiaries) by the savings banks, generating high capital gains.

The rise of 200 base points in the European Central Bank's official interest rate over the period analyzed also brought increases in the intermediation margin. Finally the expansion of international investments, especially those of the main banks, and the increased credit activity of credit institutions in Spain also contributed to ROE growth.

4 Main components of profitability

Having analyzed the trend in return on equity we may now study the contributions of its main components. In other words, the profitability of investments made and the effect of leverage on the differential between return on investment and the cost of debt.

As a reference, it is worth bearing in mind the following accounting equation (for more detail, see appendix):

$$\text{ROE} = \text{ROI} + \text{D/NW} (\text{ROI} - \text{I} (1 - \text{T})), \text{ where}$$

ROE is return on equity, ROI is return on investment, D is debt, NW is net worth, I is the cost of debt and T is the actual tax rate.

4.1 Return on investment

ROI enables us to ascertain the profitability generated by investments that have been financed with own or exterior funds and that involve some kind of capital cost. When ROI exceeds the cost of debt, it has a favourable influence on ROE according to the company's degree of leverage.

Table 3 shows the trend in ROE in the sampled companies:

ROI				
	2004	2005	2006	1st half of 2007
Energy	7.67%	10.22%	9.57%	9.05%
Industry	9.22%	9.01%	11.62%	11.99%
Construction and real estate	7.58%	8.33%	10.12%	9.53%
Services	9.12%	10.53%	10.80%	10.15%
Credit institutions	1.94%	2.83%	2.96%	3.54%
Aggregate total	2.95%	3.95%	4.24%	4.70%

Source: Prepared by author.

TABLE 3

As we see, ROI underwent steady and sustained growth, prompted by good business results in a context of expansion of investments. However, the trend was uneven in the various sectors:

- **Energy:** After reaching two digits in 2005, return on investment tended to fall in 2006 and the first half of 2007, due in this latter period to strong corporate investment by one electrical utility and the fall up to June 2007 in the sale price of exploration and production products in oil companies, due to the US dollar's loss of value against the euro.
- **Industry:** This was the only non-financial sector to show year-on-year rises over the period in question, with ROI reaching 12% at the end of the first half of 2007. Buoyant demand allowed companies in the sector to transfer to sale prices the rising costs of raw materials (such as nickel), mitigating adverse impact on results.
- **Construction and real estate:** The rise in earnings since 2004, remarked upon in the previous section, allowed ROI to increase despite the growth in investment prompted by various business amalgamations in 2006, especially in the real estate sector. But the first half of 2007 showed signs of a slowdown in the indicator due not only to the flatness remarked on earlier of fair values for real estate investments but also to the maintenance of great buoyancy in investment.
- **Services:** Profitability in services was 10% as from 2005 but was unable to exceed 11% owing to large investments in the communications sector. The maturity period of acquisitions will mark the trend in ROI in the coming periods.
- **Credit institutions:** As a whole, the listed credit institutions experienced a sustained rise. As remarked on above, the improvement in the intermediation margin (with the upturn in rates) and the ordinary margin (through the basic margin and the result of financial transactions) helped to keep the trend in results more buoyant than in investment, despite the latter's strong expansion.

In order to further investigate the key factors in ROE we should break it down into the two main factors: income margin (results / income) and investment turnaround (income / investment):

4.1.1 Income margin

This indicator reflects the profit margin obtained from sales, as entered in each company's consolidated results account.

Table 4 shows the trend in this indicator for four of the sectors under study. Credit institutions are excluded because of the different nature of their results accounts.

Income margin	TABLE 4			
	2004	2005	2006	1st half of 2007
Energy	11.30%	12.40%	11.49%	12.50%
Industry	7.48%	6.63%	8.28%	8.31%
Construction and real estate	10.62%	12.06%	21.24%	24.83%
Services	13.79%	14.19%	15.30%	16.21%
Aggregate total	11.24%	11.96%	13.67%	15.14%

Source: Prepared by author.

Margins in the various non-financial sectors being considered here showed highly positive progress over the study period, thereby contributing to growth in results. In particular the moderation in certain costs (procurement, staff costs, amortization, etc.), which grew at a slower rate than income, explains a large part of the profit generated. By sector we may note the following points:

- **Energy:** The sales margin remained above 11% despite the 4.6% drop in turnover in the oil sector in the first half of 2007, as in those six months the energy industry was benefited by moderation in procurement costs at 8.8%. In 2006 sales grew notably in the water and gas sector thanks to combined cycle electricity generation.
- **Industry:** This is the sector that traditionally has the lowest margins in relative terms, though they remained positive and showed a slightly upward trend. An increase in foreign sales, especially to the rest of the euro zone and reaching 60.6% in total in the first half of 2007, was a catalyst for profit.
- **Construction and real estate:** This is the sector with the highest margins in the period in question, achieving a cumulative annual growth rate of 32.7%, largely explained, like the other indicators analyzed, by fair-value accounting for real estate. Given that sales of real estate investments must moreover be entered into accounts with the result obtained, the price rise had a favourable effect on margins in 2006 and in the first half of 2007. Moreover, the interests of some construction companies in the electrical industry permitted the inclusion of larger book profit as from 2005.
- **Services:** The companies in this sector experienced a steady rise in turnover. Contributions to results from companies acquired in the euro zone in the communications sector in 2006 and non-recurring capital gains from the sale of subsidiaries in the first half of 2007 help explain the margins in excess of 15% over the periods in question.

4.1.2 Investment turnaround

This indicator reflects the number of times that corporate investments have been recovered in each period through turnover as shown in a consolidated group's accounts. It therefore allows us to evaluate the rates and periods at which the investments made are recovered through corporate turnover.

Table 5 shows the trend in this indicator in the period under study. Credit institutions are excluded because of the different nature of their results accounts and the different composition of their balance sheets.

Investment turnaround

TABLE 5

	2004	2005	2006	1st half of 2007
Energy	0.68	0.82	0.83	0.72
Industry	1.23	1.36	1.40	1.44
Construction and real estate	0.71	0.69	0.48	0.38
Services	0.66	0.74	0.71	0.63
Aggregate total	0.73	0.82	0.75	0.64

Source: Prepared by author.

As we see, investment turnaround as from 2005 declined in the non-financial sectors as a whole. This was contributed to by strong growth in investments, with increases of 32% in 2006 and 27% in the first half of 2007, largely prompted by corporate expansion operations chiefly within the European Union. By sector we may make the following remarks:

- **Energy:** The 4.6% drop in income in the first half of 2007 was essentially due to a temporary reduction in oil prices resulting in lower turnaround at the end of that period in comparison with 2005 and 2006. It is also worth noting the rise in turnaround in 2005, owing to the 32% sales increase in electrical utilities due to low rainfall, a rise in demand and the economic recovery in Latin America.
- **Industry:** This sector showed a steady rise in the indicator up to a turnaround rate of 1.4 in June 2007. Despite the investments made in 2006, with growth of more than 30%, the base metal and metal transformation sectors managed to maintain or increase their turnaround rates thanks to the good performance of demand for their end products.
- **Construction and real estate:** Construction firms' strategy of diversifying risk by investing in new businesses, especially electrical energy, and the concentration of real estate firms with other companies in the sector, meant that the investments recorded in 2005 were multiplied threefold if we compare the figure with cumulative investments at June 2007, prompting a decline in turnaround through corporate turnover, whose growth stood at 23.4% in 2006 and 14.8% in the first half of 2007.
- **Services:** Owing to the expansion strategies of telephony companies, investment recovery through turnover took a slight downturn in 2006 and the first half of 2007. In 2006 the rate of variation for new investments underwent growth of 49%, while income went up 41.5%.

4.2 Financial leverage

Financial leverage is defined for the purposes of this article as the ratio between a consolidated company's debt and its shareholders' equity. It enables us to evaluate the multiplier effect on ROE of the difference between ROI and the cost of debt when there is a positive differential, or the reducing effect on ROE when the differential is negative.

Table 6 shows the aggregate and sectoral trend in this indicator:

Financial leverage

TABLE 6

	2004	2005	2006	1st half of 2007
Energy	1.62	1.53	1.40	1.37
Industry	1.15	1.18	1.10	1.03
Construction and real estate	2.13	2.22	2.87	3.06
Services	2.28	2.27	2.68	2.90
Credit institutions	17.12	17.32	16.43	16.36
Aggregate total	8.44	8.45	8.40	8.11

Source: Prepared by author.

During the period under study, leverage was stabilized on some eight occasions. Accordingly the increase in debt over that period must have been offset by an increase in equity. However, this trend is dependent on the performance of the financial sector. If we leave out credit institutions, leverage rises moderately but steadily as from 2005. In a sectoral analysis the following remarks may also be made:

- **Energy:** Leverage followed a downward trend in the study period, with a cumulative annual rate falling to 5.6%. The lever effect on electrical utilities was above average for the energy sector owing to large investments, funded chiefly with debt, and this became more notable in the first half of 2007.
- **Industry:** Industry had the highest leverage of the sectors under consideration. The trend in the period analyzed was moreover downward, reaching almost unit level at the end of the first half of 2007. Good company results, especially in 2006 and the first half of 2007, resulted in an accumulation of earnings and allowed investments in both periods to be financed, and so the ratio of debt to equity in the sector went down.
- **Construction and real estate:** This is the industry with most leverage among non-financial sectors, with an increase in 2006 and the first half of 2007 to the point that debt tripled equity. This development is largely explained by the financing of major investments in the energy sector and some international concentration operations. Corporate concentration processes in the real estate sector in 2006 also had a direct impact on the rise in outside financing, and accordingly on leverage.
- **Services:** Leverage increased in 2006 and in the first half of 2007. It is worth noting the sector of concession companies, which had to increase their financing in order to make their latest corporate acquisitions. Also the communications sector showed leverage levels above average for the sector, though if we consider the usual debt coverage indicators (debt/EBITDA and EBIT/financial costs), the data are more favourable.
- **Credit institutions:** This sector is by its very nature the one with most leverage. But the accounting data obtained show less leverage if we compare liabilities in 2005, which amounted to 95% of total balance sheets, to the first half of 2007, with 94%, as the proportion of equity grew against other liabilities. The financing of operations to acquire other credit institutions with shareholders' equity influenced equity growth and the drop in leverage as from 2006.

4.3 Cost of debt

This analysis ends with the cost of debt net of tax effect. Also provided is the differential between return on investment and the cost of debt net of tax effect. These two indicators appear in tables 7 and 8 respectively.

Cost of debt net of tax effect

TABLE 7

	2004	2005	2006	1st half of 2007
Energy	3.06%	3.42%	3.15%	2.99%
Industry	2.87%	3.10%	3.47%	3.61%
Construction and real estate	3.02%	3.34%	3.27%	4.20%
Services	4.37%	3.99%	4.54%	3.83%
Credit institutions	1.29%	2.00%	1.98%	2.50%
Aggregate total	1.50%	2.12%	2.20%	2.62%

Source: Prepared by author.

Differential: ROI - Cost of debt net of tax effect

TABLE 8

	2004	2005	2006	1st half of 2007
Energy	4.61%	6.80%	6.42%	6.06%
Industry	6.35%	5.91%	8.15%	8.38%
Construction and real estate	4.55%	4.99%	6.85%	5.32%
Services	4.75%	6.54%	6.26%	6.32%
Credit institutions	0.65%	0.83%	0.98%	1.04%
Aggregate total	1.45%	1.83%	2.04%	2.08%

Source: Prepared by author.

As we see in table 7, over the period in question there was a gradual rise in the cost of debt in line with the trend in interest rates. Consequently there was a rise in financial costs in consolidated results accounts. However, it is worth noting that ROI in all sectors was well above the cost of debt. By sector we may note the following:

- **Energy:** In the period 2004-2006 the cost of debt was above 3%, with no great variation. It is notable that in the first half of 2007 the sector's debt went up by 34% over that of 2006 due to the financing of a corporate acquisition, which might in future lead to a small upturn in the cost of debt for the sector.
- **Industry:** In this sector the cost of debt grew as from 2005 much more moderately than ROI. In any event we may note that the cost of debt net of tax effect was at the end of the first half of 2007 in excess of 3.6%, whereas in 2004 it was below 2.9%, which entails (other things being equal) a direct increase in industrial companies' financial costs, reducing the positive effect on profitability of growth in demand.
- **Construction and real estate:** The differential between ROI and the cost of debt net of tax effect, which in 2006 grew by 1.8% over 2005, fell in the first half of 2007 by 1.5%, again confirming the signs of a loss of growth momentum in the sector.

- **Services:** The trend in the cost of debt in the service sector was largely influenced in 2006 by the big increase in the debt of communications companies (some 64%) due to the financing of various acquisitions. But the differential between ROI and the cost of debt net of tax effect stayed above 6%.
- **Credit institutions:** Credit institutions saw their costs practically double relative to their liabilities, from 1.3% in 2004 to 2.5% in the first half of 2007. The differential between ROI and those costs, however, grew steadily over the period under study as a result of continuing growth in demand for credit.

5 Conclusions

In the period from 2004 to the first half of 2007 the profitability of listed companies showed very positive performance. This was in spite of the adverse effect of rising oil prices as from 2004 and rising interest rates as from 2005.

In particular, in listed companies taken as a whole, return on equity (ROE) increased year on year up to 22% in the first half of 2007. The various components of ROE (ROI, leverage and the differential between ROI and the cost of debt) maintained a positive trend in the whole period under analysis, though in the most recent interval ROI fell back a little despite the rise in income margin as a result of lower investment turnaround.

This positive trend in profitability affected all sectors, though the profitability of listed real estate firms showed signs of deceleration in 2006 and the first half of 2007. The solid progress of the industrial sector is also to be noted, with a gradual rise in the various profitability indicators analyzed.

Finally we should say that our study has shown an increase in the size of the large companies listed in the last few years, chiefly through the merging of businesses of which the effects on profitability will come to light in the coming years.

Appendix

To facilitate the interpretation of the results obtained, below are the definitions used in order to establish some of the data used in the study performed:

- The period result used for ROE is that obtained by a group after tax and including the results of ongoing and suspended operations. The period result used for ROI is as above, but before interest net of tax effect.
- The tax rate (t) used is that actually borne by a company so as to obtain corporate tax book expenditure.
- The cost of debt (i) is calculated with financial costs and borrowing. Subsequently and for comparison with ROI its tax effect is taken into account.
- Net worth as used here includes minority interests and discounts own shares as stipulated in the IFRS, adopted by the EU.
- Balance sheet magnitudes (net worth, NW; investments, debt, D) included in indicators are calculated from the subtotal of balances at the start and at the end of each period, except in 2004, as no data were available for the start of that period.
- Results account magnitudes for the first half of 2007 were annualized by means of extrapolating their amounts to the whole year so as to allow comparison with the other periods.
- For companies in non-financial sectors, investments are equal to total assets minus current liabilities that have no explicit interest, and the debt indicator does not include these liabilities.
- For the credit institution sector the following criteria were applied: investments are equivalent to assets, debt is equivalent to liabilities, income is equivalent to interest and similar revenue and capital instrument revenue and financial costs are interest and similar charges forming part of the intermediation margin.

Developments in collective investment funds in Spain

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1 Introduction

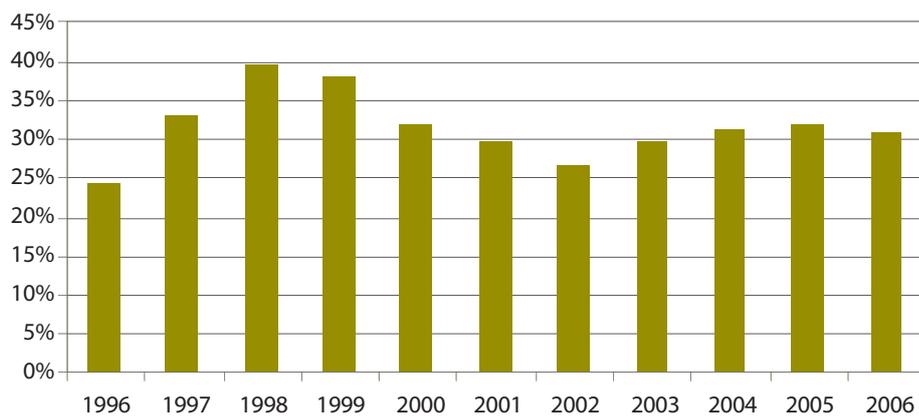
Collective investment funds (CIFs) in Spain manage a volume of financial assets representing on average 30% of gross domestic product, which shows the sector's considerable size. Indeed, in a comparison with the major European countries, Spain comes second in terms of assets over GDP after France.

The demand for the services provided by CIF managers was affected in the latter part of 2007 by a situation of the financial markets which tended to favour alternative products such as deposits. This change occurred in an environment in which recently adopted tax changes somewhat reduced the appeal of holdings in investment funds. It therefore seems a good moment to review the industry's recent development so as to get an idea of the situation from which it is facing the notable changes that have occurred in the economic and financial environment.

This article describes the recent developments in CIFs, focussing chiefly on the most significant characteristics and magnitudes of investment funds – the form of collective investment that accounts for more than 80% of the sector's total volume – and on the possible challenges that may be faced. The second section of the article is wholly given over to this sub-sector. In the third section we briefly describe developments in other forms of CIF, and the fourth section sets out some general conclusions.

Percentage of fund assets over Spanish GDP

FIGURE 1



Source: Prepared by author.

2 Investment funds

2.1 Assets, investors and number of funds

Table 1 shows the trend in the main magnitudes of investment funds (IF) in the period 2001-2007. First we may note that the number of investors over this period ranged from 6.5 to 8.5 million¹ (individuals and corporations), with positive growth from September 2002 to the second quarter of 2007, at which point the trend changed, due to the current market situation, with a drop of 3.31% in the third quarter of 2007.

Distribution of investors and of assets according to investor type

TABLE 1

	2001	2002	2003	2004	2005	2006	2007		
							I	II	III
INVESTORS	7,454,374	7,090,418	7,617,566	7,880,076	8,450,164	8,637,790	8,741,054	8,757,377	8,467,203
Individuals	7,295,612	6,929,757	7,431,310	7,666,310	8,202,638	8,389,301	8,490,813	8,499,732	8,216,426
Variation		-5.01%	7.24%	3.16%	7.00%	2.28%	1.21%	0.11%	-3.33%
% of Total	97.87%	97.73%	97.55%	97.29%	97.07%	97.12%	97.14%	97.06%	97.04%
Corporations	158,762	160,661	186,256	213,766	247,526	248,489	250,241	257,645	250,777
Variation		1.20%	15.93%	14.77%	15.79%	0.39%	0.71%	2.96%	-2.67%
% of Total	2.13%	2.27%	2.45%	2.71%	2.93%	2.88%	2.86%	2.94%	2.96%
ASSETS (€m)	181,300.97	174,734.85	210,627.16	236,088.40	262,200.90	270,431.30	273,542.20	277,352.60	269,907.07
Individuals	143,058.82	134,563.71	156,349.57	172,068.90	193,948.60	201,411.00	202,506.40	204,173.30	200,124.54
Variation		-5.94%	16.19%	10.05%	12.72%	3.85%	0.54%	0.82%	-1.98%
% of Total	78.91%	77.01%	74.23%	72.88%	73.97%	74.48%	74.03%	73.62%	74.15%
Corporations	38,242.16	40,171.15	54,277.59	64,019.50	68,252.30	69,020.30	70,934.32	72,579.10	69,782.53
Variation		5.04%	35.12%	17.95%	6.61%	1.13%	2.77%	2.32%	-3.85%
% of Total	21.09%	22.99%	25.77%	27.12%	26.03%	25.52%	25.93%	26.17%	25.85%
NUMBER	2,599	2,538	2,554	2,620	2,723	2,850	2,885	2,921	2,947
Variation		-2.35%	0.63%	2.58%	3.93%	4.66%	1.23%	1.25%	0.89%

Source: Prepared by author.

The trend in fund assets has also been upward since early 2003, with two-digit growth in the period 2003-2005 thanks to large gains on the stock markets. Subsequently this growth slowed, until in the first quarter of 2007 there was a first fall in asset volume, representing a negative variation of 2.68% over total assets in the previous quarter.

The number of registered funds has grown since 2003 at rates below 5%. This figure may be a sign of the sector's maturity following various integration processes: mergers of funds run by the same manager with a view to achieving economies of scale from the management of large investments, mergers of financial funds or groups with the consequent disappearance of managers and their funds, changes in the investment policies of existing funds as a result of the establishment of new ones, etc. In any event, most newly created firms are guaranteed fixed and variable income funds and funds with "alternative" policies, mainly dynamic and value-at-risk funds (known as "VAR" funds).

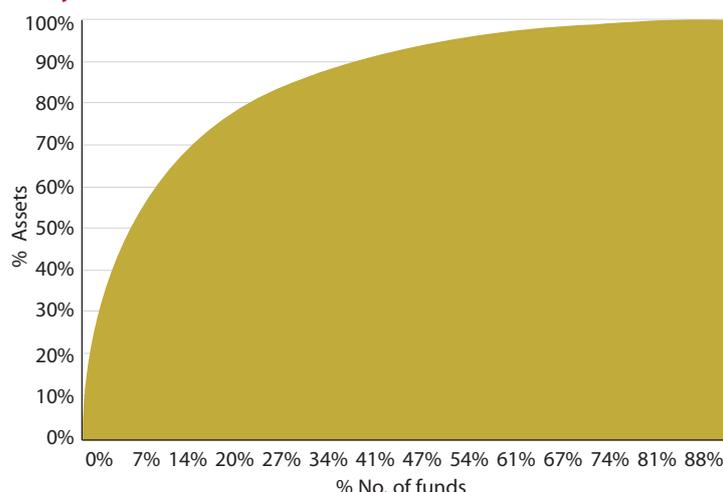
¹ The investor figures include unquantifiable duplications due to the existence of investors investing in more than one fund.

2.1.1 Distribution by number of funds and investment category

As may be seen in figure 2, in September 2007, 80% of fund assets were concentrated in just 24% of funds (705 of the 2,948 registered funds). This shows the sector's high level of fragmentation, with many funds with few assets. This pattern does not appear in other EU countries, where the concept of compartmentalized funds or firms has prevailed. But in Spain, until legislative developments are completed to regulate these funds, in order to be able to offer identical policies in which the sole difference is, for example, the commissions applied, a new fund needs to be set up.

Fund assets by number of funds in %

FIGURE 2



Source: Prepared by author.

Table 3 shows the investment policy categories with largest asset volumes. Thus short-term fixed income funds (also including monetary funds or old FIAMM funds) account for almost 40% of fund assets but only 13% of the number of funds registered. If we also include guaranteed and global funds that also have highly conservative policies, as their management is based on limiting the losses that the fund may bear annually (known as VAR funds, dynamic management with protected capital, etc.), this group would account for more than 65% of total fund assets. Investors therefore show great aversion to risk, as they invest chiefly in conservative or low-risk funds.

Distribution by investment policy

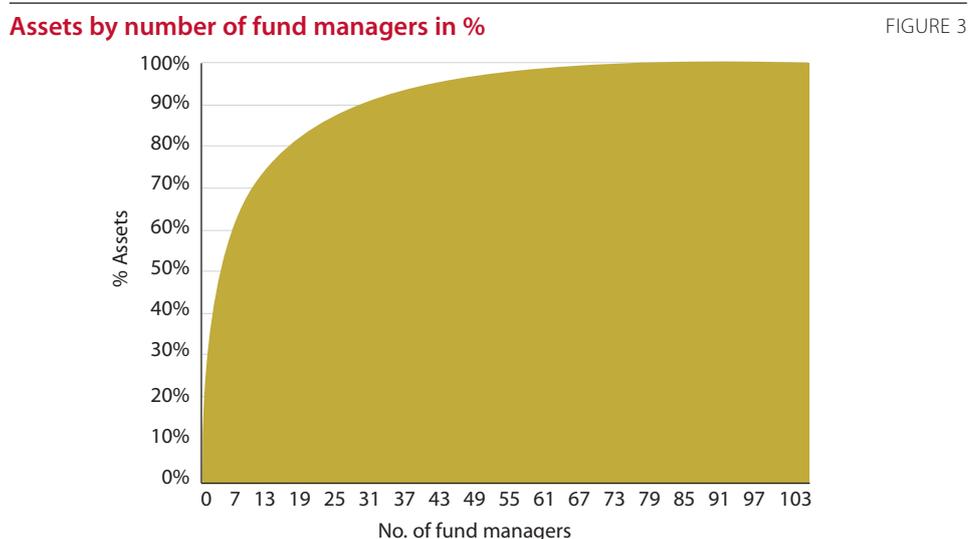
TABLE 3

	% funds of total /total	% assets of total
Short-term fixed income	12.75%	39.74%
Guaranteed variable income	20.01%	15.89%
Global fund	15.57%	12.57%
Guaranteed fixed income	8.18%	5.86%
Variable income euro	4.14%	3.64%
Domestic variable income	4.10%	3.21%
Mixed fixed income	4.68%	3.19%
Variable income Europe	2.41%	3.13%
Long-term fixed income	5.33%	3.06%

Source: Prepared by author.

2.1.2 Asset distributions by managers and financial groups

Figure 3 shows the distribution of funds by fund managers. As we see, a single firm manages more than 20% of fund assets, and the top five manage more than 50%.



Source: Prepared by author.

If, in turn, we group the assets managed by fund managers according to the type of financial group to which they belong (table 4), we see that banks and savings banks manage more than 90% of fund assets. If we compare the figures for 2001 and 2006, we see that conventional banks have lost about 3% of their market share to savings banks.

Distribution by financial group TABLE 4

	December 2001	December 2006
Banks	65.5%	62.9%
Savings banks	25.5%	28.2%
Securities firms and trade houses	4.0%	4.3%
Insurance companies	3.1%	2.6%
Others	1.9%	2.0%

Source: Corporation Savings Report (December 2006).

Thus the IF industry is relatively concentrated and strongly linked to credit institutions.

2.1.3 Distribution by investor type

Over the period 2001-2007, 21% to 27% of the asset volume was in the hands of corporations, which represented barely 3% of the number of investors. Within this category of investors we find pension funds, insurance companies and CIFs themselves. In other words, investors which, by their very nature, might give a certain stability to fund assets.

In the case of investments made by CIFs in other Spanish funds, we should keep in mind that actual monetary investments made by corporations and individuals may be

duplicated, for when one fund invests in another, the inflow of money from outside the sector occurs once only (in the investing fund). In the asset data given in table 1 above, that monetary investment may be counted twice, in the investing fund and in the underlying fund. Such duplication is likely to occur, for example, chiefly in funds of funds.

Thus in September 2007 there were 3,150 CIFs (1,341 funds and 1,809 unit trusts or securities firms), representing 0.04% of total investors (1.26% of total corporate investors), but which held investments in funds with a total volume of 20,676.14 million euros (19,696.08 in IFs and 980.63 in unit trusts). So actual capital input from non-IF investors would be 250,201.99 million euros, i.e. 7.3% less than the total posted asset volume.

2.2 Materialization of investments

Table 5 shows the trend in cash investments held by IFs over the last few years, grouped by asset type or category.

Cash and deposits represent an insignificant portion of total fund assets, though they grew considerably last year, up 5.42% to 14,620 million euros, as a result of larger investments in time deposits.

Materialization of investments

TABLE 5

(€m)	December 2004		December 2005		December 2006		September 2007	
BALANCE SHEET ENTRIES	Amount	% of total	Amount	% of total	Amount	% of total	Amount	% of total
Cash and deposits	6,506.50	2.76%	8,207.50	3.13%	10,462.90	3.87%	14,620.21	5.42%
Portfolio investment	230,212.70	97.24%	255,273.60	97.00%	260,002.90	96.43%	255,004.41	94.60%
Domestic portfolio	113,896.90	48.24%	123,200.20	46.99%	126,726.80	46.87%	136,394.77	50.53%
Equity	9,578.30	4.06%	11,602.10	4.42%	13,806.80	5.11%	12,568.54	4.66%
IF holdings	16,782.60	7.11%	17,255.90	6.58%	17,322.80	6.41%	19,631.32	7.27%
Public monetary assets	4,434.90	1.88%	4,149.40	1.58%	2,887.70	1.07%	2,329.64	0.86%
Other public	11,422.90	4.84%	10,088.70	3.85%	9,891.60	3.66%	9,488.64	3.52%
fixed-income assets								
Private monetary assets	19,735.90	8.36%	26,850.70	10.24%	28,483.20	10.53%	35,553.42	13.17%
Other private	14,235.60	6.03%	18,835.60	7.18%	23,105.30	8.54%	24,363.44	9.03%
fixed-income assets								
Repos	37,706.70	15.97%	34,417.80	13.13%	31,229.40	11.55%	32,459.77	12.03%
Foreign portfolio	113,527.30	48.09%	127,751.70	48.72%	127,611.80	47.19%	112,495.06	41.68%
Equity	12,056.60	5.11%	15,944.60	6.08%	18,761.00	6.94%	19,628.05	7.27%
IF holdings	13,761.50	5.83%	20,381.60	7.77%	28,905.70	10.69%	21,086.38	7.81%
Fixed income	87,709.20	37.15%	91,425.50	34.87%	79,945.10	29.56%	71,780.63	26.59%
Other investments	2,157.60	0.91%	3,041.30	1.29%	5,605.80	2.37%	5,633.06	2.39%

Source: Prepared by author.

As regards portfolio investments, the percentages invested in the Spanish market account for 50% of the total assets managed, of which about 39% corresponds to fixed-income assets and 11% to equity and holdings in other Spanish funds.

The more than 12 billion euros invested in Spanish variable income assets represent just 2.08% of the Ibex-35's market capitalization², which shows what a small share is held by IFs in the capital of listed companies.

² Data at 30 September 2007 according to which the capitalization of the IBEX-35 was 602,814 million euros.

But both in repos and in some types of fixed-income investment, the volumes held by funds may be regarded as significant in relation to total active balances.

Thus the more than 32 billion euros invested in repos represents 37.5% of the total temporary transfers made by credit institutions³.

Table 6 shows more detail of Spanish fixed-income investments held by IFs at September 2007. The greatest volume is concentrated in commercial paper tradable in the AIAF fixed-income market: more than 32 billion euros, representing 12% of fund assets and 33% of total AIAF-tradable paper issues.

Another asset type in which a significant volume is invested – more than 12 billion euros – is issues from asset and mortgage securitization funds. There appear to be some 8.1 billion euros in mortgage securitizations and 4.3 billion euros in asset securitizations.

Spanish fixed-income investments in IFs relative to total issues

TABLE 6

(million euros)	Fund investments	% of fund assets	Active balances issued	
			on the AIAF market	% of total issues
Commercial paper	32,582	12.08	97,795.9	33
Bonds and debentures	11,706	4.34	142,655.3	8.21
Mortgage and asset securitization bonds	12,664.63	4.69	297,196.9	4.26

Source: Prepared by author.

As regards foreign investments, it is worth noting those made in fixed-income assets, for a volume in excess of 71 billion euros, representing 27% of total fund assets. Of these, some 31 billion correspond to public fixed income and some 11 billion to mortgage and asset securitization issues.

Following the events since July 2007, caused by the subprime mortgage crisis in the US, the global credit markets, including private fixed-income ones, have faced liquidity problems. Moreover, there have so far been disparate effects in public fixed-income and private fixed-income issues. As regards public fixed-income issues, representing about 16% of fund assets (including both Spanish and foreign issues), demand has increased, driving up prices, due to the replacement of risky assets with secure ones.

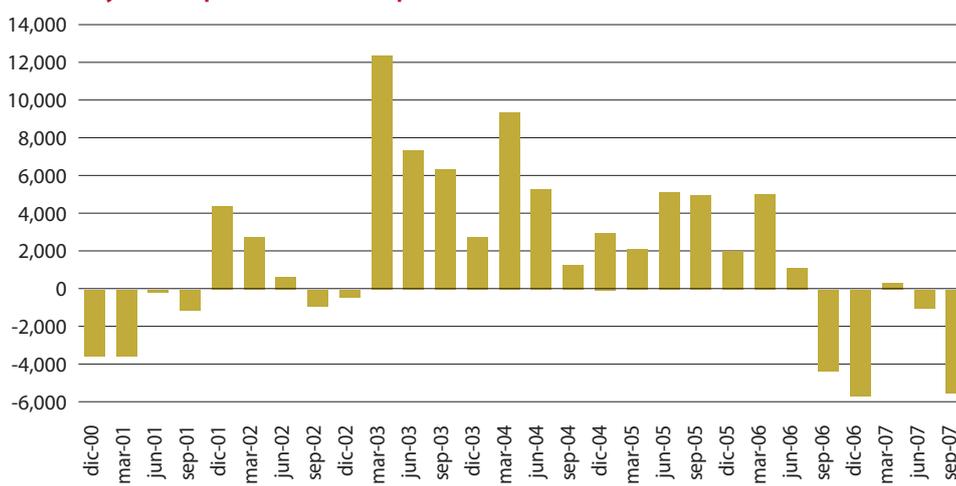
However, as regards private fixed-income issues, especially those with medium to long-term maturity periods, representing about 24% of fund assets, two adverse effects have occurred. On one hand, there has been a general increase in risk premiums, between 25 and 100 base points depending on the issuer type, rating or maturity period, resulting in a fall in asset prices. On the other hand, there has been a general reduction in the liquidity of this kind of assets, which has in turn reduced their value.

³ Bank of Spain statistics: 86.901 million euros in repos.

2.3 Developments in net capital inflows/outflows

As may be seen in graph 4, as from March 2006 the trend in IF assets changed, for after significant growth in previous years we entered a situation of high new outflows, notably 5,633 million euros in the last quarter of 2006 and 5,486 million euros in the third quarter of 2007. In percentage terms these net outflows represented some 2% of the funds' total assets.

Quarterly developments in net capital inflows/outflows 2000-2007 FIGURE 4



Source: Prepared by author.

This trend may be partly due to the income tax change that came into effect on 1 January 2007. As from that date, capital gains generated with a term of more than one year were subject to tax of 18% as opposed to the previously applicable rate of 15%. Moreover, and this is perhaps the more significant change, the taxes on returns from any kind of financial saving were made equal, which removed the fiscal advantage that IF holdings had traditionally had over deposits.

As of summer 2007 the upward trend in repayments became sharper as a result of the effects of the mortgage crisis on credit institutions' financing conditions. Thus, in order to be able to keep financing credit activity, the financial institutions have since the third quarter of 2007 been running big campaigns to attract deposits, on which highly attractive returns are offered.

As shown in table 7, the growth in deposits over the last few years has been very considerable, more than two digits in percentage terms and more than 75,047 million euros over 2007. Thus, in terms of return, time deposits have on average recorded highly significant growth in the last two years, representing considerable competition for monetary funds, fixed-income funds, guaranteed or otherwise, and some global funds with highly conservative risk profiles.

Trend in deposits	2004	2005	2006	TABLE 7 Sept-07
RETURN				
Savings bank benchmark deposit rate ¹	-	1.875%	2.875%	3.630%
INVESTMENT VOLUME (million euros)	623,749	732,471	884,995	960,042
Variation	13.95%	17.43%	20.82%	8.48%

¹ Also known as the CECA benchmark rate, it is defined as 90% of the arithmetic mean (eliminating values straying \pm twice from the typical deviation) of non-discount issue registered deposits and certificates of deposit, taken out or renewed in the month, for a term equal to or greater than one year and less than two.

Source: Prepared by author.

Finally, in the third quarter of 2007 repayments were also brought forward by increases in risk premiums and by the reduction in liquidity of the instruments most affected by the crisis, leading to losses in funds exposed to these assets. The effects of these tensions have been felt all over Europe, which in last September experienced the greatest asset loss of all history – some 70 billion euros.⁴

3 Other collective investment institutions

This section will briefly review the developments in other forms of collective investment that might come into competition with funds as investment alternatives, either because of the type of investor at which they are aimed or because they are of a different kind as regards their investment objectives.

3.1 Unit trusts

Unit trusts have since their creation been the investment vehicle used by major investors for practically exclusive management of their financial investment portfolios, with departments and even managing firms specialized in offering such private banking services.

In the 90s and early 2000s the growth in these trusts was very considerable. Thus between 2000 and 2002 unit trust registrations grew well into two percentage points (in 2001 they grew at 40.15%), and by at September 2007 unit trusts managed assets with a volume in excess of 32 billion euros.

But though the number of unit trusts (3,124) is greater than that of funds (2,947), there is a great distance between the two in asset terms, as the volumes generated by such trusts represents only 12% of total fund assets.

⁴ Source: the newspaper "El Confidencial", according to information supplied by Lipper.

Main unit trust magnitudes (*)

TABLE 8

	2000	2001	2002	2003	2004	2005	2006	Sept 2007
INVESTMENT VOLUME								
(million euros)	12,494.6	16,605.8	16,125.6	19,438.1	22,923.7	25,488.9	28,922.8	32,360.1
Variation		32.9%	-2.89%	20.54%	17.93%	11.18%	13.76%	11.61%
No OF INSTITUTIONS	1,507	2,112	2,566	2,763	2,962	2,989	3,049	3,124
Variation		40.15%	21.5%	7.68%	7.20%	0.91%	2.01%	2.46%

(*)Trusts that have submitted non-public statements (therefore not including those in the process of being wound up or liquidated)

Moreover, since early 2005 the growth in the number of institutions registered has slowed considerably, which may be due chiefly to the uncertainty generated by certain tax measures.

One of the novelties introduced by Royal Decree 1309/2005 adopting the Regulations implementing Law 35/2003 on CIFs was the absence of the requirement for unit trusts to be listed on a regulated market in order to be able to benefit from the 1% tax rate. But, though massive delisting orders might have been expected, what has occurred in fact is a change in the market or trading system, and almost all of these trusts are now traded on the Alternative Stock Market (MAB).

This market is an authorized, organized trading system, subject to supervision by the Spanish SEC, for the transaction, settlement, clearing and registration of trades in shares and other CIF securities, in securities and instruments issued by or linked to low-capitalization stocks and recently also in venture capital firms.

3.2 Venture capital firms

Another investment vehicle being used increasingly by major investors, thanks to the regulatory changes since late 2005, is venture capital firms.

Thus over 2006 the number of registered venture capital firms rose from 77 to 101, i.e. an increase of 31%, whereas in previous years such registrations had barely risen. Moreover, the volume invested went up by 1,134 million euros, 38% above the volume managed in 2005.

3.3 Foreign CIFs traded in Spain

These firms may be the IF industry's chief competitor. In recent years there has been a very notable rise in trading in foreign CIFs. As may be seen in table 9, from December 2000 to the third quarter of 2007, the volume invested increased fivefold and the number of institutions twofold. Moreover, if we compare the volumes traded with IF assets, we see that they rose from just 4% in 2001-2003 to 16.5% in 2006-2007.

Main magnitudes of foreign CIFs traded in Spain (*)

TABLE 9

	2000	2001	2002	2003	2004	2005	2006	2007(*)
INVESTMENT VOLUME								
(million euros)	8,594	7,533	6,538	9,158	17,785	33,614.7	44,102.9	44,506
Variation		-12.3%	-13.2%	40.1%	94.2%	89.3%	31%	0.92%
% of IF assets		4.15%	3.74%	4.35%	7.53%	12.82%	16.31%	16.49%
No OF INSTITUTIONS	170	191	218	233	238	260	340	397
Variation		12.35%	14.14%	6.88%	2.15%	9.24%	30.77%	16.76%

(*)Provisional data at September 2007.

Source: Prepared by author.

Various reasons may explain this highly significant increase in volumes invested, such as:

- The creation by various financial institutions of platforms for transactions in foreign funds, which has allowed investors to access that market more easily.
- Access to other markets, such as some emerging markets, and certain “alternative” forms of management of which the Spanish market has a more limited offering.
- Closely linked to the previous factor is the large increase in investments made in foreign CIFs by Spanish CIFs, as this may be the way to offer exposure to other markets and management types but with Spanish brands and with no need for investors to have their own means of access.

Thus in December 2000, investments in foreign CIFs by Spanish funds amounted to just 6,864 million euros (1.72% of total CIF assets). But by September 2007 the volume invested by Spanish funds exceeded 23 billion euros (7.65% of total CIF assets), of which 15 billion euros corresponded to CIFs traded in Spain. This volume represents 34% of the total volume traded.

However, in 2007 there was a stabilization of investments in traded CIFs, with an increase up to September of just 0.92%, in keeping with the trend in Spanish fund assets.

Finally we should also note that the Spanish fund industry continues to be aimed at the domestic market, as at December 2006 only 2% of Spanish fund assets were traded beyond Spain’s frontiers.

3.3 Hedge funds

The regulations applicable to hedge funds were developed in the course of 2006 and early 2007, making 2007 the year in which hedge funds really took off.

As we see in the table below, there are 17 hedge funds registered, and 30 funds of hedge funds, between them managing more than 1 billion euros at September 2007.

Main magnitudes of hedge funds and funds of funds

TABLE 10

Fund type	December 2006		September 2007	
	Hedge funds	Funds of funds	Hedge funds	Funds of funds
INVESTMENT VOLUME (million euros)	24.42	0.59	207.82	813.91
INVESTORS	21	2	247	3,037
NO OF INSTITUTIONS	5	2	17	30

Source: Prepared by author.

The growth of funds of funds, both in number of investors (3,037) and in assets managed (813 million euros) has been much greater than that of hedge funds, chiefly because this a product open to small investors.

Moreover, the regulations on Spanish financial CIFs⁵ permit investment in hedge funds and funds of funds of up to 10% of their assets. Thus in September 2007 there were 158 Spanish CIFs that had invested some 185 million euros in funds of funds, representing 23% of the total volume managed by this type of fund. Investment in hedge funds is significantly lower, amounting to some 35 million euros (17% of the total managed by this type of fund).

3.4 Real estate collective investment funds

Finally, table 11 shows the trend in real estate funds and companies. Both in terms of the asset volumes managed by this type of non-financial institution and in the numbers of investors, they are far behind financial investment funds. Thus in September 2007, the volumes managed by real estate collective investment funds were equivalent to just 3.5% of securities IFs.

Trend in real estate CIFs

TABLE 11

	2004	2005	2006	Sept. 2007
FUNDS				
Number	7	7	9	9
Investors	86,369	118,857	150,304	151,577
Assets (million euros)	4,377.9	6,476.9	8,595.9	8,905
	-	47.95%	32.73%	3.6%
COMPANIES				
Number	2	6	8	6
Investors	121	256	749	800
Assets (million euros)	56.4	213.9	456.1	504

Source: Prepared by author.

In addition, the trend exhibited by these institutions has been in keeping with that of the real estate market, i.e. after several years of notable asset increases there was a moderate slowdown in 2007, with an increase in real estate fund assets of just 3.6%.

⁵ Article 36.1 letter j) of Royal Decree 1309/2005.

4 Conclusions

The investment fund industry in Spain is currently facing multiple challenges. These arise from the removal of fiscal advantages as against other types of instrument and growing competition from deposits, in the context of a struggle between credit institutions to attract traditional cash deposits. However, as described in the course of this article, the IF sector continues to be one of the main institutional investors in the Spanish economy and still has a great volume of assets and investors, both individuals and corporations.

Furthermore, regardless of the vicissitudes that may in the short term affect the volumes managed, the appeal of investment funds in terms of liquidity, diversification and low credit risk is likely to continue to support the industry's general buoyancy.

II Studies

Analysis of price movements ahead of the announcement of takeover bids

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1 Introduction

The ultimate goal of regulating the misuse of insider trading is to prevent the inefficiencies it creates in securities markets. These inefficiencies are created by the lack of investor confidence, and may result in their abandoning the securities market. This would in turn lead to the increased cost of business financing.

As in most developed countries, in Spain the use of insider trading is prohibited, and is subject to an administrative or criminal penalty. The 1998 law on the securities market (LMV) states that one of its main objectives is to preserve market integrity. Under the law, the National Securities Market Commission (CNMV) is responsible for prosecuting the use of insider trading. Market integrity¹ is understood to mean that the market should operate properly and that investors should participate on an equal footing in terms of information, so that none may influence the price significantly, and without manipulating the price or using insider trading.

Article 81 of the LMV defines insider trading as “specific information referring directly or indirectly to one or more tradable securities or financial instruments included within the scope of this Law, or one or more issuers of such tradable securities or financial instruments, which has not been published, and which should it be published, could significantly influence or could have significantly influenced its price in a market or organized trading system”.

Thus if the trading decisions with securities or financial instruments are based on studies using published data, or are the result of experience and professional skills, this cannot be considered an illegal use of insider trading. If the media publish the possibility of an event taking place, or repeat market rumours, this cannot be considered insider trading either. In this paper, this kind of information is called unpublished information. It is information about an event that is not certain to occur, and would be insider trading if the event were to take place.

The aim of this paper is to analyse the changes in the share prices of companies that are the targets of takeover bids, prior to the announcement of the bids. The overall aim is to determine whether a possible misuse of insider trading can be detected behind these movements, and how such movements have changed over the years in response to various initiatives by the supervisor to address the issue. Specifically, the paper analyses whether the creation of the Market Surveillance Unit (UVM) in 1997 and the law on the reform of the financial system in 2002 have contributed to reduce incentives for the possible use of insider trading in Spain, and to what extent.

¹ See the definition in García Santos (2005).

This will be done by studying price changes in companies that were targets of takeover bids over the period 1992-2006 using the methodology called event studies. The analysis follows the methodology used in the United Kingdom by Dubow and Monteiro (2006). The authors analyse whether the introduction of new legislation (in this case the Financial Services and Markets Act, FSMA) has resulted in a reduction of the number of possible abuses of insider trading in the U.K. securities markets. The results obtained in the United Kingdom are rather pessimistic, as they suggest that about 30% of announced takeover bids were preceded by abnormal price movements, and that this figure increased after the new act was introduced.

Before this paper, a number of authors had studied the effectiveness of regulating against insider trading, comparing its possible use by informed agents before and after new legislation was introduced. Their results coincide with those of Dubow and Monteiro (2006): there is no evidence indicating that an increase in regulations prevents informed agents from using insider trading.

Specifically, Bris (2005) carried out a study on 4,541 acquisitions in 52 countries. Across the countries as a whole, 30% of the acquisitions studied showed evidence of insider trading in the years leading up to the implementation of regulations. This data increased to 58% after the introduction of legislation on the matter. Thus it appears that laws prohibiting the use of insider trading increased returns for those using it, making its use increasingly profitable. According to Arshadi and Eysell (1991 and 1993), regulatory prohibitions have not been completely effective in preventing the use of insider trading in North American securities markets. They observed that the introduction of the Insider Trading Sanctions Act (ITSA) in 1984 did not lead to a fall in the use of insider trading. The ITSA introduced a new measure by including fines of more than three times the profit obtained or loss avoided by the use of insider trading.

The paper is set out as follows. Section 2 explains the way the sample has been drawn up and sub-samples selected. Section 3 describes the parametric tests employed from the theoretical point of view together with the methodology used by Dubow and Monteiro (2006) that is to be replicated for Spanish securities markets. Section 4 gives the results obtained. Finally, Section 5 provides the conclusions.

2 Description of the sample

2.1 Periods analysed

The procedures for preventing and prosecuting the use of insider trading have been perfected over the years since the creation of the CNMV.

Two important landmarks have been the creation of the UVM within the CNMV in 1997 and the publication of Law 44/2002 of 22 November 2002, on the reform of the financial system.

Although the CNMV already investigated the use of insider trading, in February 1997 it created a more specialized team (both in human and technical terms) called the UVM that allowed it to detect more possible cases of insider trading. The existence of the UVM sent a clear signal to the market of CNMV's strengthened commitment to prosecute the use of insider trading.

At the same time, the aim of the measures introduced by Law 44/2002 was to increase market transparency. Given the problems that exist in demonstrating ex-post the use of insider trading, the best way of preventing its use is to reduce ex ante the existence of this kind of information, and this is the main aim of this law. The most notable changes introduced were as follows:

- 1 The definition of insider trading was extended as to the kind of instrument penalized, adding the derivatives market of the securities involved in the insider trading to the securities themselves.
- 2 The kind of information to be communicated to the CNMV was clarified, as was the way this information should be communicated. Thus the time during which the information is only known by insiders is reduced.
- 3 Preventive organizational measures were implemented against information leaks between different areas of an entity or within a group of entities, by making "Chinese walls" compulsory. In addition, a list of securities on which insider trading is available has to be drawn up and kept up to date, as well as a list of persons and the dates on which they have accessed this information. This aims to reduce the number of persons with access to insider trading.

Taking into account these measures, the period under analysis has been divided into three sub-periods:

- From 1 January 1992 to February 1997 (period I)
- From March 1997 to September 2002 (period II)
- From November 2002 to the end of 2006 (period III)

2.2 Refining the data used

This work is focused on analysing the movements occurring ahead of the announcement of a takeover bid, given the effect that this produces in securities markets of providing a situation favourable to the use of insider trading. The difficulty in analysing these kinds of operations is the complexity they involve. The leaks of insider trading are more probable in this case than in other kinds of company transactions. This is because the preparation of a takeover bid requires the involvement of a wide range of persons, legal firms, financing banks, investment banks, etc.

The sample used consists of all the significant events that the CNMV has published relating to future takeover bids during the period 1992-2006. The choice of the

announcement of takeover bids has been made regardless of whether the bid was finally accepted or rejected, as long as there was at least one trading session after suspension. The only takeover announcements considered have been those for shares with a high liquidity and for companies that have not had any suspensions near the time of the bid. These conditions have led to many announcements being left out in the first half of the 1990s, and fewer later on.

In the case of competing takeover bids, the 20 working days before and after the first announcement of a takeover bid have been eliminated. This modification aims to eliminate the effect that the preceding announcement may have had on the share price of the company that was the target of the bid. This condition means that only new offers that were sufficiently distant from the previous offer were considered, specifically more than 30 working days.

In addition, the sample eliminated those announcements preceded by other suspensions in trading with the aim of having a window of analysis with unbroken trading. Thus, for example, this new filter means that when we talk about the eighth data item previous to the suspension of trading due to a bid, we are really referring to the eighth trading day before the announcement, and not to a data item that may have been registered a month before the takeover bid. This leaves us with a total of 132 announcements, representing 50.2% of the total number. Table 1 shows that a significant number of announcements have been eliminated from the observations in period 1, leaving only a third of the total announcements of takeover bids registered in this period.

Number of announcements of takeover bids registered and in the sample TABLE 1

	Announcements of bids registered	Bids analysed	
		Number	Percentage
Period I	113	37	32.7%
Period II	91	53	58.2%
Period III	59	42	71.2%
Total	263	132	50.2%

Source: CNMV.

Breaking down the total number of takeover bids according to the reason for launching the bid, two kinds can be distinguished: bids to delist the company in question, and "other bids". The bids to delist are those in which the investor plans to take the securities out of the market, and the "other bids" are the rest. The breakdown by type of bid (see Table 2) shows that in the three periods studied the most numerous were the "other bids".

In addition, the bids can also be broken down according to whether the news of the bid is positive or negative. The positive news is when the trading suspension is lifted there is a positive return in the shares of the company that has been the target of the bid. A bid with negative news is one resulting in a negative return after the suspension. The majority of the announcements in the sample are of positive news (see Table 2).

Number of announcements in the disaggregated sample

TABLE 2

	According to type of bid		According to type of news	
	Delisting bids	Other bids	Announcement with positive news	Announcement with negative news
Period I	4	33	23	14
Period II	15	38	42	11
Period III	7	35	35	7
Total	26	106	100	32

Source: CNMV.

3 Empirical methodology

The empirical work is divided into two parts. The first compares the price movements of the shares ahead of the announcement of the takeover bid, for the three periods chosen. The aim is to analyse whether the improvement in the processes of detecting the use of insider trading has been reflected in the market, and to what extent. The second part then applies the methodology used by Dubow and Monteiro (2006) to compare the changes in the number of significant announcements preceded by abnormal price movements. The hypothesis of these authors is that these movements preceding the announcement could reflect the illegal use of insider trading.

Although the existence of abnormal price movements ahead of news about a company tends to be related to improper use of insider trading, this approach has its limitations. In fact, neither does the existence of abnormal movements ahead of such news necessarily imply the use of insider trading, nor does the use of insider trading imply that there are abnormal movements ahead of such news. Three different situations can be distinguished:

- 1 No abnormal price movements are observed prior to the announcement, but insider trading has been used. This is the case when informed agents decide to act discreetly so that the price does not change ahead of the news, and they are not detected. These cases have not been included in the analysis of this work, and in general they are difficult to detect.
- 2 Abnormal price movements are observed prior to the announcement, but no insider trading has been used. As commented above, there may be analysis based on published information, rumours or information leaks behind these movements, with the result that the news is expected by the market. In these cases, it cannot be considered that an illicit act is present, as no informed agent has been credited with the movements. There are a number of investors with unpublished information which is later published, but at the time of the movements its publication was not foreseeable. In this case, the unpublished information, based on rumours, may not have turned out to be true, but abnormal price movements could have been observed.

- 3 Abnormal price movements are observed prior to the announcement, and insider trading has been used. Within this situation, it may be that the informed agent provokes the information leaks so that there are movements prior to the announcement, creating uncertainty in the market and the supervisor. Thus the benefit of using insider trading is reduced with respect to the case where the investor acts discreetly, as when there are leaks the price begins to rise. However, the probability of being discovered is lower, as there are many investors investing at the same time; and in addition, if the actions are investigated, they can be attributed to the rumours existing in the markets. In this case, there an illicit act has taken place, as the informed agent knows that the announcement will almost certainly take place, while the rest of the investors do not. The problem with these cases is proving the illicit act.

Both parts of the empirical analysis aim to identify the abnormal price movements and use the event studies methodology.

The daily return of the value i for time period t , $R_{i,t}$ is defined as $R_{i,t} = \ln P_{i,t} - \ln P_{i,t-1}$ where $P_{i,t}$ and $P_{i,t-1}$ are the prices in t and $t-1$ respectively. And the abnormal return is $AR_{i,t} = R_{i,t} - E(R_{i,t})$ with $E(R_{i,t})$ being the expected value of the daily return. The expected returns are defined using the market model relating the asset return with the return of a representative portfolio of the market $R_{m,t}$ in this paper the Ibex-35, giving $R_{i,t} = \alpha_i + \beta_i \cdot R_{m,t} + \varepsilon_{i,t}$ where $\varepsilon_{i,t}$ is a random variable with a $N(0, \sigma_i^2)$ distribution. The parameters α and β are estimated consistently by ordinary least-squares using the observations of the estimation window T_i (240 days of trading, from $t=-250$ to $t=-10$). In addition, the abnormal returns accumulated between session τ_1 and τ_2 for asset i are

$$CAR_i(\tau_1, \tau_2) = \sum_{t=\tau_1}^{\tau_2} AR_{i,t}$$

To evaluate whether the abnormal performances are significantly different from zero for sessions prior to the announcement of the takeover bid, parametric tests have been carried out based on the abnormal performances and the accumulated abnormal performances. Villanueva (2007) describes the tests used in detail.

Dubow and Monteiro (2006) propose an objective measure to determine which announcements may be considered significant. From among the announcements that contain new relevant information, they separate those that have had an abnormally steep movement in prices prior to the announcement.

Significant announcements are considered to be those in which total cumulated abnormal returns, $CAR_i(-2,+1)$, are so large that the probability they have been produced as a result of a random variation in share performance is very low, in fact just 1%.

For these significant announcements, an examination is carried out to see whether there has been a pre-announcement CAR, $CAR_i(-2,-1)$, that is statistically significant for 10%, and whether this CAR is in the same direction, positive or negative, as that of the total CAR, $CAR_i(-2,+1)$. These pre-announcement price variations are called "informed price movements" (IPM) as it is probable (although not necessary) that such movements reflect trading on unpublished information.

A measure of “market cleanliness” is defined including the number of significant announcements preceded by abnormal price movements.

$$\text{Measure} = \frac{\text{Number of IPM}}{\text{Number of significant announcements}}$$

The problem with this form of choosing significant announcements is that it tends to overestimate the number of IPM. This is because securities with high cumulative abnormal returns before the announcement, a high $CAR_i(-2,-1)$ contribute to the total cumulative abnormal returns also being significantly high, with a high $CAR_i(-2,+1)$ and thus it is more likely that the announcement is considered significant. Thus the authors propose two technical corrections to the measure² (Measure 1 and Measure 2).

4 Results

4.1 Results of the tests

The announcement of the takeover bid involves providing significant information to the securities market, which to a greater or lesser extent is produced in the first session after the announcement (in $t=0$). As can be observed in Chart 1, the effect increases gradually over the three periods: the effect is greater in period III than in period II, and greater in period II than in period I.

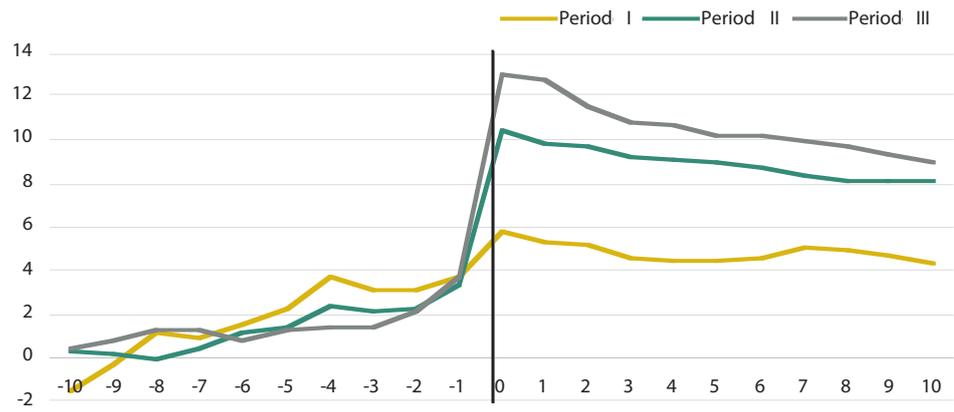
This difference in period III may be explained by the introduction of Royal Decree 432/2003 of 11 April, modifying Royal Decree 1197/1991 of 26 July, on the rules for takeover bids. This Royal Decree extends the possibility of improving the offer in competitive bids, making it easier for minority shareholders benefit from the better prices. Specifically, once the acceptance term of the last of the competitive takeover bids has been authorized, an auction period begins. Five days from this date, all the bidders can present an improved price in a secret and sealed bid, or extend their offer to a greater number of shares. Thus in period III it can be seen how the impact of abnormal returns after the announcement was greater, as the minority shareholders saw that the price of this asset could continue to rise thanks to possible competitive takeover bids. In addition, during period III the stock market was rising, encouraging investors to invest.

However, a considerable change had already been noticed in period II in the abnormal returns following the announcement of a takeover bid. This is the period prior to the new Royal Decree. Thus it can be concluded that the market has since the end of the 1990s been changing its idea of the significance of a takeover bid and the impact it has in the share price. Today the announcement of a takeover bid usually involves considerable gains for the holders of shares in the company that is the target of the bid.

² For more detail, see Villanueva (2007).

Cumulative abnormal returns for all announcements

FIGURE 1



Source: CNMV and prepared by author.

Measures for abnormal returns ($ZSAR_t$) and cumulative abnormal returns ($ZSCAR(-10, T_2)$) for all announcements

TABLE 3

	$ZSAR_t$			$ZSCAR(-10, T_2)$		
	Period I	Period II	Period III	Period I	Period II	Period III
-10	-1.5	0.3	0.4	-1.5	0.3	0.4
-9	1.2	0.0	0.6	-0.4	0.2	0.7
-8	2.4**	-0.4	1.1	1.1	-0.1	1.2
-7	-0.2	0.8	0.6	0.8	0.4	1.3
-6	1.6	1.8*	-0.8	1.5	1.1	0.8
-5	2.2**	1.0	1.4	2.1**	1.4	1.2
-4	3.3***	2.6**	0.4	3.7***	2.3**	1.3
-3	-1.1	-0.3	0.6	3.1***	2.0**	1.4
-2	0.4	0.8	2.1**	3.0***	2.2**	2.1**
-1	3.0***	3.9***	5.5***	3.7***	3.3***	3.7***
0	6.6***	23.3***	31.4***	5.8***	10.4***	13.0***
1	-0.7	-0.2	1.1	5.2***	9.9***	12.7***
2	0.1	0.5	-2.5**	5.1***	9.6***	11.6***
3	-1.8*	-0.5	-1.3	4.6***	9.2***	10.8***
4	-0.1	0.7	0.7	4.4***	9.1***	10.6***
5	0.3	0.6	-0.5	4.4***	8.9***	10.1***
6	0.8	0.3	1.5	4.5***	8.7***	10.2***
7	2.7**	-0.3	0.0	5.0***	8.3***	9.9***
8	0.0	-0.2	0.1	4.9***	8.0***	9.7***
9	-0.6	1.2	-0.3	4.7***	8.0***	9.4***
10	-2.1**	1.2	-0.4	4.3***	8.1***	9.0***

Note: * means significant to 10%, ** to 5% and *** to 1%.

There is a very different behaviour in the sessions prior to the announcement depending on the period we analyse, as can be seen in Chart 1, where the cumulative abnormal returns before the announcement are greater for period 1 than for the rest of the periods. Thus the difference between the three periods stems from the sessions where the price movement begins to be significant. In periods I and II the news of the takeover bid is anticipated earlier than in the final period. Whereas in period I there is a significant movement at time $t=8$, in period II it is in $t=-6$, and in period III in $t=-2$ (see Table 3). In other words, something has changed in the market during our sample period, producing a delay in the price movement prior to the announcement of a takeover bid.

It can also be observed in the table that in period III, although the market is delaying the announcement of the takeover bid until later, the effect is greater. As can be seen in Chart 1, the result is that the corrected cumulative abnormal returns are similar for the three periods in the session prior to the announcement. This result confirms that the news was anticipated.

If these effects are analysed for the different kinds of announcements, it is worth paying particular attention to the announcements of the so-called “other bids”, and the announcements of bids with positive news.

An initial difference between the “other bids” and the announcements of bids to delist is the lack of significance of the effects on prices in the second case (see Villanueva (2007)). This occurs both at the time of the announcement and before it, with the exception of period III where it has a positive impact after the announcement. For the sub-group of “other bids” an anticipation of the price movements can be observed more clearly in period I than in periods II and III.

A second analysis distinguishes between the announcements of bids with positive news and those with negative news (see Villanueva (2007)). Among the negative announcements it is worth highlighting the significant effect that exists at the time the suspension of trading is lifted, and three sessions later for period I. This effect is not obtained in the other two periods, where it is not significant. In addition, in none of the three periods can an anticipatory behaviour be noted for these negative announcements. For the positive announcements the same results are obtained as for all the takeover bids as a whole.

4.2 Results of the comparison of the significant takeover bid announcements preceded by abnormal price movements

Observing the importance of announcements of takeover bids and price movements prior to these announcements, the next step would be to determine the number of significant announcements of takeover bids preceded by an abnormal price movement. The aim is to analyse whether the creation of the UVM and the introduction of the new law in 2002 have had any effect in the market, and led to a reduction in the number of possible uses of insider trading. This analysis replicates the methodology used by Dubow and Monteiro (2006) outlined in Section 3.

The number of significant announcements is much greater in period II and III (18 and 19 respectively) than in period I (8 announcements). This result is maintained if one observes the percentage with respect to the total number of announcements analysed in each period.

Observing measures 1 and 2 (see Table 4) it can be seen that for periods I and III around 40% of the significant announcements are preceded by abnormal price returns. This highly significant result contrasts with that obtained in period II when it was only produced in fewer than 7% of cases.

Number of significant announcements preceded by abnormal price movements in the 2 previous sessions

TABLE 4

	Measure	Change	Measure 1	Change	Measure 2	Change
Period I	50.0%	-	48.3%	-	43.0%	-
Period II	16.7%	-33.3%	14.1%	-34.2%	6.8%	-36.2%
Period III	45.0%	+28.3%	46.8%	+32.7%	39.2%	+32.4%

Source: Prepared by author.

To conclude, it can be said that the creation of the UVM within the CNMV produced a positive effect on the integrity of the market, lowering the number of significant announcements preceded by an abnormal price movement. This result is obtained despite the fact that the number of significant announcements was practically double with respect to the previous period. But this good trend was broken in 2002, when the measure once more returned to the levels of period I. So it seems that the introduction of the law of 2002 had no positive effect, as the informed agents once more invested in sessions ahead of the announcements.

Bearing in mind the results of the previous section, it can be concluded that for the Spanish case the measure analysed is overestimated, above all in period III, as according to our results in this period the market anticipated the announcement of the takeover bid in two sessions, whereas in period I it did so in five, and in period II in four. For this reason the measure has been reworked, increasing the time period before the announcement to 5 sessions, instead of the 2 that were used earlier.

Thus, an announcement is now considered significant when the total cumulative abnormal returns $CAR_i(-5,+1)$, are so large that the probability of giving a random result is 1%. These significant announcements are considered to have been preceded by abnormal or informed price movements (IPM) if the previous cumulative abnormal gains $CAR_i(-5,-1)$, are statistically significant for 10% and with the same sign as the total. The new results are shown in Table 5.

While the number of significant announcements falls slightly with respect to the previous analysis, the number of those preceded by abnormal price movements does vary, above all in the final period, situating the IPM as equal for the three periods (4 announcements). The latter provokes a considerable change in the measures set out for period III.

Number of significant announcements preceded by abnormal price movements in the 5 previous sessions

TABLE 5

	Measure	Change	Measure 1	Change	Measure 2	Change
Period I	57.1%	-	54.7%	-	48.9%	-
Period II	25.0%	-32.1%	21.9%	-32.8%	15.3%	-33.6%
Period III	25.0%	0.0%	22.6%	+0.7%	16.7%	+1.3%

Source: Prepared by author.

According to the new analysis, from 1992 to February 1997 (period I), about half the significant announcements were preceded by abnormal price movements during the five sessions prior to the announcement. This result is similar to that

obtained when using the two previous sessions. In other words, it reinforces the idea that at the beginning of the 1990s a large percentage of significant announcements of takeover bids were preceded by abnormal price movements in the time leading up to the announcement.

With the results obtained in the two analyses carried out, it can be seen that the greater surveillance of misuse of insider trading introduced by the CNMV at the end of the 1990s has had a strong impact on the possible abuse of insider trading. Thus between period I and period II the measure is reduced to half, to between 10-15% of significant announcements preceded by an abnormal price movement.

The greatest difference between the two studies in this section resides in the comparison between period II and period III. The effect is ambiguous depending on the model, although in neither of the two analyses does the measure improve, but it worsens substantially if the two sessions prior to the announcement are taken into account, and remains invariable when five sessions are used. This confirms the results obtained in the previous section: the market has changed and in period III the abnormal price movements took place in sessions close to the announcement of the takeover bid.

5 Conclusions

The results obtained provide evidence that the effect on the Spanish securities markets of the announcement of a takeover bid has changed greatly over the last fifteen years.

The market interprets the announcement of a takeover bid as positive news for the company that is to be taken over, as the abnormal gains are positive after the announcement of the bid. From the end of the 1990s the announcement of the takeover bid was understood as much more relevant news about the company that was the target of the bid than at the beginning of the 1990s. This effect was heightened with the introduction of Royal Decree 432/2003 of 11 April, on the rules for takeover bids. The new law allows companies other than the initial bidder to make other bids and thus benefit minority shareholders, since this may lead to a further increase in the share price.

After an initial rise in abnormal returns as a result of the announcement, prices are corrected in later sessions for all the sample under analysis. This correction is greater in those periods where the impact after the suspension of trading is highest.

Analysing the ten sessions prior to the announcement of a takeover bid it can be seen that the behaviour of the abnormal returns has varied over the years. For the whole period an anticipation of the announcement of the takeover bid can be seen in the sessions leading up to it, which suggests the existence of informed agents in the Spanish securities markets. But the fact that there are movements prior to the announcement of the takeover bid does not necessarily imply that insider trading has been used. It may be that there have been unintentional information leaks

when preparing the takeover bid which have led to the market anticipating the possibility of a future bid before the announcement is made. These abnormal movements may be understood to be the result of an illicit act if some of the informed agents know for certain that the takeover bid will take place because they hold insider trading.

The difference between the periods resides in the session in which the movement prior to the announcement begins. While in the 1990s the movement begins to be significant in the fourth or fifth session prior to the announcement, since the end of 2002 this movement was delayed until only the two prior sessions. Despite the fact that the anticipation of the announcement occurs increasingly later, the amount involved is increasingly greater. This has led to the cumulative abnormal returns in the session prior to the announcement being similar for all the sample analysed.

Thus the changes in the system of monitoring against the use of insider trading may have led to a delay in the use of unpublished information prior to the news of a takeover bid. This may be because agents with unpublished information may have changed their behaviour in recent years, and now delay the use of this information; or it may be that the agents obtain the unpublished information increasingly late. However, despite the greater intensity of surveillance of the use of insider trading, it seems that there are investors with unpublished information who use it in sessions prior to the announcement, although it cannot be proved beyond doubt that its use is of necessity an illicit act.

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The results of mutual fund management

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1 Introduction

One of the recurrent subjects dealt with in the financial literature is whether management adds value to the results obtained by portfolio managers. Specifically, the aim is to determine whether the results persist over time, and thus whether future returns can be predicted according to past ones. However, some of the works in this field suggest that persistence may be due to a number of causes. What is particularly interesting is persistence related to the skill in selecting successful securities.

An important question to discuss here is the content of the information the investor should consider when taking investment decisions. According to some studies the investor takes into account past returns when choosing a fund, and the publication of these returns represent an incentive for managers. This situation would justify regulations to ensure that the information managers provide is comparable, standardized and does not lead to dishonesty. This raises the question of the form in which the results should be presented, in other words whether as raw returns over a determined period of time or as returns adjusted for risk. In the latter case the investor would have more complete information when it came to choosing a fund which best fitted his risk profile.

This study is based on an analysis of management results or performance¹. To do so, it first uses the Sharpe ratio and the Jensen alpha indicators relating returns with the risk associated with a particular portfolio or investment strategy. The second section deals with measuring performance, distinguishing between traditional measures (the Jensen alpha, Sharpe ratio and Treynor ratio) and others that have been introduced subsequently.

The third section reviews some of the recent studies carried out on persistence. It points to the different conclusions that have been reached and the reasons given by those claiming the existence of persistence.

The fourth section covers the work carried out on the influence that past returns have on shareholders when choosing a fund or making a transfer.

The fifth and sixth sections present an empirical study on persistence carried out with equity funds registered in the CNMV over the period 2000-2006. The fifth section analyses performance using the Sharpe ratio and Jensen's alpha, while the sixth analyses persistence using regressions and contingency tables. These two techniques are applied to the Sharpe ratios, Jensen's alphas and the raw returns not adjusted for risk. The seventh section offers conclusions.

¹ The word "performance" takes into account the results and the risk.

2 Measures of performance

2.1 Traditional measures of performance

The most common indicators of performance are Jensen's alpha, the Treynor ratio and the Sharpe ratio. The Sharpe ratio takes into account the return and risk of funds, with no reference to a market index. The other two measures take market indices into account. The Sharpe and Treynor ratios are relative measures of performance, whilst Jensen's alpha is an absolute measure.

Jensen's alpha

For Jensen (1967) the concept of a portfolio's performance had two dimensions: the skill of a manager in increasing returns thanks to his ability to predict the changes in the prices of securities; and his skill in minimizing the insurable risk inherent in the type of assets in which the fund invests by an appropriate diversification of the portfolio. Jensen's alpha refers solely to the first of these two dimensions.

It gives information on the returns a manager can achieve over and above what could be expected given the level of risk of the managed fund. Within the CAPM² model, Jensen's alpha is based on the calculation of the model's constant.

This measure is an indicator of absolute performance. In other words, as well as being able to establish a ranking of funds using the alpha associated with each of them, it provides an absolute assessment of whether the fund is doing well or badly.

The Jensen equation: $R_{jt} - R_{ft} = \alpha_j + \beta_j (R_{mt} - R_{ft}) + u_{jt}$

Where:

R_{jt} is the return of fund j in period t.

R_{ft} is the return of risk-free investments in period t.

R_{mt} is the return of the benchmark market index of fund j in period t.

Treynor ratio

This is another measure of performance introduced by Treynor (1965). It is a relative measure, as it measures the excess of return obtained with respect to risk-free assets by systematic unit of risk (beta) assumed. Unlike Jensen, Treynor uses the hypothesis that the assets are correctly valued, and the only thing that the manager has to do is diversify the portfolio properly in accordance with the level of risk chosen. Thus it does not take into account the additional returns that the manager may obtain through his skills in predicting or picking undervalued assets. In other words, it assumes passive portfolio management.

In this way, assuming that the fund portfolio is properly diversified, the Treynor ratio may offer a good prediction of the future performance of the fund.

² Capital Asset Pricing Model.

Treynor Ratio = average $(R_{jt} - R_{lt}) / \text{beta}_j$

Sharpe ratio

The ratio introduced by William F. Sharpe in 1966 was originally called the "reward to variability ratio". The ratio relates the measure and standard deviation of the return differential of a fund with respect to risk-free assets. It thus indicates the additional returns that are obtained by total unit of risk assumed. It abandons the hypothesis of Treynor, i.e. it accepts that the fund portfolio may not be correctly diversified. The ratio may thus indicate that the fund is not performing as well as the market, and this would be justified by the existence of diversifiable or non-systematic risk in the portfolio.

The Sharpe index is more universal in nature than the Treynor and Jensen, in the sense that it considers the total risk assumed by the portfolio, including both the specific risk and the systematic market risk. If an investment fund represents a small part of the total investor portfolio it is better to take Jensen's alpha or the Treynor ratio as a reference of the fund's performance, as the contribution of this fund to the total portfolio will depend on its market risk. However, if the mutual fund represents most or all of the investor's portfolio, then it is better to take the Sharpe ratio as an indicator of performance.

Sharpe ratio = average $(R_{jt} - R_{lt}) / \text{standard deviation } (R_{jt} - R_{lt})$

2.2 Other measures of performance

Return to risk ratio

This is calculated by dividing the average return by the standard deviation over a determined period of time.

Return to risk = Average return / Standard Deviation

Tracking error

This indicator is very useful for analysing funds which replicate indices. It is a measure of the volatility of the differences in returns of a fund and its corresponding benchmark. It is the same as the standard deviation of the difference between returns or relative returns (fund returns – benchmark performance). The smaller the tracking error, the better the fund replicates its benchmark in returns and risk.

Tracking error = $\sqrt{\frac{\sum (\text{Relative returns} - \text{Average of relative returns})^2}{\text{Number of observations} - 1}}$

Information ratio

This is defined as the ratio of the manager's active or relative return in relation to the active risk. The active return is the return the manager expects ex ante or obtains

ex post in excess of the benchmark performance. The active risk is in fact the tracking error defined above, i.e. the volatility of the active return. A manager who only replicates the index will not obtain an active return or confront active risk.

$$\text{Information ratio} = \frac{\text{Average of relative returns}}{\text{Tracking error}}$$

2.3 Cost analysis in the evaluation of funds

There is a great deal of literature³ providing evidence that once expenses are discounted, mutual funds do not systematically beat the market. The analysis of the value added by active management should be related to the transaction costs associated with it. Most studies in the United States conclude that active management on average obtains worse results than the indices⁴.

When discussing fund expenses a distinction has to be maintained between operating expenses and transaction costs. The former are represented by the total expense ratio (TER). The TER represents the extent to which the performance of a fund is influenced by the expenses in which it incurs, taking into account not only management and custodial expenses but also other kinds of expenses such as auditing, administration and distribution.

Thus the TER does not include transaction costs, which are counted as part of the price of an asset and not as an expense. Sometimes the portfolio turnover rate is used. This is an indicator providing information on fund transactions, calculated according to the acquisitions and sales of a fund's portfolio securities and shareholders' subscriptions and redemptions.

The European Commission (EC) announced in 2004 that it was in favour of funds including the TER and the portfolio turnover rate in their simplified prospectus, and issued a Recommendation on some of the contents of this prospectus⁵, describing the indicators and how they are to be calculated. The Recommendation also advises the Member States to demand a quantitative risk indicator based on the fund's volatility, although subject to future convergence work on such risk indicators.

$$\text{Turnover rate} = \left(\frac{((\text{acquisition} + \text{sale of securities}) - (\text{subscriptions} + \text{redemptions}))}{\text{net average assets}} \right) * 100$$

In addition, the EC recommends that the transaction costs should be presented separately. In any case the portfolio turnover rate should be disclosed as an additional indicator of transaction costs.

Until 2006 there were no data in the CNMV on turnover or transaction costs because the CIS circular on prospectuses⁶ requiring disclosure of the TER and the portfolio rate was still very recent.

³ Fernández (2007).

⁴ Otten y Bams (2003). Jensen (1967).

⁵ Commission Recommendation 2004/384/EC of 27 April 2004.

⁶ CIRCULAR 3/2006 of 26 October of the National Securities Market Commission (CNMV) on the prospectuses of collective investment schemes (CIS).

Another of the contents recommended by the EC is the disclosure of a benchmark regardless of whether the investment objective is explicitly established with reference to such a benchmark. This benchmark is particularly useful in evaluating the quality of management by simply comparing the performance of the fund with the benchmark, and for calculating Jensen's alpha.

3 Persistence in the results

If the activity of the managers added value to a fund, then it should be possible to see a trend for repeated results over consecutive periods in funds managed by these managers. In this case, the historical performance values of a portfolio can be extended to future periods. The literature on the subject talks about "hot hands", i.e. funds that obtain results superior to the average for consecutive periods of time. Persistence in negative results has thus been dubbed "cold hands".

Research work carried out in this field has not come to similar conclusions. At times the results are also not comparable because in some cases the raw returns obtained by the fund are used and in others the risk-adjusted returns.

The studies can be divided according to the conclusions obtained. One of the groups includes the studies by Ferruz and Vargas (2004), Hendricks, Patel and Zeckhauser (1993), Goetzmann and Ibbotson (1994), Brown and Goetzmann (1995) and Wermers (1997), which state that there is persistence in the positive results in the short term. Within this group other work has been carried out investigating persistence in the long-term results and its causes. The conclusion here is that there are managers with different levels of information and skills when it comes to picking winning securities. These studies include the following: Ciriaco and Santamaría (2005), Elton, Gruber, Das and Hlavka (1993), Elton, Gruber, Das and Blake (1996) and Grinblatt and Titman (1992).

A second group of researchers show that persistence exists in obtaining bad results. In other words, that the funds which do not obtain good results are more likely to follow this trend in the future. For example, Carhart (1992) analysed the persistence of long-term results and attributed it to expenses and fees.

The work of Grinblatt, Titman and Wermers (1995) attribute the existence of persistence to a "herd effect" among mutual fund managers, i.e. persistence appears simply because all the managers employ a common strategy. It has been observed that many managers buy securities according to their past returns, and in addition, they all do so at the same time.

Carhart (1997) admits the existence of short-term persistence, but points to the main causes as management expenses and the "momentum effect", i.e. the accidental momentum of last year's winning securities because of the trend to buy past winners, as has already been mentioned.

However, other work show that there is no persistence in the performance of mutual funds. This is the case of Menéndez and Álvarez (2000) and Jensen (1967). Jensen used alpha estimates for a sample of funds, and came to the conclusion that the majority of managers did not have the ability to predict the prices of securities, and that if any fund outperformed others it was mere coincidence.

Brown et al. (1992) and Malkiel (1995) consider that the discovery of persistence in a particular sample of funds could be due to the so-called “survivorship bias”, very common in fund samples, as the worst funds end up disappearing and the samples used for the studies tend to include only the funds existing at the end of the sample period.

Carhart, Carpenter, Lynch and Musto (2000) found that the survivorship bias weakened the results on the existence of persistence. The funds that disappear are those which do badly over various years, not those which do badly only in one year. Thus not taking into account funds that offer negative results in a persistent fashion weakens the results of persistence tests. Carlson (1970) is among the authors who have investigated the existence of persistence with raw returns and with risk-adjusted returns. He pointed out that it was more difficult to find persistence with risk-adjusted returns.

A possible cause of persistence in returns is the habitual practice of managers of assigning results discretionally between the funds they manage in order to maintain one of them in top place in the rankings. This bad practice was the subject of regulation in Spain in the new Regulation on collective investment schemes (CIS)⁷. As a result of the CNMV detecting irregularities in the assignation of results among CIS managed by the same CIS management company, Article 98.2 of the new Regulation on CIS has included the obligation that the CIS management company has to include internal control procedures in its internal rules of conduct to prevent these kinds of actions. Specifically, they should establish internal control procedures to prove that the investment decisions in favour of a particular CIS or client are adopted before the transmission of the order to the intermediary. At the same time, they should have objective and pre-established criteria available for the distribution or breakdown of operations affecting various CIS or customers, to guarantee fair and non-discriminatory treatment between them.

3.1 The British regulatory approach

A debate began at the start of this decade in the U.K. between the Financial Services Authority (FSA) and the Association of Unit Trusts and Investment Funds (AUTIF) about the information which should be made available to fund investors.

This debate arose as a result of a series of publications by the FSA⁸ discussing the use of past fund performance in the Comparative Tables it offers on its website⁹.

⁷ Royal Decree 1309/2005 of 4 November, passing into law the Regulation of Law 35/2003 of 4 November, on collective investment schemes.

⁸ Bacon and Woodrow (1999):

“Report of the Task Force on Past Performance”. FSA 2001.

Rhodes, M. (2000).

⁹ The FSA website offers a series of Comparative Tables on investment products (pensions, deposits, mortgages, funds, etc.) to help investors choose the best product. The tables are updated daily.

These reports concluded that the information on the past results of an equity mutual fund is not relevant for the investor when choosing funds, as there was no significant relationship between the past and future results of mutual funds. In addition, the FSA considered that not only is it not relevant, but could in fact confuse the investors. It also suggested the possibility of restricting the use of any data on past results in a fund's advertising, despite of (or because of) the importance that investors give to this data.

In response to these publications, in 2002 AUTIF commissioned two studies from the consultancy Charles River Associates (CRA) on the persistence of equity fund performance in the U.K. The main aim of these was to defend the usefulness of information on past results of funds in the U.K. for investors' decisions.

The FSA answered the two CRA reports in another document in April 2003 called *Performance Persistence in Mutual Funds*¹⁰, analysing the conclusions of these reports. Below we summarize the analysis of each of them.

The first CRA report (2001) was focused on analysing the existing academic literature on performance persistence in mutual funds. It mainly referred to equity funds in the United States and the U.K. One of the main conclusions of the report is that the studies analysed suggested that past results are a source of useful information for investors, but that they have to be used properly. Thus they called on the regulators to help improve the use of the information rather than to restrict it. In addition, if the investors no longer considered past returns when taking their decisions this would remove incentives for managers.

The second CRA report (2002) is a study on the persistence of results based on a sample of U.K. funds over 1981-2001, and including both live funds and those that disappeared during this period. It is unlike previous studies in that it uses raw returns instead of risk-adjusted returns because most investors consider the former rather than the latter when taking investment decisions. It found more evidence of persistence with this kind of data than with risk-adjusted indicators.

The paper by Blake and Teimermann (2003) published as a response to the two reports criticizes the use of raw returns. Not adjusting returns to risk may lead investors to choose funds with a high risk, without considering whether the level of risk assumed in the fund is justified by the returns obtained. In the long term, funds with a greater risk tend to obtain better results, while those with a lower risk tend to be among the worst. Thus it cannot be said that managers who obtain good returns have superior management skills, as any manager who wants to increase the fund returns can do so increasing its risk exposure (hedge funds, for example, do so by leveraging).

The quality of management should be measured against a benchmark index. Only good managers can improve fund returns against the index without increasing risk. This skill is what some of the indicators described in Section 2 measure. If the increased returns of a fund are the result of an increased risk, this would not be reflected in Jensen's alpha, for example.

¹⁰ Blake y Timmermann (2003).

The FSA finally decided that it was inappropriate for it to include information on past results in its Comparative Tables because:

- The data that should be taken into account by investors are risk-adjusted returns;
- There is little evidence of persistence in these kinds of indicators;
- The information about past returns is already available for investors, as it is published elsewhere;
- If the regulatory body should publish this information, this would give it an importance it does not have;
- The FSA highlights the importance of costs when it comes to choosing a fund, and this is what is included in its Comparative Tables.

Currently no data on past returns appear in the Comparative Tables on the FSA website. However, the FSA does recommend some links where this information can be found, and points out some guidelines about what should be taken into account: investors should consider the risk they are prepared to assume; be aware of the period of calculation of the returns that are published; and look for indicators relative to performance, i.e. those that take an index or other funds in its category as a reference. Also not included in the tables is any kind of risk indicator, as according to the FSA, the concept of risk and the level that each person may be prepared to assume is extremely subjective and difficult to quantify.

4 The influence of past returns on the choice of a fund

It if is decided that the information on past results is useful for investors when choosing funds, then it has to be determined whether investors really make use of it. Some studies find evidence that there is a positive and significant relationship between past returns and present flows into mutual funds.

Various models have been designed to determine the relationship between the asset growth of a fund and its historical returns¹¹. One of them is Sirri and Tufano (1998). They define the net relative growth of a fund as a dependent variable and the past return, risk and fees as explicative variables. The authors not that investors' behaviour is asymmetrical. In other words, outflows when returns have been low are lower than inflows when there are high returns.

From the perspective of agency theory, the positive relationship between fund returns and the flows into funds constitute a system of incentives for managers, and in this way there is a partial match between the incentives for both parties. However,

¹¹See Ciriaco and others (2002).

the asymmetrical behaviour of investors observed by Sirri and Tufano may also give rise to a greater assumption of risk by investors in order to increase returns.

There have been a number of studies on the existence of incentives for managers to assume excessive risks. In particular, the work of Urra (2004) considers the aim of occupying a good position in the ranking to be a factor that could affect the behaviour of managers with regard to risk. If the ranking is taken into account by investors and the managers receive their remuneration according to the volume of managed funds, the aim of achieving a good position will influence the risk assumed. In addition, it has been observed that this phenomenon is stronger when the fund is closer to the top of the rankings.

Thus most studies find evidence that information on past returns plays an essential role in investment decisions. This suggests that regulations should pay particular attention to the quality of information so that it available in time and in comparable form.

5 Analysis of the performance of a sample of equity mutual funds

This section analyses the performance of Spanish equity funds in the 2000-2006 period. It uses the Sharpe ratio and Jensen's alpha. The sample is made up of 622 mutual funds of all categories that invest in equity, i.e. national (NE), euro (EE), international Europe (EIE), Japan (JIE), the United States (USIE), emerging countries (EMIE) and others (OIE).

To avoid survivorship bias as much as possible when analysing persistence, the sample includes all the funds that have had a life of two years or more within the period of the study (2000-2006). Despite this, there is some bias because of the need to ensure that the number of data for two consecutive years coincide in order to make the regressions and contingency tables. The bias is even greater when regressions are run with data for the two and three previous years.

The calculation of the Sharpe ratio with monthly returns has used the one-month Spanish Treasury bill interest rate.

Jensen's alpha has been calculated by classifying the equity funds by investment type, as the benchmark index is different for each group of funds. Jensen's alpha has been calculated by classifying the equity funds by investment type, as the benchmark index is different for each group of funds. The choice of the benchmark index has a significant influence on the calculation of the alpha. These indices do not include dividends, which is a disadvantage when comparing with the funds, which do receive them and reinvest them.

Comparing the Sharpe ratios for each year of the individual funds with the ratios of the indices, it can be seen that in bull markets most funds do better than their

benchmark index in terms of return-risk. This means that the indices are more volatile in their results. On the other hand, in bear markets, few funds beat the index in terms of return-risk. A possible explanation of this asymmetrical behaviour may be the fees and other fixed costs, such as the cost of transactions designed to prevent or reduce losses.

Number and percentage of funds that beat the benchmark index in terms of return/risk (Sharpe ratio)

TABLE 1

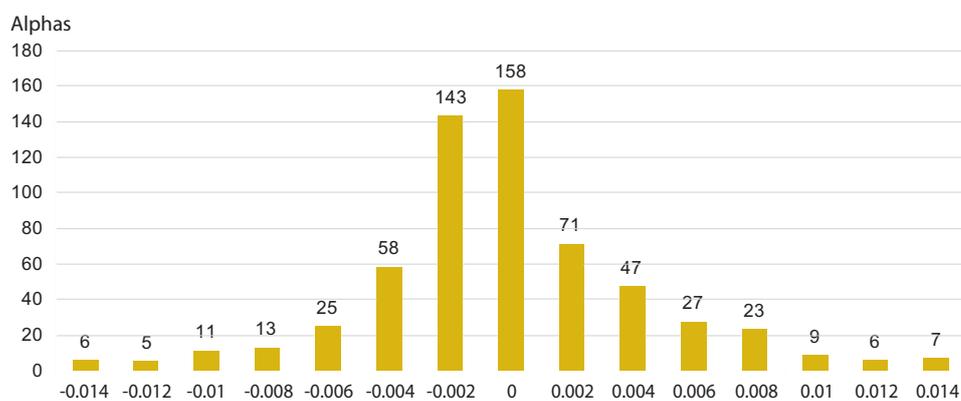
Year	Total funds	Fund SR > Index SR	% of total
2000	377	43	11.4
2001	513	36	7.0
2002	564	21	3.7
2003	520	497	95.6
2004	521	425	81.6
2005	495	470	94.9
2006	483	400	82.8

Source: Prepared by author.

In addition, an alpha has been calculated for each fund for the whole period of the study, 2000-2006 using monthly data. The number of data used for the calculation of each alpha ranges between 24 and 84, depending on the survivorship period of the fund. As can be seen in Chart 1, the alpha distribution shows a concentration around zero (158 funds), -0.4% (58 funds), -0.2% (143 funds), and 0.2% (71 funds); in all 430 funds out of the 622 that make up the sample. Nevertheless, there are various funds with positive alphas and others with very negative alphas, as can be seen in the frequency distribution.

Alpha distribution calculated for the whole period 2000-2006

FIGURE 1



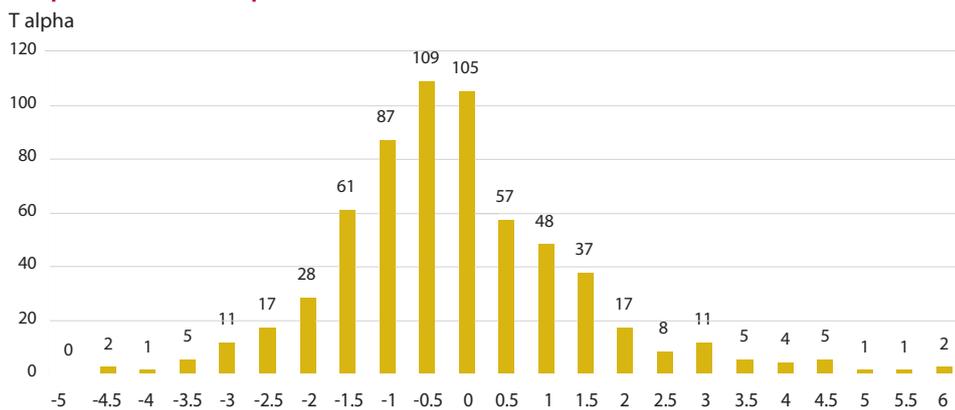
Source: Prepared by author.

Chart 2 shows the frequency distribution of the alpha t statistic¹². Most values obtained are not statistically significant as they are concentrated around the (-1.5, 1.5) interval.

¹² T = alpha / standard deviation of alpha

T-alpha distribution, period 2000-2006

FIGURE 2



Source: Prepared by author.

All in all, the results of the alphas demonstrate that most managers do not show skill in picking winning securities, nor do they have different levels of information. However, there are managers who show a clear superiority in obtaining positive and statistically significant alphas¹³, as can be seen in the charts. The same can be said of some managers in the opposite sense, in other words that they obtain results which are clearly inferior to those in the other funds.

6 Analysis of the persistence of results¹⁴

Regression analysis of the results obtained in consecutive years and contingency tables have been used to study persistence. Some authors, such as Grinblatt and Titman (1992) have run regressions with performance data for ten years divided into two groups of five years (the division was chronological and random); others such as Kahn and Rudd (1995) have run performance regressions in the same way as Grinblatt and Titman (1992) but also using contingency tables.

This paper uses short and long-term regression analysis and contingency tables. The study is carried out with two of the performance indicators mentioned above: the Sharpe ratio and Jensen’s alpha, as well as raw returns.

The analysis carried out with the Sharpe ratio deals with all the mutual funds in the sample as a single group, both in regressions and in the contingency tables. With regard to alpha, as the sample has been divided into groups by type to carry out the alpha calculations, the regressions to determine the existence of persistence and the contingency tables have been drawn up separately for each group. The groups used have been as follows: NE, EE and IE; the latter includes the EIE, JIE, MIE, OIE and USIE funds.

¹³A $t > = 2$ indicates that the estimated alpha is significantly different from zero.

¹⁴In this section all the tables with results obtained for each performance indicator have been eliminated. Only the summary table is shown. To expand the content, see the reference monograph.

The study of persistence based on raw returns has been carried out in two ways: with all the categories of funds together, as has been done with the Sharpe ratio; and separately, as has been done with Jensen's alpha.

6.1 Regression analysis

This methodology determines by ex post values whether the relationship between the performance of a particular period and that corresponding to the previous period is statistically significant.

Sharpe ratio

A Sharpe ratio has been calculated for each fund and year. Thus they are annual ratios calculated with 12 monthly data. Annual regressions have been run of the ratios (Sp) calculated in this way for all the equity funds that were live for two consecutive years, as follows:

$$Sp_t = a + b * Sp_{t-1} + e$$

If b is significant the risk-adjusted return of funds in period t is related to the previous period. If it is positive this may indicate a certain persistence. In the periods in which b is negative there is no sense in stating that there is persistence, as the idea is to determine whether funds tend to repeat results year after year, whether negatively or positively, but not with a different sign each year.

Next, regressions are run taking the performance of the previous two and three years as the independent variable, to determine whether the capacity for predicting based on past performance is maintained for longer periods. This kind of regression was suggested by Ferruz and Vargas (2004).

$$Sp_t = a + b * Sp_{t-1,t-2} + e$$

$$Sp_t = a + b * Sp_{t-1,t-2,t-3} + e$$

$$\text{Where } Sp_{t-1,t-2,t-3} = ((1+Sp_{t-1}) * (1+Sp_{t-2}) * (1+Sp_{t-3})) - 1$$

The results are given in Table 2.

Jensen's alpha

The analysis of persistence through regressions of Jensen's alpha has been carried out classifying the equity funds into three groups: NE, EE and IE, including all the international funds that invest in emerging countries, Japan, the U.S., Europe and others. Annual alphas with 12 data items have been calculated for each fund.

When making the calculations with a more reduced sample of funds all of the same category, it becomes clearer that a persistence exists in the NE and EE funds, both in regressions with two periods and in multi-periods (see Table 2).

Raw returns

First, the equity funds were taken as a single group as was done with the analysis using the Sharpe ratio. Then they were divided into three groups, as was done with the analysis using Jensen's alpha.

The results show that the findings given above - that there is more evidence of the existence of persistence with raw returns - are also found in the whole set of funds used for the study in the period of time under consideration.

As can be observed in Table 2, 2003 is the year with least persistence in terms of returns of previous years. This was the year when the securities market indices began to recover after the dotcom crisis of 2000.

6.2 Contingency tables

Contingency tables, as set out by Goetzmann and Ibbotson (1994) and Malkiel (1995) are double-entry tables showing the number of funds with a particular performance over two successive years. The funds are classified each year into winners and losers according to whether the results are above the average or not. When comparing the result with the following year four cases are possible: winner-winner, loser-loser, winner-loser and loser-winner.

Table 2 brings together all the results of the persistence analysis. Each cell indicates the periods in which the existence of persistence is noted for each indicator and method.

Summary of the persistence test results				TABLE 2
		Short-term regressions	Long-term regressions	Contingency tables
Sharpe		All except 2001 and 2006	All except 2005	Yes: 2002, 2003, 2004 No: 2001, 2005, 2006
Raw returns		All	All	All except 2001
Jensen	EE	All	All	All except 2001
	IE	All except 2002, 2005, 2006	All except 2005, 2003	All except: 2001 for WW and 2002
	NE	All	All	All except 2001
	EE	All except 2003	All except 2003	All except: 2001, 2004, 2005 for WW 2002, 2003 for LL 2001, 2003 for WW+LL
Raw return	IE	All	All except 2003	All except: 2003, 2006 for WW 2001, 2004 for LL 2001, 2003, 2004 for WW+LL
	NE	All except 2003	All except 2003	WW: only in 2005, 2006 LL: all except 2003 WW+LL: all except 2003

Source: Prepared by author.

The conclusions that may be reached from this table lead us to think that there are reasons for admitting the existence of performance persistence in funds, although it is not clearly visible in all the periods, all groups and all methods and indicators used. The year 2003 is an exception repeated in a number of cases, presumably

because of the recovery of the markets in this period. This fact makes us think that most managers follow passive strategies, and that there is a certain “herd effect” among them. However, some managers achieve better results than the indices in bull markets and post lower losses in bear markets, as seen in section 5. The fact that these managers exist justifies the usefulness of information contained in past results for investors when it comes to choosing a fund.

In addition, in the contingency tables a large proportion of funds appear repeated both as winners and losers with risk-adjusted indicators of performance. This contradicts the theory that persistence exists only in negative results because of the costs incurred in searching for undervalued securities. Nevertheless, persistence is greater in losing funds than in winning funds when the analysis is carried out with raw returns.

7 Conclusions

The debate on whether the past returns of mutual funds influence future returns, and thus the question of whether this information should be taken into account by investors has been extensive, particularly in the United States and the U.K.

Many of the studies carried out have tried to analyse the reason for persistence, as what is really relevant for investors is that this persistence should be the result of managers' skills in picking securities, and not of other causes such as the survivorship bias in the sample of funds chosen for the study, the accidental trend of winning securities, the "herd effect" among managers, or the personal assignation of results by the managers. Another series of studies conclude that there is a persistence of negative results because of the funds' fees, transaction costs and fixed costs.

From the point of view of the regulator, the point of this debate should be to decide on whether it is relevant for funds to include past returns in their advertising. In general, experts want information on past returns in funds to be published. In addition, they consider it better to give risk-adjusted returns, as otherwise investors would not be taking correct decisions. Some managers increase their portfolio returns by increasing risk, i.e. beta, while the alpha does not vary. Jensen's alpha is a good indicator of managers' skills and it should be taken into account by the investor if the fund forms part of a broader portfolio. The Sharpe ratio is a good measure for those who invest their money in a single fund, as this indicator takes into account the total risk of the fund (systematic and non-systematic).

This paper's performance analysis of equity funds for the 2000-2006 period leads to the following conclusions: (i) When compared with the benchmark indices, the Sharpe ratios indicate a greater volatility in fund results than in the indices, and thus a greater risk-adjusted performance by funds when markets rise. When markets fall, the fixed costs and attempts to obtain profits in unfavourable market

conditions lower the returns significantly; (ii) in addition, the monthly alphas calculated for the whole 2000-2006 period are mainly concentrated around zero or are negative, indicating that most managers do not have the necessary skills to pick winning securities, nor do they have the information needed to obtain extra returns. Nevertheless, it has to be stressed that there are a number of funds with a positive and statistically significant alpha.

The calculations in this document, both with risk-adjusted indicators and with raw returns, suggest that there is useful information for investors in the historical performance of funds. In fact, the results show the existence of persistence in nearly all the periods under analysis with the methods used, and for different performance indicators. This suggests that it is a good idea for this information to be available. Nevertheless, any action that regulates this matter should take into account the difficulty of defining sufficiently precise indicators of the quality of management, as well as the sensitivity of the ranking of performance results to the choice of a particular indicator.

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Financial activism and innovation: implications for corporate governance

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1 Introduction

Today it is easy to separate the economic return on shares from their voting rights. This is particularly true through the use of customer tailored OTC derivatives and securities lending.

Until recently the possibility of separating voting power from economic return in shares did not have significant consequences for corporate governance. However, recent years have seen the arrival of new investors, particularly hedge funds, who use the capacity to decouple economic return from voting rights of shares for their own benefit. The investment strategy of these hedge funds consists in taking an active part in the decisions made by the company and exercising voting rights that do not correspond to the economic interests that the hedge fund has in the company. This can lead to situations in which the economic return a hedge fund receives from this kind of investment does not correspond to the return on the company's shares, with the hedge fund having significant voting rights from the shares it holds.

This kind of investment strategy in which financial innovation is used to influence company decisions tends to be far from transparent. Hu and Black (2006a) demonstrate how the financial products used by this kind of investor, above all derivatives, are designed not to be detected by regulations promoting transparency in the securities market.

Apart from the above consequences, Kahan and Rock (2006) show how the activism of these investors in taking positions on corporate decisions may have two divergent consequences: on the negative side, a greater short-sightedness in decision-making by company directors; on the positive side, this activism will ensure that control is reinforced over directors and will reduce the kind of agency problems faced by other investors.

The fact that there are agents who use activism supported by financial innovation as an investment strategy confronts corporate government regulation with its biggest challenge in recent decades. The main problem arises from the fact that self-regulation by companies cannot be an answer to this state of affairs. Company boards could use this opportunity to strengthen their internal control, increasing their voting power.

Section 2 presents the formulas available to investors for separating the voting rights of shares from their economic returns. Section 3 describes the consequences of activism and financial innovation on corporate governance. It also presents the recent regulations on transparency resulting from this situation, and the proposals for new regulations that may be considered necessary in the future. Finally, Section 4 presents the conclusions.

2 Formulas for separating voting rights from economic return on shares

Until now, recommendations on corporate governance have only partially taken into account developments in financial innovation that have allowed a separation between the voting power and economic return on shares.

To understand the consequences of being able to make such a separation, we first have to identify the most common type of corporate governance architecture in listed companies. Normally these kinds of companies have a single class of share with voting rights, and each share has a right to one vote. Shareholders have homogenous preferences regarding the company they own, and the objective of the company is to maximize shareholder profit. Normally there are two kinds of shareholders: those who are directors and those who are not. The latter only influence decisions affecting the company through the general shareholders' meeting.

To help analyse in depth the consequences that financial innovation has on corporate governance it is useful to define some concepts (see Hu and Black (2006a)):

- 1 **Voting rights:** Investors' formal voting rights, depending on the ownership of shares, and informal rights, depending on instructing third parties how to vote.
- 2 **Economic ownership:** The ownership of economic returns on shares. This ownership may be direct when the shares are owned, or indirect in the case of ownership of a financial product related to a share. The latter type of product is defined as a **coupled asset**. Economic ownership, the sum of the direct and indirect ownership, may be positive, if it is the same direction as the return on shares, or negative, if it is the opposite direction¹.

After analysing the definitions, it can be seen that the appearance of assets coupled assets related to shares has created new forms of linking economic ownership and voting rights.

Table 1 offers some examples of how the definitions are applied to different combinations of shares and coupled assets:

¹ An example of negative economic ownership is when an investor has 1,000 shares of a company and at the same time decides to sell 2,000 futures. During the life of the futures the investor will have a negative economic ownership equivalent to 1,000 shares.

Portfolios of shares and coupled assets

TABLE 1

	Ownership of Vote	Economic Ownership	Coupled Assets	Net Economic Ownership
Empty vote				
Share hedged by <i>Equity Swap</i>	Yes	Direct	Equity Swap	Zero
Share hedged by options	Yes	Direct	Call or Put	Zero
Vote capture by share borrowing	Yes	No	No	Zero
Vote capture by securities borrowing with short sale	Yes	No	No	Negative
Hidden morphable ownership				
Voting rights through share purchase	Informal right to acquire counterparty shares	Indirect	<i>Equity Swap</i>	Positive
Voting rights through deciding how others vote shares	Informal right to decide the vote of shares bought by the counterparty	Indirect	<i>Equity Swap</i>	Positive

Source: Prepared by author.

2.1 Empty voting

An empty voter is an investor whose portfolio of shares and coupled assets in a company give him a voting power substantially greater than his economic ownership.

Investors can achieve a situation of an empty voter through the use of derivatives on shares and share borrowing. In the case of share derivatives, they are normally OTC. These derivatives tend to be used as a hedging strategy by the owner of shares to ensure that the investor's final exposure to the share return is substantially reduced, and could even be negative.

The fact that investors can hedge the market risk of their shares may have significant consequences for the corporate governance of the companies in which these investors are shareholders. Such investors can mitigate the effects that company resolutions based on shareholders' votes have on the price of their shares. This situation can give rise to perverse incentives when it comes to voting.

The following example illustrates situations in which share owners have perverse incentives: An investor who is not a director holds a determined percentage of a company's shares. A hostile takeover bid is launched against this company and creates value for the company. The current members of the board of directors own a high percentage of the company, although not a majority, and they are not interested in the takeover bid being successful. In these circumstances, the investor who is not on the board of directors may adopt the following strategy: overhedge the shares he owns with derivatives on these shares, for example through the sale of a greater number of futures than the number of shares he holds. This overhedging means that the investor obtains a profit from his strategy when the share price falls, and such a fall may be easily achieved by voting against acquisition in a hostile takeover bid.

The second strategy that can be adopted to reduce economic ownership whilst maintaining voting rights is to borrow shares in the share lending market. Stock lending contracts (which are also considered a form of coupled asset) transfer the voting rights to the borrowers, but the economic power over the shares remains with the lenders. Thus the borrower obtains the voting rights but not the economic ownership, and the lender retains the economic ownership without the voting rights.

Borrowing shares is an easy way for an investor to achieve the position of empty voter. As has been mentioned above, a share borrower who keeps them gets the voting rights of the shares but not their economic power. In this case, the optimum strategy for the investor is to borrow the shares a few days before the record date for the general shareholders' meeting and return them the day following the record date.

When an investor becomes an empty voter, either using derivatives or borrowing securities, it is not clear that this always prejudices shareholders as a whole.

2.2 Hidden ownership

Hidden ownership occurs when the number of shares owned by an investor is below the minimum required for disclosure to the register of significant shareholders, but he has voting rights greater than this minimum. This ownership is derived from the combined ownership of shares and coupled assets. The owner is usually not obliged to disclose his position, as in most cases current legislation does not oblige disclosure of ownership derived from coupled assets. When this hidden ownership is linked to informal voting rights it is called hidden morphable ownership.

Share derivatives can also be used by investors to avoid regulations requiring disclosure of the percentage of shares held in a company. Official registers of significant shareholdings, above all of investors who are not directors, are largely based on the idea that votes and economic ownership of shares are coupled. However, the use of derivatives such as equity swaps allows some investors to hold voting rights without the need for economic ownership of the shares. This means that the other investors do not know the true level of their holding in a company. This strategy has been used by some hedge funds in recent years.

The fact that there are investors whose effective voting rights represent a significant percentage that is not public knowledge to the remaining shareholders because of the regulations on disclosure of significant holdings may have important consequences for the corporate governance of companies. It may prejudice shareholders as a whole, as it makes it difficult to take control of the company and is reflected in a lower share price.

2.3 Assets of other companies

There are situations in which an investor uses his investment in one company as a related asset to influence what happens in another. Two situations can be distinguished here: when a company is the target of a takeover bid, and when derivatives are used on one company's assets to hedge a position in shares of another.

When a company is the target of a takeover bid two situations may arise, depending on whether the investor has positive or negative economic ownership. If an investor has a negative economic ownership of a company that is the target of a takeover bid, the investor may follow the strategy of buying the shares of the

company making the bid so that it abandons its intention of acquiring control of the other company, thus prejudicing the remaining shareholders of the company targeted by the bid.

A classic example in which the rest of the shareholders benefit is when an investor buys shares in a company that is the target of a takeover bid and sells the shares of the bidder short.

Some investors' investment strategy involves acquiring derivatives on shares that are closely linked to the shares in their portfolios, normally companies in the same sector. A significant example occurs when officers with a large shareholding in a particular company use this method as a way of diversifying their portfolio and reducing its concentration. These investors would want to hedge by using put options on the shares of the company in which they are officers, but they could be accused of insider trading.

3 Recent regulations and proposals for the future

3.1 Consequences of activism and the decoupling of voting rights from economic ownership of shares

The activism of these investors, particularly hedge funds, in the decision-making of the companies is strategic and ex ante: The managers of the hedge funds first decide if they can profit by taking active positions in company decisions; and if the result is positive they take a holding in the company to make their position pay. Before the appearance of these hedge funds, when investors took positions in a company's decision-making, it was always as a result of situations in which the investor had taken a position in the company prior to the situation occurring.

The activism introduced by this new kind of investors brings with it advantages and disadvantages for the remaining shareholders and for the company itself. It is worthwhile remembering that these hedge funds operate to increase returns for their participants. Sometimes their interests coincide with those of the rest of the shareholders, but not always, particularly in the case of the minority shareholders. When the hedge fund interests coincide with the rest of the shareholders the existence of these investors is beneficial for everyone. They act as catalysts for the interests of the shareholders as a whole, taking decisions that benefit all of them, sometimes against the company directors. However, there have been cases in which the interests of the activist hedge fund have not coincided with the rest of the shareholders. Despite this, it tried to convince them that their position was the correct one².

² A case of this kind occurred in the attempt by AXA to buy MONY. In this case there were hedge funds both in favour and against the operation. One of these hedge funds, Highfields, held 5% of MONY, and exerted pressure to prevent the acquisition from taking place. However, the Highfields interests cannot be understood fully without also knowing that they held a short position in bonds convertible into AXA shares. These bonds were convertible into shares only if the acquisition was successful. If it did not take place, they would be redeemed at face value plus interest. Given the Highfields investments in MONY and AXA, its interest was that the takeover bid should not be successful, regardless of whether the acquisition benefited the interests of the shareholders of MONY as a whole.

One of the objectives of this kind of hedge fund is to change the managing board when they consider that the company is badly managed. The result of this investment objective is that the managing boards of companies have incentives to improve the management of their companies. This is a situation in which all the shareholders benefit, as the existence of these hedge funds lessens the agency problems existing between members of managing boards of listed companies and their shareholders. Nevertheless, Kahan and Rock (2006) point out that the pressure exercised by these hedge funds may result in directors preferring projects giving short-term results, even though they may be able to undertake better long-term projects, thus acting against the interests of the shareholders.

So the entry of these kinds of investors has brought with it both positive and negative consequences for the rest of the investors participating in securities markets. As pointed out above, many of the activities of these hedge funds are far from transparent, so that their true scope is unknown. Knowledge of these activities, and the consequences they bring with them, should be improved through greater transparency. A decision can then be made on whether regulatory changes are needed on certain questions.

3.2 Recent regulations and proposals for the future

Some of the short-term proposals that have appeared in the literature aim to reform the register of significant shareholdings and the content of the information that collective investment schemes (CIS) have to communicate to their participants and shareholders in their portfolio. These reforms would give us a better understanding of the scope of the financial innovation which some shareholders use to gain control of their companies or to avoid compliance with obligations derived from their significant shareholdings. This may be the case when a takeover bid is launched for the whole of a company³. With information on the use that the various shareholders make of financial innovation, the regulator would be in a position to assess whether more regulatory changes in the securities market are needed, and of what kind.

In Spain, some of these reforms on the disclosure of significant shareholdings have been adopted recently in Royal Decree 1362/2007 of 19 October, on the transparency requirements related to disclosure about issuers whose securities are traded in an official secondary market, or in another regulated market in the European Union⁴. The Royal Decree has introduced measures affecting both shareholders who are directors and those who own shares indirectly.

In the case of shareholders who are directors of a company, the main new point is the obligation to communicate their position in terms of voting rights. The shareholders who are not members of the board of directors are affected by a number of measures: The thresholds obliging communication have been affected

³ Article 60.2 of Law 6/2007 of 12 April governing the rules for takeover bids and transparency of issuers obliges the shareholder of a company whose percentage of voting shares is 30% or more to launch a takeover bid.

⁴ This Royal Decree is part of the transposition of Directive 2004/109/EC of the European Parliament and of the Council on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

by adding a minimum threshold of 3% to the previous thresholds of 5%, 10% etc.⁵ The current rules for investors who are members of the board of directors have also been extended to investors who are not members in terms of the types of assets they have to disclose. Under this Royal Decree investors who are not members of the board of directors will have to make a disclosure each time that their voting rights exceed one of the thresholds. This is applicable not only to the shares they own, but also to any derivatives they may have that are linked to shares in the company. These reform measures registering participatory shareholdings puts Spain in a leading position among regulators in this matter, on a par with countries such as the United Kingdom and Hong Kong.

In the future, if the measures contained in the Royal Decree are considered insufficient, a further step may be taken to improve transparency. In the case of communication of major holdings the next step would be disclosing short positions if a particular threshold has been exceeded. These short positions would be measured in terms of economic ownership, and in no case could investors' long and short positions compensate each other.

If deemed necessary an increase in the quarterly information given by CIS to their participants could also be considered. Specifically, it may be a good idea to include securities that they have lent, as well as those they have borrowed⁶.

A further increase in transparency would be required before tackling future reforms. First, the regulator has to find out the scope of influence that financial innovation has over the corporate governance of companies to be able to tackle any more far-reaching regulatory changes that may be considered necessary. Tackling regulatory changes without having the relevant information could result in overregulation.

Investors in listed companies have to inform the market at certain intervals and in certain circumstances about the economic and voting powers they hold. This obligation has costs and benefits that the regulator should take into account. On the benefit side the share price is more likely to reflect the value of the companies effectively if the investors know the decisions of major investors and possible changes in control which may be produced in companies. This is because they would be allowed easy access to information that, in theory, is private. In addition, by making it public it no longer has to be searched for. On the other hand, the private search for information may also help to improve efficiency in share price formation as well as boosting the market for company takeovers, and thus improving supervision of the management boards of companies.

In addition to any possible reforms increasing transparency, greater co-ordination is needed of the information available to the rest of the international regulators, given the increased internationalization of the securities markets. Only in this way can we obtain a coherent vision of what is occurring in the various national financial markets.

⁵ It should be remembered that these thresholds are 1% and their respective multiples when the investor is resident in a tax haven or country whose regulator does not work with the CNMV.

⁶ Although it is true that only rarely does a mutual fund borrow securities, as it may not operate short, theoretically it could hold them and be an empty voter through the percentage of shares it has borrowed. Although under current regulations the CIS operating under the common scheme cannot use this as one of their investment strategies, its occasional use may not be discounted.

If as a result of the new information obtained through greater transparency the regulator should decide that a more extensive regulatory intervention is needed, reform measures could be taken covering some of the following aspects:

- Creating regulations determining shareholders' voting rights and changing the one-share-one-vote rule.
- Improving the structure of companies' decision-making voting systems.
- Intervening directly in markets that allow a separation of the economic returns of shares from their voting rights.

These measures aim to influence a number of aspects and are not mutually exclusive.

4 Conclusions

The emergence of complex financial derivatives and securities lending has given investors the possibility of separating the economic ownership of shares from their voting rights. However, it has only been in recent years that investors have appeared with the investment strategy of obtaining profitability by influencing the governance of the companies in which they are shareholders. These investors, in many cases hedge funds, have used both financial derivatives and securities lending in order to achieve the following: (i) positions in which economic ownership and voting rights are separated from the principle of one share one vote; and (ii) that these positions are hidden and not in the public domain.

The appearance of this new kind of investor has brought with it both positive and negative consequences for the rest of investors. At times, the influence of these shareholders on the board of directors and on other shareholders has resulted in decisions being taken by the company that have benefited them but harmed the rest. However, the existence of this kind of investor has also strengthened the control exercised by shareholders over company directors, reducing agency problems. In addition, given the characteristics of such investors, their direct or indirect control over company directors may tend to strengthen the preference in companies for short-term results over long-term ones. This would make companies short-sighted, with the consequent harm to shareholders.

Royal Decree 1362/2007 of 19 October was passed as a response to this demand for greater transparency. It lowered the minimum threshold for disclosure for shareholders who are not directors to 3%. In addition, it makes these investors communicate their positions in any derivative as long as it means that their voting position is above or below the threshold of 3% and all the multiples of 5%. Shareholders who are directors now also have to disclose their position in terms of the voting rights they own.

In the light of the new information that the recent reform of the register of major shareholdings could provide through Royal Decree 1362/2007 of 19 October, more intensive regulatory actions could be considered in the future. Additional measures that have been proposed in the literature include a profound reform of the register of major holdings, or the increase in quarterly information submitted by the CIS to their participants.

Beyond the increase in transparency, the regulator may in the future intervene in the current structure of companies' decision-making voting systems. Nevertheless, this kind of action would only be justified if significant additional evidence was obtained that the separation between economic and voting rights led to adverse effects on shareholders as a whole.

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III International Reports

European initiatives in clearing and settlement

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1 Introduction

The European post-trade industry exhibits a high degree of fragmentation. And while there is widespread consensus that clearing and settlement systems are reasonably cost efficient at the national level, this is not the case with cross-border transactions, especially in equity instruments where trading is still concentrated in regulated markets.

It is also widely acknowledged that the inefficiency of post-trade service provision in the European Union (EU) is a major stumbling block on the way to the integration and consolidation of European securities markets.

The European Commission (EC) has so far taken the view that improving competition in these activities can largely be left to the industry itself, with no need to adopt specific harmonising rules. But it has also recently launched a number of initiatives, some of them still at the development stage, to try and steer them in the right direction. Other public authorities have also been taking steps to increase the standardisation of clearing, settlement and registration practices.

This article offers an overview of the current situation of post-trade services in the EU, while evaluating some of the initiatives now underway to enhance their performance and facilitate industry integration in Europe.

Its text is structured as follows: section two below provides a brief description of post-trade activities, focusing on their characteristics, the main institutions responsible for their delivery and the applicable EU legal framework. Section three looks at the initiatives set in train by the EC, starting with the Markets in Financial Instruments Directive (MiFID), which establishes some free choice with regard to clearing and settlement service providers. This is followed by a discussion on the progress made in removing barriers to efficiency in cross-border transaction settlements under the coordinating eye of the CESAME Group, and a review of the content and first results of the commitments taken on through the Code of Conduct. Section four is given over to the work being done by the ESCB-CESR Working Group¹ to draw up a set of standards for securities clearing and settlement systems. Although this initiative has been parked for the moment, it is worth discussing in the scope of this article since it may shortly resume its activity under growing pressure from the EC and the European Central Bank (ECB).

Developments in the TARGET2-Securities project (T2S) launched by the ECB are subjected to comment in section five. Finally, the article closes with some reflections on the changes these novelties could produce, together and separately,

¹ ESCB and CESR are the acronyms of the European System of Central Banks and the Committee of European Securities Regulators.

in the industry and its supervision, and an analysis of some shortcomings and risks in the strategy being followed by the public authorities, which has so far leaned to the side of self-regulation.

2 Characteristics of securities registration, clearing and settlement infrastructures. The harmonised legal framework

Securities market infrastructures comprise Central Securities Depositories (CSDs), International Central Securities Depositories (ICSDs) and Central Counterparties (CCPs). These organisations provide the bulk of services along the post-trade value chain, from clearing and settlement through to registration.

CSDs guarantee the integrity of central securities registers, keep the securities accounts of participants, handle clearing and settlement via the book-entry transfer of securities, and reconcile the securities positions that the system recognises and records in the name of its participants with the positions the latter carry in their books on behalf of their clients. These are all considered basic functions of securities clearing, settlement and registration. At times CSDs may offer supplementary, value-added services like the exercise of shareholder economic and voting rights and/or securities or cash lending.

ICSDs (Euroclear Bank and Clearstream Banking Luxembourg) specialise in post-trade services for Eurobonds and other internationally traded securities, corresponding in the main to fixed-income instruments. They perform functions similar to CSDs, but without exercising control over the integrity of securities issues, most of which are registered with both ICSDs.

A CCP has the principal function of clearing transactions by interposing itself as buyer to the sellers of securities and as seller to the buyers. What it does, in other words, is relieve participants of counterparty risk, while simplifying CSD and ICSD settlement and guaranteeing the performance of netted transactions.

In the main, post-trade infrastructures work to two business models incorporating different levels of global risk. At one extreme we have the traditional model, heavily regulated in national law, which confines CSDs to the core activities of ultimate settlement and registration of securities and expressly prohibits the taking of risks like those inherent to securities or cash lending. This is the model currently governing the activity of Iberclear.

In other cases, national regulations allow central securities depositories to act on their own account, and offer bank-style services (whether or not they hold a banking licence) that are subject to credit risk. The two ICSDs are the clearest exponent of this model in that they offer their participants cash or securities loans that are not wholly collateralised.

Credit institutions and investment firms also offer certain post-trade services, like the maintenance of customers' securities records (indirect holdings) or their book clearing and settlement, which must always be validated, by netting in most cases, in the central settlement systems of CSDs. Given this auxiliary role, they are classed as industry intermediaries and not as a part of its infrastructure.

The consolidation and integration of post-trade services in Europe is viewed as fairly advanced in the case of fixed-income instruments, which tend to be bilaterally traded OTC with settlement handled by the two ICSDs. Equity trades, meantime, are basically settled through national CSDs, with each security specialised in a single CSD handling both domestic and cross-border activity. This arrangement is seen as largely unsatisfactory from a competition standpoint.

Settlement of domestic trades is considered reasonably efficient on the whole. Conversely, cross-border transactions have to be cleared and settled through a specific CSD, which brings in a series of intermediaries, basically global and local custodians, and pushes up the price of services, with sizeable differences across the length of the chain. This situation is widely attributed to a competition deficit in these activities.

The payment systems used in securities settlement are likewise highly integrated, thanks to the single currency and the utilisation of the TARGET² large-value payments settlement system, with a decentralised structure linking up 15 national real-time gross settlement systems and the payment mechanism of the European Central Bank. The new TARGET2, due for start-up in February 2008, will offer participants more versatility, and allow them to tighten their cash management by pooling liquidity in a single cash account that serves for all of Europe.

The EC's Internal Market DG has centred its efforts on market regulation, in order to speed up financial integration, and has preferred, for the moment, to promote self-regulation in the post-trade arena.

In effect, to find specific EU norms on clearing and settlement we have to go back to Directives 98/26/EC, on Settlement Finality in Payment and Securities Settlement Systems, and 2002/47/EC on Financial Collateral Arrangements.

More recently, Directive 2004/39/EC on Markets in Financial Instruments (MiFID) included a number of articles prescribing freedom of access to clearing and settlement systems and CCPs. This was a response, albeit partial only, to the Resolution of the European Parliament of January 2003, which called on the EC to draft a specific Directive regulating a common framework for clearing and settlement activities.

² Acronym of Trans-European Automated Real-time Gross Settlement Express Transfer System. The system works to the principle of minimum harmonisation.

3 European Commission initiatives

The increase in cross-border transactions plus the observed inefficiency of their clearing and settlement are a cause of growing concern for the public authorities.

The EC's prize objective is to complete the integration of the European financial space. And it sees the coordinated involvement of the private sector and public authorities as the best way to move towards an efficient, secure and integrated post-trade environment. Initiatives to date have staked on self-regulation (removal of barriers to efficiency in cross-border settlement, Code of Conduct), with harmonising legal action (MiFID) very much in second place.

The idea is that this combination of public and private measures will drive a greater degree of competition and transparency in clearing and settlement services, and help correct the inefficiencies detected.

3.1 Directive on Markets in Financial Instruments (MiFID)

Enacted in April 2004 and in force since 1 November 2007, the text gives legal backing to the removal of exchange concentration rules and some limited rights of choice regarding clearing and settlement service providers, from the standpoint always of regulated markets and multilateral trading facilities (MTFs), and their participants (investment firms).

Article 34 authorises investment firms to access CCP and clearing and settlement facilities based in other Member States, for the purpose of finalising their transactions.

Article 35 stipulates that investment firms and MTF operators may enter into arrangements with a CCP or settlement system in another Member State, with a view to providing for the clearing and/or settlement of some or all transactions concluded in their respective trading systems.

Article 46 gives regulated markets the right to enter into appropriate arrangements with a CCP or settlement system in another Member State to conduct the clearing or settlement of some or all trades concluded by market participants under their systems.

The exercise of these rights is predicated on the prior consent of the competent authority of the regulated market, MTF or investment firm, which may deny permission whenever the access requested, whether inward to domestic systems or outward to those of other Member States, could demonstrably impair the smooth, orderly functioning of the venue in question. Likewise, CSDs or CCPs requested to provide services can refuse to do so for legitimate commercial reasons.

The possibilities for cross-border access to settlement systems envisaged in the MiFID are difficult to put into practice, because they depend on the existence of system linkages³. Also their scope is limited, in that they extend no choice to CSDs and CCPs wishing to access other CSDs or CCPs or transaction feeds from trading venues.

³ At present, inter-CSD links lack any capacity to deliver against payment, confining themselves to the transfer of payment-free securities. Only the two ICSDs have a connection supporting delivery versus payment.

3.2 Identification and removal of legal, fiscal and technical barriers

In order to speed up the process of financial integration, the EC commissioned a series of evaluation studies on the efficiency of post-trade services in cross-border transactions within the EU⁴. The results were eloquent as regards system inefficiency with a number of barriers detected to effective competition.

The EC opted to combat this situation by means of a three-pronged strategy⁵. It set up the CESAME Group (Clearing and Settlement Advisory and Monitoring Expert Group), with a remit to coordinate the chosen strategy, and to oversee the elimination of technical and market practice barriers. At the same time, it urged the private sector to get actively involved through the ECSDA⁶.

It also created FISCO (Fiscal Compliance Group), to remove the barriers arising from the different fiscal regimes in place, and the Legal Certainty Group, whose job was to study, diagnose and decide the right strategy for overcoming barriers of a legal nature.

For the moment, the industry has agreed to eliminate national differences in the IT and interfaces used by clearing and settlement providers via the rollout of the new SWIFT Common Communication Protocol⁷. The enforcement of this agreement will be monitored by specifying milestones per infrastructure (in terms of the number of processes covered by messages compatible with the new protocol), which must be met before the deadline date of March 2011. Operators have also agreed to use ISIN codes to identify securities and to adopt standards conducive to a greater degree of settlement finality. The obstacles entailed by the lack of harmonised legal support for bilateral netting agreements and use of collateral are deemed to be overcome now Directive 2002/47/EC on Financial Collateral Arrangements has been transposed to all jurisdictions.

3.3 The Code of Conduct

In his speech of 11 July 2006 to the members of the European Parliament's Economic and Monetary Affairs Committee, Commissioner McCreevy summed up the EC's main lines of action in the clearing and settlement area.

He announced the bringing forward of measures to remove the technical or market practice barriers identified in the Giovannini Reports, to be steered by the CESAME Group since his own mandate ends in mid 2008.

He also told the Committee that the industry was willing to conclude an agreement to strengthen transparency, interoperability and competition within the sector. This commitment would hasten the integration of clearing and settlement systems and allow users a choice of provider. The agreement would be written up as a Code of Conduct (CoC) setting out guidelines for action and timetabling the objectives stated.

4 The Giovannini Reports.

5 Established by two Communications to the European Council and Parliament: "Clearing and Settlement in the European Union. Main policy issues and future challenges" and "Clearing and Settlement in the European Union – The way forward", in May 2002 and April 2004 respectively.

6 Acronym of the European Central Securities Depository Association.

7 The Society for World Interbank Financial Telecommunication provides secure messaging services for interbank communications which are widely used in currency, money and securities markets for confirmations and payments.

The CoC was published on 7 November 2006 and lays down three action lines to secure greater transparency and comparability in prices, to facilitate access and interoperability between trading venues, CSDs and CCPs, and to introduce accounting separation and service unbundling in each branch of activity.

The EC has established a Monitoring Group (MOG) under its own chairmanship for CoC implementation and compliance, attended by representatives of the Internal Market and Services, Economic and Financial Affairs and Competition directorates, as well as from the ECB and CESR. Infrastructure users and providers also have representation on the Group.

Among the functions of the MOG is to liaise between the authorities and national regulators, CESAME and CoC signatories in order to verify compliance with Code commitments to keep separate accounts by branch of activity and unbundle the prices and costs of each service offered.

Initially, the CoC will only apply to cash equities, without ruling out its future extension to fixed income and derivative products.

This extension of the Code's reach is conditioned in part on the effectiveness of current initiatives to enhance the transparency of other marketable instruments (possible application of MiFID disclosure requirements to fixed income and derivative products).

The Code has been signed by all the CSDs affiliated to ECSDA, the CCPs grouped in EACH⁸ and exchanges belonging to FESE⁹, including some institutions from non-EU countries.

3.3.1 Price transparency and comparability

The signatories first of all undertake to post an itemised price list on their websites complete with a brief description of each service offered, as an aid to user comparison. This measure has been applied as of 31 December 2006, though work is proceeding to improve certain aspects relative to discount schemes, price examples and billing reconcilability.

3.3.2 Access and interoperability between markets, CSDs and CCPs

Secondly, the CoC stipulates terms and procedures to assure users effective system access rights under transparent, non-discriminatory conditions, in order to move towards the interoperability of trading platforms, central counterparties and central securities settlement systems. The implementation deadline in this case was 30 June 2007.

The CoC upholds the rights of CCPs and CSDs to access other CCPs, CSDs and market feeds; the rights of CSDs to access CCP feeds and, finally, that of trading venues to access CSDs and CCPs for the purposes of clearing and settling

⁸ Acronym of the European Association of Clearing Houses.

⁹ Acronym of the Federation of European Securities Exchanges.

transactions. This in effect means that CSDs and CCPs get the same right of choice of clearing and settlement venue as MiFID articles 34, 35 and 46 grant to investment firms, regulated markets and MTFs.

This access can be of three types¹⁰: that of CSDs or CCPs as participants in other CSDs or CCPs (standard unilateral access), access as participants requesting certain additional services to specification (customised unilateral access) or the access of a CSD or CCPs to another organisation's transaction feed.

Interoperability is understood as any advanced relationship among organisations such that one party is not generally connected to another's standard service offering, but instead agrees to establish customised functions. Organisations entering into interoperability agreements should be prepared to make the appropriate technical developments. Among the goals of interoperability is that each user can select different providers for each service.

Access requests will follow a publicly available process, and may only be turned down on the grounds of risk-related criteria or by making a legitimate business case, along the lines established by the MiFID for freedom of access. Refusals should accordingly be notified in writing to the requesting organisation with a reasoned explanation. In the event of discrepancies, mediation mechanisms will be brought into play. Requesting organisations should in any case comply with the legal, fiscal and regulatory arrangements applicable to the receiving organisation.

Access and interoperability requests processed to 8 October 2007 were confined in all cases to fixed income instruments.

The majority of requests originate from CCPs belonging to the largest corporate groups in the European securities industry. Specifically, British CCP LCH.Clearnet Ltd has requested access to the feed of Virt-x, the Swiss international trading platform for leading European equities, to the Swiss CSD and CCP, and to the transaction feed of the United Kingdom CSD. The CCP of the Euronext Group, LCH.Clearnet S.A., has applied for access to the CSDs and feeds of Belgium, France, the Netherlands and Portugal. Swiss CCP SIS x-clear has likewise requested access to the feed of Virt-x, while Eurex Clearing, the CCP for German bonds, has requested access to the German feed and CSD.

Remaining applications were made by the two ICSDs, seeking access to German CSD Clearstream Banking Frankfurt, and by the latter organisation, which has requested access to Belgian, French, Dutch and Swiss CSDs and the feed of the German CCP.

The progress of acceptance procedures for these applications reveals the diversity of applicable legal frameworks operating in the European Union. In Germany, for instance, CCPs must be legally configured as banks, meaning any CCP wishing to access their infrastructure is obliged to first change its corporate form. In Finland, meantime, central counterparty activity is legally confined to Finnish CCPs. And nor are supervisory responsibilities uniformly distributed. In some countries, the supervision of clearing and settlement is entrusted to the central

¹⁰For full details, see the Access and Interoperability Guideline published by EACH, FESE and ECSDA on 28 June 2007.

bank, along with exclusive oversight of CCPs, while in others these same functions are shared with the securities regulator.

3.3.3 Accounting separation and service unbundling

Thirdly, as of 1 January 2008, CoC signatories belonging to groups with an integrated offering must prepare separate accounts and itemise the prices and costs of the different services they offer (unbundling). The idea is to foster competition by disclosing the relationship between the revenues and costs of each service, to detect possible cross-subsidies between services and to allow users to select only the services they want to buy.

The services of trading venues, CSDs and CCPs will be individually presented, differentiating between the provision of book-entry securities accounts, clearing and settlement, credit provision, securities lending and collateral management. This unbundling will mean clients can choose a particular service without having to buy the full package off the same provider. Each service will be available at the corresponding listed price.

Special offers are allowed for groups of services, providing they are also for sale separately at their unbundled price. Also, the prices of such offers should be transparent and published as specified in the first section of the CoC.

All groups owning one or more trading venues, CSDs or CCPs should present annual accounts separately when required to by their national regulators. Organisations which have a separate corporate structure offering clearing and settlement must also disclose the revenues and costs of each service on a separate basis at the request, likewise, of national regulators, in order to bring to light any cross-subsidies.

Signatories will make an annual self-assessment of their compliance with this part of the CoC and will commission its verification from an external auditor. The corresponding reports will be available for inspection by the competent regulator; the first being filed on the signatory's own motion and the second on demand from the regulator, although signatories are willing to send both without request. The first assessment will be made on 1 January 2008, referring back to 2007.

The signatories have so far failed to harmonise the criteria and procedures to be used in drafting these statements, so there is no guarantee that cross-subsidies will be detected as envisaged in the CoC.

Other points pending definition are the role to be played by regulators affiliated to the CESR and how much of the content of assessments they can pass on the MOG, given the risk of moral hazard arising from legal restrictions regarding the confidentiality of this information and the absence of any legal basis for their engaging in such activities. Solutions will also have to be found so the regulators of non-EU signatories to the CoC can participate in the verification process.

4 ESCB-CESR Joint Working Group on Clearing and Settlement

On 25 October 2001, the European System of Central Banks (ESCB) and the Committee of European Securities regulators (CESR) agreed to form a Working Group to develop a clear and equitable regulatory and supervisory framework for securities clearing and settlement within the EU. This framework would comprise a set of standards to be met by EU securities clearing and settlement facilities. The starting point would be the CPSS-IOSCO¹¹ recommendations published in November 2001, which would be strengthened for application in the EU context and converted into standards, i.e., with a higher reputation cost in the event of non compliance.

The goals of these standards would be to improve financial stability by reducing systemic risk, to create a balanced regulatory framework at a reasonable cost and with only a limited impact on market infrastructure, to enhance the safety, soundness and efficiency of clearing and settlement systems by defining appropriate conditions to reduce the risk of their activities, and to promote and sustain the integration of EU markets by means of more competitive structures and strong, reliable rules that can build confidence in the system while strengthening investor safeguards.

It was decided that standards should take a functional approach, i.e., applying to all relevant functions across the securities clearing and settlement chain. They would also address all organisations at the point of delivery, whatever their legal status. Although they do not have the rank of Community law, regulators and supervisors have agreed to bring them within their assessment frameworks and monitor their implementation and compliance. In this way, it was felt, they could take the place of a harmonised EU legal framework, even though in some cases complying with standards would require changes in national legislation calling on the intervention of the public authorities¹².

The standards document was published in September 2004¹³. The final text included custodian banks within its ambit, while leaving some major questions unaddressed; among them, the status to be accorded to CSDs, the mandatory collateralisation of exposures for intraday credit and the articulation of a coordinated supervision structure.

The ESCB-CESR group analysed these and other questions throughout 2005 together with the European Committee of Banking Supervisors, which agreed to oversee and supervise the intraday financing risk carried by organisations with bank status. However no agreement could be reached. Among the most controversial points was the scope of application. The inclusion of custodian banks and ICSDs, all of them organisations with bank status, was seen by some as a potential dual regulation, on top of the prudential rules applied to credit institutions under the Basle II framework.

¹¹Committee on Payment and Settlement Systems and International Organisation of Securities Commissions respectively.

¹²In the midst of the drafting of the standards the EC decided not to heed the European Parliament's request for a specific clearing and settlement Directive. The standards probably contributed to this decision, on the grounds that they could go a long way to harmonising supervision practices and improving the management of system risk.

¹³"Standards for Securities Clearing and Settlement in the EU".

The standards for collateralisation of credit risks, including those associated to intraday financing, were another bone of contention, especially with the supervisory jurisdictions of the ICSDs, who refused to accept the full collateralisation of open positions. Discrepancies also arose about how to define the basic functions of a CSD and the value-added services they are able to perform, evidencing yet again the diversity of national legal frameworks operating in the EU area. Settlement with central bank money was another controversial proposition, which met with the opposition of ICSD jurisdictions. Nor was agreement forthcoming on certain aspects of coordinated system supervision.

In 2007, a number of institutions called for the ESCB-CESR Group to resume its work on setting definitive clearing and settlement standards. First to raise its voice was the EC, which is now recommending that standards take an institutional approach and should be mandatory for ICSDs, though not so custodian banks whose risks it considers adequately addressed by Basle II. This would enhance the safety of the post-trade industry, reducing the risks inherent to its activities. In this respect, standards would complement the access and interoperability commitments envisaged in the CoC, while providing securities regulators with a homogeneous framework for overseeing compliance with MiFID articles 34, 35 and 46. If the decision, eventually, is to apply them solely to CSDs and ICSDs, their scope of application will exactly mirror the CoC's.

The ECB is also strongly in favour of getting the standards document completed, agreed and into circulation, because a harmonised European framework for clearing and settlement would be a great help to the T2S project. In particular, standard 18 dealing with regulation, supervision and oversight would be a useful starting point for constructing a system supervision and oversight model based on coordination between the competent authorities, with positive externalities for the supervisory function and the future governance structure of T2S.

In the CESR, opinions are divided about the value of reviving the project. The Committee has however called for closer coordination between clearing and settlement supervisors to cope with the growing number of cross-border transactions, and is also keen to see more progress in harmonising system supervision and oversight practices. Although the authorities in countries where Euroclear operates already have some experience of coordinated supervision, the mounting number of access and interoperability requests means more work will be needed in this direction.

Most of the regulators belonging to the CESR advocate a specific legal text for clearing and settlement in the form of a Directive or Regulation; in particular, one that will define and harmonise acceptable levels of risk and the corresponding collateral arrangements. However there is considerably less consensus around the exact content of its clauses or the range of activities permissible to post-trade infrastructures.

For the moment, CESR has created a new Post Trading Experts Group, whose functions include advising CESR, as a member of MOG, about the role securities regulators should play in controlling compliance with the Code of Conduct. The Committee is also preparing its participation in the T2S Advisory Group, which it will attend as an observer with particular interest in the project's legal implications and potential impact on the industry.

5 TARGET2-Securities¹⁴

In July 2006, the ECB's Governing Council (GC) announced the opening of discussions on the set-up of a single platform for settling securities transactions in central bank money, to be operated by the Eurosystem within the new TARGET2 payment system. Such a project, it was felt, would help reduce the overall level of systemic risk affecting settlement activity in Europe.

The main goal of T2S is to provide the European securities industry with a single, harmonised platform for settling all trades, domestic and cross-border, with central bank money. This, in effect, would make the "cross-border" concept redundant for transactions between Member States. T2S will offer participants an efficient service, contributing to speed up integration while fostering competition in post-trade services. CSDs will continue to handle remaining post-trade functions, including custody and asset servicing.

T2S thus complements the EC's strategy of making post-trade services safer and more efficient within a framework that guarantees equal opportunities. As well as reducing industry fragmentation in Europe, partially at least, the project should bring down settlement costs while boosting efficiency.

CSDs can decide voluntarily whether to take part in T2S, and euro area depositories who opt out will still have an interface for settling transactions in central bank money. T2S will also be open to non-euro area CSDs, and will look further ahead, if the demand is there, at extending settlement services to currencies other than the euro. Besides complying with the terms of the CoC, it will have a governance structure that finds room for project participants, and will be adequately supervised and subject to competition law.

T2S will provide a simple alternative route to access and interoperability between trading venues, CSDs and CCPs, obviating the need to find bilateral solutions in each case as envisioned in the Code of Conduct. This should give a decisive push to the achievement of free choice of settlement venue, allowing participants to centralise their securities accounts at a single CSD for all European Union transactions.

Likewise, the participation of both securities regulators and central bankers in some form of coordinated oversight of the new system will help overcome the traditional conflicts of interest in the supervision of central bank-operated payment systems, thus giving the project added backing and credibility.

In this respect, the resumption of joint work by ESCB-CESR would augur well for the project's future.

¹⁴For more on this project, see Susana Núñez and Montserrat Jiménez's article in this issue of the CNMV Bulletin.

6 Closing remarks

The European initiatives discussed here, and their various complementarities, should do much to advance the cause of post-trade system efficiency by fostering competition in services and encouraging more integration among providers.

The approach taken, with its emphasis on self-regulation, has, however, certain limitations. The success of the combined rollout of these projects will hang very much on the good will and active collaboration of the industry. Also, this approach will tend to perpetuate the heterogeneity of the legal rules applying to post-trade activities in EU jurisdictions, including those that govern institutional aspects (qualifying conditions for service provision), applicable taxation and the degree of supervision to which they are subject.

Nor is the strategy informing these initiatives entirely free of risks. The decision not to impose standard conditions on all organisations providing post-trade services could place some of them at a competitive disadvantage. In fact, we cannot rule out the danger of these measures sparking a “race to the bottom” among Member States, with the subsequent relaxation of average regulatory standards. The combined action of initiatives may also affect the future configuration of the post-trade industry to the benefit of credit institutions; better placed to confront the risks entailed by value-added activities.

The European authorities should therefore remain attentive to outcomes, make sure the industry continues to operate within a balanced competition framework and, periodically, reassess the need to call on direct regulation if self-regulation is demonstrably not resolving market failures¹⁵.

In any case, the current situation is one of growing complexity for the supervisory function, which will have to adapt its practices and procedures to the changes taking place in transaction reporting, and to the fragmentation of equities trading that may ensue from the MiFID. Supervisors will have to deal with increasingly busy trading in both regulated markets and OTC, channelled through domestic or other EU investment firms, with no local establishment, and with clearing and settlement through the CCPs or CSDs of other jurisdictions in a risk environment foreseeably greater than today's. All this will demand an improvement drive in coordinated supervision and joint working which facilitates the rapid exchange of data, including ownership data, between EU authorities.

¹⁵The Spanish authorities have published their own report *Los sistemas de compensación, liquidación y registro de valores en Europa. Situación actual, proyectos en curso y recomendaciones* prepared jointly by the Comisión Nacional del Mercado de Valores and Banco de España. December 2007.

Target2-Securities

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1 Introduction

Since the beginnings of the European Union (EU), two objectives have marked the course of European public initiatives in the financial sphere. Firstly, the establishment of a single currency and, secondly, the completion of a single, EU-wide market in financial services. More specifically, the Lisbon European Council of March 2000 acknowledged the key role of efficient financial markets for Europe's long-term competitiveness and economic development: *“Efficient and transparent financial markets foster growth and employment by better allocation of capital and reducing its cost. They therefore play an essential role in fuelling new ideas, supporting entrepreneurial culture and promoting access to and use of new technologies. It is essential to exploit the potential of the euro to push forward the integration of EU financial markets. Furthermore, efficient risk capital markets play a major role in innovative high-growth SMEs and the creation of new and sustainable jobs.”*

Private and public initiatives of the last few years aimed at increasing competition between securities infrastructures have progressed only slowly and done little to further the integration of European financial markets. One of the key challenges in this respect is to overcome the fragmentation of securities market infrastructures. Market movements alone have proved insufficient, partly because these infrastructures operate as domestic monopolies, due to the nature of their activity¹ (natural monopolies) and the support they find in respective national regulations.

On the question of payment infrastructures, central banks have been working, with growing intensity since the advent of the euro, to put cash transfers in Europe on a sound, efficient footing with an even playing field for all participating organisations. At an initial stage, the Eurosystem created the TARGET real-time gross settlement system by linking up each national central bank's settlement system with all the rest. In other words, the first instinct was to opt for a decentralised architecture with harmonisation of the most crucial elements (RTGS², business hours, access conditions for intraday financing, etc.). Further ahead, with European financial institutions increasingly calling for more modern, harmonised payment systems that can address their needs in a cross-border environment, the Eurosystem began work on the second generation TARGET, a centralised payment system (TARGET₂) that entered operation in November 2007 and operationally combines the payment systems run by each central bank in a single technological platform, although legally there is still one system for each central bank. TARGET₂ (T₂) provides all participating organisations with the same services, functionalities and interfaces and a single price structure. It accordingly allows them to operate under the same conditions throughout Europe, fostering the efficiency and integration of financial markets. With the T₂ system, they can also centralise cash in a single account with the consequent advantages for liquidity management. T₂ also offers cash settlement

¹ Such as economies of scale and scope or network externalities.

² Real-time gross settlement.

services to other systems settling in central bank money³; among them retail payment systems, clearing houses and securities settlement systems.

It is against this backdrop of Eurosystem integration of settlement infrastructures, and given the number and diversity of models populating the European securities settlement industry, that the idea arose for TARGET2-Securities (T2S). This project, which the Eurosystem is offering to CSDs⁴, adopts an integration approach that more or less parallels that of the abovementioned T2. Hence just as T2 does for cash, the plan is to combine the settlement of all securities transactions in a single technological platform maintaining the securities accounts of CSDs. Further, in the interest of maximum efficiency and safety, the settlement of the two transfers, securities and cash, ensuing from each securities trade will be handled by the same platform. Participants will continue to hold cash accounts at central banks and their securities accounts with CSDs, while conserving their contractual and business relations with the latter. Both initiatives, T2 and T2S, are technical and operational tools that facilitate market integration and, as such, stand to contribute decisively to the completion of a single European financial market.

This article offers a run-through of the main lines of the T2S project with reference to its possible impact on the financial markets and financial system in general. The second section examines the background to the initiative, while the third goes into detail on the project itself, including certain technical and operational features. In the fourth section, we look at some of the benefits that could spring from the T2S initiative, following on in the fifth with a discussion of its possible implications for the Spanish market. Finally, our sixth section examines the progress to date of the T2S project and its likely future evolution.

2 Why T2S

The harmonisation and integration⁵ of securities market infrastructures (stock exchanges, trading platforms, central counterparties, CSDs, etc.) have progressed at different speeds in the trading and post-trade environment⁶ and, in the latter case at least, are clearly behind the requirements for a single financial market. In effect, trading infrastructures have embarked on a consolidation process⁷, both nationally and internationally, that extends beyond the purely European sphere. Stock exchange demutualisation⁸ technological development and European regulations aimed at liberalising the sector have prompted a wave of mergers and acquisitions. In some

3 Cash accounts that institutions hold at national central banks.

4 Central securities depositories.

5 Understood as the existence of a single set of operating rules, free access to services and the equitable treatment of all participants.

6 The post-trade environment takes in securities registration, clearing and settlement. The term post-trade infrastructures usually refers to central counterparties and domestic and international central securities depositories.

7 Through alliances, mergers and acquisitions.

8 Change in ownership structure and management whereby mutual associations formed by market members or users are transformed into financial companies whose owners/shareholders are not necessarily exchange users. In some cases, demutualisation is accompanied by the stock market listing of these companies' shares.

cases, this consolidation has involved same-service infrastructures, for example the merging of stock exchanges into a single group (horizontal concentration). In others, it has involved organisations operating at different stages of the securities transaction chain (vertical concentration) like, for instance, the merging of a stock exchange with a central counterparty and a central securities depository.

Among headline operations we can cite the merger of the New York Stock Exchange (NYSE) and the *Euronext* group in early 2007, the union of Scandinavian and Baltic exchanges within the new OMX Group, and the June 2007 merger between the London Stock Exchange (LSE) and Borsa Italiana; a product, in turn, of the vertical consolidation of Italy's trading, clearing and settlement infrastructures. The group *Deutsche Börse* (DB) is also the result of a primarily domestic round of vertical consolidation, though it also includes the international securities depository *Clearstream* (Luxembourg). Spain has not stood aloof, and its securities infrastructures too have been vertically consolidated within the *Bolsas y Mercados* (BME) holding company.

In the post-trade environment, integration has been less and by any standard insufficient. This is especially true of the securities settlement systems where integration is most needed. Some steps have been taken, but the industry is still mainly organised at a domestic level, with 18 central securities depositories operating in the euro area; each, as we state earlier, with the monopoly in its own country. Of the few international initiatives of note, we can single out *Euroclear's*, setup of a common settlement platform for all national CSDs belonging to the group. Another consolidation move was protagonised by the Scandinavian CSDs (NCSD Group), although, as with *Euroclear*, it was decided to keep national CSDs running separately. Finally we have the abovementioned integration within *Deutsche Börse* of the German CSD *Clearstream Banking Frankfurt* and the international securities depository *Clearstream* (Luxembourg).

One result of this fragmentation in the post-trade industry is that cross-border transactions within Europe are far more expensive than the strictly national equivalent. Among other reasons, because the purchase of securities deposited at non-national CSDs requires a long chain of intermediaries, adding considerably to the cost.

Further, the legal and fiscal framework and market practices differ from one EU country to another, and these differences can harden into entry barriers that put the brakes on competition.

The European authorities are aware of this situation and have attempted different types of remedies. A number of directives have been passed in recent years to speed up harmonisation and integration in financial sectors; chief among them the Directive on Settlement Finality in Payment and Securities Settlement Systems (1998/26/EC), the Directive on Financial Collateral Arrangements (2002/47/EC) and the Markets in Financial Instruments Directive (MiFID) (2004/39/EC)⁹. None of these texts deals in explicit depth with securities clearing and settlement matters, though the MiFID's article 34 seeks to reinforce the principle of free cross-border access to settlement facilities.

⁹ Formed by the CSDs of France, Belgium, the Netherlands and the United Kingdom plus international securities depository *Euroclear Bank*.

¹⁰ Transposed to Spanish legislation by Law 47/2007 of 19 December.

In 2006, the European Commission studied the possibility of drafting a specific Directive on clearing and settlement, in the wake of the Giovannini report¹¹, identifying barriers in the way to achieving a single EU securities market. Finally, however, the decision was to await the results of a newly launched Code of Conduct, sponsored by Commissioner McCreevy, which was just then being signed by the industry¹². This Code's ultimate aim is to boost competition in clearing and settlement activities and bring down the costs of cross-border securities transactions. The Code of Conduct includes a series of measures to enhance the transparency of service pricing, to facilitate access and interoperability¹³ between market infrastructures¹⁴, and to introduce accounting separation and service unbundling in each branch of activity. The goal, ultimately, is to facilitate free choice of provider as a spur to competition in the sector.

Europe's central bankers and, particularly, the Eurosystem have been following settlement initiatives in securities with keen interest, for a number of reasons. The first is their concern for the stability of the financial system, since these infrastructures can pose systemic risks due to the huge volumes they handle; mainly settled, furthermore, with central bank money (most euro-denominated securities trades are settled against the cash accounts held at central banks). In fact, the T2 large-value payment system could grind to a halt if a failure in securities settlement systems left participants without the cash to meet other payment obligations or securities to deliver as collateral in order to access central bank liquidity.

The second reason why sound, efficient securities settlement systems are so important for central banks is that they use them to execute monetary policy operations and for intraday financing of their counterparties. As such, integration is also a way to maximise the effectiveness of monetary policy transmission. Central bank credit operations must be fully collateralised with assets which, in most cases, are deposited in CSDs. And Eurosystem liquidity provision could be jeopardised by inefficiencies, errors or malfunctioning in the settlement process.

During the development phase of the T2 payment system, the Eurosystem surveyed all the domestic arrangements in place with respect to the interaction between euro-area payment and securities settlement systems. The technical solutions, based essentially on CSD requirements, had been hammered out at an earlier stage, though further ahead other considerations were factored into the analysis. Among them, the fragmentation affecting securities settlement in terms not only of operator numbers but also the diversity of models in use. Some of these, though passable initially in an isolated, purely local context, were unacceptable, if not unworkable, in a wider field, because, besides involving the delegation to private entities of basic central bank functions, they would undermine the goal of pooling liquidity so eagerly sought by T2 participants.

¹¹The first of these reports, published in November 2001, identifies fifteen obstacles or "barriers" to the existence of a single securities market in the European Union. The second, published in 2003, proposes concrete actions and priorities for removing the barriers defined in the first report, specifying a timetable in each case as well as the responsible organisation or authority.

¹²Represented by the Federation of European Stock Exchanges (FESE), the European Association of Clearing Houses (EACH) and the European Central Securities Depository Association (ECSDA).

¹³Interoperability refers to the establishment of operating links between infrastructures for the reporting and processing of participants' transactions.

¹⁴Including those between organisations of a different nature, e.g., between trading venues and central counterparties or between the latter and central securities depositories.

Nor was there any realistic market-led alternative for achieving integration in the terms stated by the Lisbon Council. Integration is far more important for settlement than for any other function in the securities transaction chain. So much so that if we view things exclusively from an operational or settlement risk standpoint, the best solution would be to concentrate all securities settlement in a single system or platform, so as to minimise delivery failures and, thereby, settlement risk. Taking this a step further, still in the context of risk management policy, we could say that, given the interdependencies between payment and securities systems, it is safer and more efficient to let the same platform handle securities and cash accounts. Among the advantages of this arrangement would be to facilitate and speed up delivery versus payment and credit provision by central banks, which could be practically automated in intraday transactions.

It was these considerations plus the fact that a platform of these characteristics (integrating securities and central bank money) cannot be managed by a private organisation that led the Eurosystem to study the possibility of developing a single cash and securities settlement platform (T2S). Users are receptive to this initiative to judge by the reactions garnered in the first market consultation. Obviously other European initiatives, like the MiFID and Code of Conduct, intended to favour the integration of securities markets and clearing and settlement systems, were also factors in the Eurosystem's decision. Indeed, the T2S project complements and reinforces the content of both these measures.

3 About T2S

The goal of T2S is to concentrate the settlement of securities transactions in euros¹⁵, with central bank money in a single, centralised platform maintaining both securities and cash accounts. T2S is a means to bring forward integration by establishing a basic technical infrastructure for the euro monetary area, shared by all clearing and settlement service providers (CSDs), that will operate under common rules and ensure participants equal access and an equitable treatment.

Like T2, the T2S technical platform will be owned and operationally managed by the Eurosystem, whose commitment to financial integrity and lack of economic self-interest ensures that a pan-European infrastructure of this kind can work to the benefit of all users. T2S, furthermore, will operate on a cost recovery rather than a profit-making basis.

The project will also harness synergies with T2 and other Eurosystem-run facilities. In order to maximise these synergies, T2S will be developed around the same platform as T2, bringing cash and securities accounts together. Transaction processing will enjoy the same standards of reliability and operational safety as T2, and will come with the same contingency and backup procedures, ensuring the resumption of activity and completion of settlement in cases of emergency.

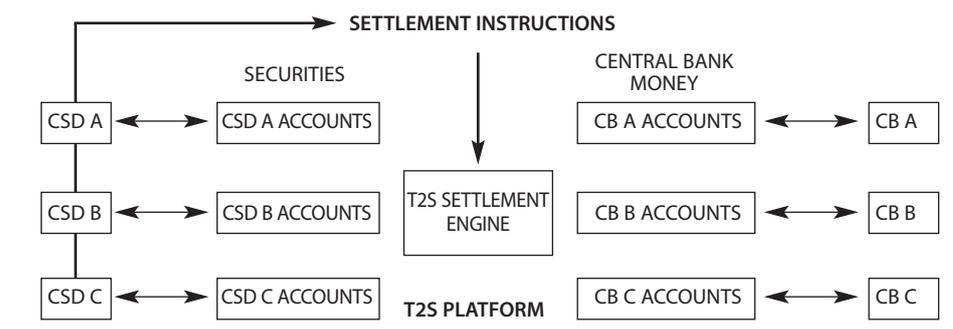
¹⁵T2S will also offer securities settlement services in other European currencies with central bank money, at the request of the market of the country in question and subject to authorisation from its central bank.

It should be stressed that this is a service being offered to CSDs with no pretensions to itself act as a depository. CSDs may delegate their settlement activities to T2S, but they will go on offering them to participants as part of the same range of services they provide today, including central registration, custody, administration, management of shareholder rights and the whole spectrum of value-added services. Also, since T2S is basically a technical support, CSDs will remain responsible for the day-to-day monitoring of the settlement process, as well as dealing directly and exclusively with customer enquiries and with any incidents that may arise. In other words, CSDs will perform the same functions as they do at present, conserving their legal and commercial relationship with participating organisations.

The settlement platform will adopt what is known as the integrated settlement model, meaning securities and cash accounts are run off the same platform. T2S will manage both kinds of accounts, facilitating improved mechanisms for managing liquidity and the assets pledged as security (collateral). In response to user demand, it is envisaged that the system will utilise “dedicated cash accounts”. The balance of these accounts will be used exclusively for the purpose of settling securities transactions and will draw on the total balance of institutions’ cash accounts in the T2 system.

An overview of T2S

FIGURE 1



Securities accounts, though housed on the platform, will continue to be carried (legally and contractually) by CSDs, which will retain control of their opening and closure, maintenance and update. Each of the securities accounts maintained on T2S must be assigned to a single CDS, and any transactions altering their balances will be entered on the T2S platform (primary and secondary market operations, etc.).

T2S will operate a database storing all such information on CSDs, T2S users, issues, securities and cash accounts and the currencies in which it settles as may be necessary for settling securities transactions. Each CSD will be responsible for updating its own information and, obviously, will have permanent access to the same, along with data on all transactions in the securities deposited in its accounts. T2S will provide different mechanisms for accessing this material and, again obviously, will facilitate member CSDs’ compliance with the supervisory and oversight functions legally commended to them, including their reporting requirements with the competent authorities.

T2S will perform only settlement services, understood as the series of processes an instruction goes through from the moment it enters the settlement system up to the point of final settlement. It will accordingly handle processes like the validation and matching of settlement instructions¹⁶ and all other lifecycle management functions up to the transfer of securities and cash.

The settlement platform will support all transactions closed on European markets (stock exchanges, trading platforms, OTC, etc.). T2S will allow participants a free choice of the trading venue where they purchase securities and the CSD where they keep them deposited.

All assets (securities) deposited in T2S member CSDs that are fungible, carry an international identification number (ISIN) and are represented by book entries will be settled on the T2S platform.

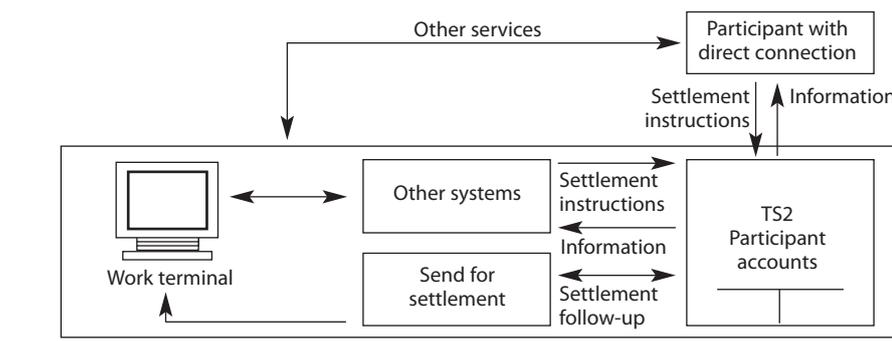
Functionally, T2S will provide gross real-time settlement of securities and cash under the convention of payment versus delivery and with harmonised business hours for all affiliated CSDs. The platform will also offer cash and securities optimisation mechanisms and facilitate “self collateralisation¹⁷”, regardless of the CSD and central bank where securities and cash accounts are held. The idea is for settlement services to be available day and night, as already occurs with certain CSDs, ensuring the earliest possible completion.

There are also plans for the platform to offer a centralised matching service for OTC trades. CSDs have argued against, considering this a value-added service over and above the settlement process. Participants, however, view matching as a prior requirement tied in with settlement and contend that its separation would be inefficient. They also see numerous advantages in having a centralised process. Finally, it has been agreed that all transactions between the participants of different CSDs should be matched on T2S, along with those of participants opting to connect direct to the platform, as we now go on to describe.

T2S will allow participants to connect directly to the platform, with the agreement of the corresponding CSD. This facility, of a purely technical nature, has met with heavy criticism from CSDs who see it as a way to sever their relations with their users. Participants, however, especially those that work with several CSDs, are adamant that T2S should offer this service, which would give them a single entry point for transaction reporting. T2S, finally, will give participants the option to connect directly to the platform, on the grounds that this is a purely technical matter that will neither interfere in CSD-participant relations nor push up project costs. What participants decide will depend on many factors. Among them, their preference for holding all securities with one or several CSDs, the range of value-added services that CSDs offer, the costs of direct and indirect connectivity, etc. It is therefore too early to speculate how many participants will end up connecting directly.

¹⁶Corresponding to OTC trades, i.e., those concluded outside trading systems, and those that are not cleared by central counterparties, which would enter T2S already matched.

¹⁷“Self collateralisation” refers to the extension of intraday credit via an automated process that allows the purchasers of securities immediate cash for the operation against assets eligible as collateral in the Eurosystem. Likewise, the seller of securities can recover assets pledged with the central bank against the cash raised from the sale, so they are available for delivery.



4 Potential benefits of T2S

There are many reasons to consider T2S an ambitious and broad-ranging project. It involves a large number of institutions, affects a wide spectrum of financial instruments and requires the management of numerous securities issues and transactions, and hence the processing of huge volumes of securities and cash. It is by no means easy to grasp and, above all, to measure the implications of this scale of project. However, studies done to date conclude that its start-up will bring major changes not just in securities settlement but the financial system as a whole, and further ahead will generate both economic and social benefits for the European economy.

A number of studies have compared settlement arrangements in Europe with those of the United States¹⁸, where the consolidation of market infrastructures dates back years. They all point up the costliness of cross-border transactions within Europe, due to the industry's extreme fragmentation, in comparison with the United States. Europe needs to be able to compete successfully against the U.S. and other leading world economies and T2S can help it to do so.

The basic objective of the T2S project is to ensure that cross-border settlement within its platform is as safe and efficient as domestic settlement with no differences in cost.

The system will gain in safety and efficiency because, as opposed to today's arrangements, T2S will allow cross-border transactions to be settled on the basis of delivery versus payment in central bank money, reducing principal and liquidity risk in a form comparable to national systems. Concentrating all securities and cash accounts on a single technical platform is a way to maximise operating efficiency across all domestic and cross-border transactions, since it will reduce the failure rate in securities deliveries and the corresponding cash payments while facilitating collateral and liquidity management.

¹⁸For example, see figure 7 providing an overview of clearing and settlement system cost studies, in Heiko Schmiedel and Andreas Schönenberger's article: "Integration of securities market infrastructures in the euro area", ECB, Occasional Paper Series no. 33/July 2005.

Centralisation of settlement activity on a single platform will also help harness the scale and network economies that characterise this kind of activity, lowering the settlement cost per transaction. The more users the platform has, the larger the number of transactions across which to spread the cost of technology and communications investments. Also, the dynamic whereby lower costs generate an increase in trading and therefore settlement volumes will lever additional per transaction savings.

Among the project's direct benefits will be the harmonisation of reporting protocols and operational procedures, with appreciable efficiency gains for organisations that participate in several CSDs. This harmonisation will facilitate participants' choice of CSD by making it easier and cheaper to switch between them. In sum, it will serve to enlarge competition between the providers of these services. This increased efficiency and competition will also do its bit to bring down costs.

T2S will obviate the need for multiple technical connections between CSDs, aiding compliance with one of the main clauses of the Code of Conduct signed by CSDs; that dealing with access and interoperability¹⁹. In securities transactions between participants of different CSDs, T2S will enter the securities in participants' accounts and proceed in real time to record the corresponding adjustments in inter-CSD accounts. In other words, T2S will provide the technical means for securities movements between the participants of different CSDs to be processed in the same way as if they belonged to the same CSD, fulfilling the interoperability requirement simply and at a lower cost. CSDs, meantime, will gain more opportunities to extend custody and administration services beyond their own securities to securities issued in other CSDs, potentially earning themselves more business. They can cease to operate at a purely domestic level and gradually transform themselves into international depositories.

Not only that, CSDs that may, due to size or other factors, be at risk of disappearing or being broken up in a merger or acquisition, could find in the T2S platform a way to maintain or even strengthen their business and competitiveness. T2S facilitates the co-existence of multiple CSDs competing with each other.

And despite the disintermediation risk implied by T2S, institutions with less international reach will find they can access a wider range of assets simply and more cheaply through their provider CSDs.

T2S will facilitate the cross-border management of collateral for CSD participants, which will not only give them more leeway in designing their business strategy but will also bring down their costs by centralising cash and securities on a single settlement platform. One possible option, depending on the service range of the CSD, would be for participants to keep all their securities in a single depository which would offer them the full complement of custody and value-added services. Participants would save money, because they would no longer need to call on different local custodians to access the securities of other CSDs, as well as managing their business more efficiently.

¹⁹This would mean CSDs being willing to establish agreements with others and to provide administration and custody services for securities they have not issued. Each CSD would have to draw up a list of the securities it was ready to accept.

Another option would be for participants to sign up with various CSDs, using T2S to settle all transactions on the securities deposited with each. They could also connect directly to T2S so as to operate a single communication interface with different CSDs with the consequent saving in connection costs. We can see then that T2S can assist entities in a number of ways to tighten up their management.

Finally, T2S will provide investment firms and trading venues (stock exchanges, multilateral trading facilities, etc.) with greater choice and ease of access to the different settlement systems (CSDs) running in the EU, along the lines envisaged by the MIFID. Trading venues, like central counterparties, can choose to access T2S directly to report transactions whichever CSD they belong to. Investors will gain access to a wider range of assets, allowing them to diversify portfolios at less than the current cost. The issuers of securities will foreseeably also benefit from T2S in the shape of easier access to a wider investor base. Also, lower portfolio diversification costs and improved market liquidity could help to bring down the cost of finance.

It must be stressed, however, that these potential benefits will only materialise if CSDs affiliate massively to T2S and existing barriers can be overcome. Although no one doubts the advantages of harmonised procedures, markets tend to feel that their own characteristics unite the best in safety and efficiency. It is true that such characteristics are frequently the product of their particular historical evolution, deriving from an ongoing improvement process informed by past experience and emerging needs. But if we wish to progress towards a single market, it is simply not possible to harmonise and, at the same time, conserve all these peculiarities in the selfsame platform. The result would be a complicated, costly system that would do nothing to solve the problems caused by fragmentation. For this reason, the plan is for T2S to basically offer harmonised services and procedures. CSDs will be free to cater for the singularities of each market, as warranted by its rules or user demands, providing they are willing to absorb the extra cost. It will be up to each market to decide if the benefits of maintaining such features outweigh the economic and, possibly, competitiveness costs, on top of the assurances that must be given regarding safety and financial stability. In any event, since T2S is unlikely to enter operation before the year 2013, it may be that such national idiosyncrasies will have vanished in the interim due to the harmonising impetus of this and other projects.

In conclusion, we can state as the three main benefits foreseeable from T2S: the harmonisation of settlement, making Europe a safer and more integrated market; the savings to users, in terms of collateral/liquidity needs and financing costs, of pooling cash and collateral on the same platform; and the alignment of cross-border settlement costs in Europe with those applying nationally.

5 Possible implications for the Spanish market

Spain is by no means indifferent to the public and private initiatives unfolding in Europe in the world of finance and, particularly, securities markets, encompassing both the trading and post-trade sectors. We need look no further than the large

number of Spanish agencies, institutions and organisations engaging in forums where such initiatives are being planned or implemented.

As regards T2S, the Spanish market has been actively involved in the first phase of the project. Representatives of Iberclear, credit institutions, Banco de España and market regulators and supervisors have participated in a number of the groups set up, including the consultation group, technical groups and the national users group. Banco de España is a key project player as a member of the Eurosystem and one of the four national central banks that have offered to develop the platform.

Two factors must be borne in mind when predicting T2S's impact on the Spanish market. Firstly, the effect of other European initiatives, notably those mentioned in preceding sections as complementary to T2S, i.e., the Markets in Financial Instruments Directive (MiFID), and the Code of Conduct sponsored by the European Commission and signed by the industry. And, secondly, the time frame envisaged for the project's development, i.e., the likely situation of the markets in the year 2013.

It seems fair to say that the impact of T2S on the Spanish market will be about the same in the long term as for other European markets. With T2S, Spanish investors will be able to diversify and internationalise their portfolios at a lower cost, while issuers will have easier opportunities to raise finance in other markets. Spanish institutions will no longer need to use local or global custodians to access international markets, since they can centralise settlement with T2S and hold their securities in a single CSD; most likely Iberclear, assuming that the Spanish depository will compete with other CSDs and even securities custodians by offering a wider, more international range of custody services. The result will be to considerably reduce the cost and complexity of cross-border trades for Spanish institutions. On the downside, those acting as local custodians in Spain could suffer some loss of business, though hopefully offset by the benefits T2S brings to the financial system as a whole.

In the short term, however, the impact will vary from one market to another, depending on their characteristics. In Spain, for instance, the trading and settlement of fixed income and equity securities follow very different routes.

Fixed income instruments are traded on a decentralised, bilateral basis, either participant to participant or via trading platforms. Transactions are settled in real time on a trade-by-trade basis through Iberclear²⁰ (using the CADE platform) by the method of gross settlement of securities and cash. It is likely that T2S will make less impression on the fixed income segment, because CADE is already patterned on the European model also envisaged for T2S. That said, T2S will harmonise not only settlement models but also other procedures which may, in some instances, differ from those in use at Iberclear.

Equities are a different story and, in theory at least, the impact of T2S could be further reaching. Trading is confined at present to a single, centralised, multilateral venue (the stock exchange), which settles exclusively on Iberclear (SCLV platform),

²⁰Iberclear manages two securities settlement platforms: CADE for public debt and private fixed income securities and SCLV for exchange-traded securities (shares, warrants, etc).

in processing cycles, on the basis of gross settlement of securities and net settlement of funds. In this case, not only does the settlement model differ from that proposed for T2S, but the market's operating rules and certain of its administrative procedures, supported on the principle of exchange-only trading and associated to the registration, clearing and settlement system, have highly specific characteristics which are a difficult fit with T2S. However, the same could be said of a number of measures in the MiFID and Code of Conduct which will have to be dealt with long before the scheduled start-up of T2S.

In any event, a solution is being prepared so T2S can handle transactions closed in multilateral trading without the intervention of a central counterparty. This would be a purely operational procedure with no need for added functionalities, so would have no cost to Iberclear beyond a deeper involvement in the operating process. Moreover, the entry to force of the MiFID and Code of Conduct could mark an end to exchange-only equities trading and settlement exclusively through Iberclear. Trading could well become bilateral before the advent of T2S, meaning Iberclear would have to take the opportune steps to align itself with the harmonised model.

Two other specificities of Spanish equities trading could be hard to square with the single market: the fact that trades are final at the point of closure and that all stock exchange sales must be assigned a registration code before they can proceed to settlement. Remember that, leaving aside the eventual existence of T2S, current legislation (the MiFID, already transposed into Spanish law) removes exchange concentration rules and, with the aid of self-regulation (Code of Conduct), enshrines free access to market infrastructures and participants' free choice of provider and services. So however well these specificities may have served the market in the past, they need to be reappraised in the European context: not just because they are incompatible with T2S, though this is certainly true to some extent, but because they impede equitable treatment, and thereby free competition, by means of rules and practices applicable as a function of the trading venue, settlement platform, the CSD used for registering, type of transaction, etc²¹.

The latest European initiatives, including T2S, call for a reflection on the role of the Spanish financial system in today's increasingly open and competitive environment, and the measures that can help it make the most of emerging opportunities. Spain, in short, cannot afford to miss out on the benefits of European integration.

6 The present and future of the T2S project

For the central banks, and remaining EU organisations and institutions, securities market integration is a vital question. For this and other reasons, in July 2006 the Governing Council of the ECB decided to assess the possibility of an integrating solution that would combine securities and cash settlement on a single technical platform.

²¹That said, although they should not condition settlement, these features, more specifically perhaps the registration codes requirement, evidence the need for legal harmonisation in Europe in what is a specially sensitive area.

In March 2007, the Governing Council concluded that the project was feasible as well as beneficial for the market, on the strength of the blueprint presented and a legal, operational, technical and financial feasibility study. Thus began the first phase of the project, given over to surveying user requirements with the aid of CSDs and their participating organisations.

It was decided at this point that the T2S platform should be developed and run by the Eurosystem on the basis of the T2 platform. This decision was published along with the names of the four national central banks (of Germany, Spain, France and Italy) prepared to develop and operate T2S. All four have ample experience in the design and management of payment settlement systems, and in some, though not all cases of securities too. Further, the German, French and Italian central banks are already providers of the centralised T2 system. For Banco de España, being part of this scale of project is a testing but ineludible challenge given the importance of the Spanish securities market in the euro area as a whole.

Work on this first phase of the project was conducted in close partnership with CSDs and their users, and under conditions of complete transparency. In the same spirit, all stakeholders in the process are represented in its organisational structure. The ECB also posts regularly updated T2S news and documents on its institutional website.

The governance structure established for this project phase envisages a number of decision-making levels, though with the final decision invariably reserved for the ECB Governing Council. An Advisory Group has been set up, reporting directly to the Council, formed by 77 representatives of central banks, CSDs, users and public- and private-sector observers. A further six technical groups report to this advisory body, each charged with drafting its own chapter on user requirements. The Committee for Payment and Securities Settlement Systems handles all matters relative to T2S within the Eurosystem and likewise reports direct to the Governing Council. In all, over 188 experts from more than 77 institutions have participated in the project, including all euro area CSDs and some 33 custodian banks. Additionally, 28 national groups (set up in each euro area country plus Denmark, Norway, the United Kingdom, Sweden and Switzerland) have responded to mini-consultations on technical points launched by the project's various technical groups, to tap the knowledge and experience of different markets while learning about their needs and market practices.

The result of these six months' work was a preliminary report on "user requirements". Following its approval by the Advisory Group, the Eurosystem launched a public consultation around the text, to run from December 2007 to 2 April 2008, enquiring also about the methodology to be used for economic analysis of the project. Plans are for the Advisory Group to meet in May to evaluate this feedback and propose a final version to the Governing Council. On the basis of this report, the Council will decide whether or not to embark on the second phase, the actual development of T2S.

The project has received wide market support in this initial phase, but it has also had its share of criticism, above all from CSDs. The main points contended have been the Eurosystem's powers to carry forward an initiative of this type, offering a service to private organisations that is already part of their commercial offering. In point of

fact, however, the functions legally attributed to the ECB and other central banks within the Eurosystem, and the fact that trades are settled against cash accounts held at central banks, which are interdependent with securities accounts, fully endorse what some have termed as public-sector interference in a private-sector activity. A similar query refers to the Eurosystem's capacity to simultaneously provide a service and be responsible for its oversight. But there are ways to prevent one activity from conflicting with the other; a case in point being the governance structure of T2, in which operational and oversight functions are clearly defined and separated.

For the moment, two items pending will receive special attention in the months ahead. One is the review of the cost/benefit analysis presented in the economic feasibility study, to include some important inputs still unquantified at the time of the preliminary version. Also, once user requirements are defined (with feedback from the current consultation round), it will be possible to carry out a more thoroughgoing economic study including, among other factors, the cost to central banks of T2S development, the changeover costs for CSDs and the savings they will harness with the platform on stream. Results should also include the average cost per transaction settled and the impact on public welfare.

Work will also continue on defining the project's governance structure in the development phase, which will logically lean more on the CSDs, and the content and wording of the contracts to be signed between the Eurosystem and CSDs as settlement service providers and users respectively.

T2S can only viably achieve its goals by building sufficient critical mass, and this means securing the involvement of the greatest possible number of CSDs. The ideal situation, of course, would be for all European CSDs to sign up for the platform, maximising settlement integration in Europe. But it must be admitted that, as we write, there is no assurance that this will happen. Some CSDs will presumably have their reservations, as did the national central banks when the idea of T2 was first floated. Here too the initial formulation was that the platform would be optional, though eventually all the central banks opted in. In making this decision, the first things CSDs will want to know, as clients, is whether the project will fulfil their needs. In other words, will they be able to ensure participants the same quality of service as they now provide directly. The survey of user requirements will go a long way to settling this doubt, thanks to the conscientious involvement of CSDs. Also, participants have expressed an interest in certain facilities that some central depositories do not currently offer, but which harmonisation via T2S will enable them to bring on board. Secondly, CSDs will want to know the contractual conditions in which the Eurosystem will deliver these services, with particular regard to the demarcation of responsibilities. In the third place, their decisions will depend on service costs and the breadth and quality of the technical support and functionalities provided by T2S, as well as on whether they can proceed to the total or partial dismantling of their own technical infrastructures, and at what price. Finally, CSDs will also need to consider how the project will benefit their participants.

The benefits of T2S will not be fully felt without a harmonising drive in other areas. The initiative in this case should come from the market itself and, above all, the public sector, which must hasten to remove the fiscal and legal barriers that still persist in Europe. Without such progress, T2S's achievements will inevitably be

small. The good news is that numerous groups, both public and private, are working in this direction. Within the ECB, the T2S team is looking for harmonisation weak points that might hold back the project. Likewise, the ECB's legal experts are studying national laws to spot possible hurdles in the way of T2S's development and the adaptation of its legal structure, proposing, where necessary, legal amendments and identifying areas that require more harmonisation.

7 Conclusions

The European authorities are aware that sound, efficient securities markets are a precondition for the single financial services market contemplated in the Lisbon agenda. In this context, the T2S project both complements and reinforces other measures like the MiFID and the Code of Conduct, with which it shares the goal of improving the services available to investors and securities issuers by means of increased competition between service providers. With the implementation of these three measures, participants will be able to buy and sell securities where they like, settle all transactions at a single point and keep their securities deposited at the CSD of their choice.

The Eurosystem is offering the market a common, neutral tool that will foster market integration and competition. Among the main benefits of T2S we can cite: the harmonisation of settlement procedures, taking Europe closer to a single market; improvement in the overall safety of the securities settlement system in Europe plus savings in collateral and liquidity for participating organisations; and the alignment of cross-border transaction costs with those of purely domestic operations.

T2S will bring changes in securities market settlement systems and in the business of participating organisations. It will open up new opportunities and boost competition between service providers.

This new step towards the completion of a European market will demand changes in operational and technical procedures, in national market practices and, in some cases, in national laws. Indeed one of T2S's foreseeable benefits is as a force for harmonisation and the removal of barriers in the way of market integration.

The Spanish market, like others in Europe, will have to work out how best to position itself in the future European scenario and to make the most of emerging opportunities. Leading these opportunities will be the implementation of the MiFID and the Code of Conduct and the rollout of a single settlement platform in 2013, whose combined effect will be to increase competition and reduce costs while favouring user choice and access and interoperability between market infrastructures.

The T2S project has enjoyed the overall support of both the market and EU institutions and agencies. CSDs have been more wary, frequently because they consider the platform a competitor, instead of seeing it as a shared tool, equitably available, that can yield them new opportunities in a more contested business landscape.

A project this ambitious demands a long-term impact study, because there is no denying that the costs of start-up will be considerable. This study should be accompanied by an analysis of the opportunity cost of not developing T2S. Could there be a viable alternative to T2S, comparable in efficiency, security and costs, with the same degree of neutrality for CSDs and their participants?

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IV Regulatory Novelties

Novelties in the MiFID in relation to investment services firms

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1 Introduction

The first cornerstone in construction of a single European market in the field of provision of investment services was Council Directive 93/22/EEC of 10 May 1993 on investment services in respect of negotiable securities (the Investment Services Directive - ISD).

The European panorama of securities markets, characterised by different levels of development in terms of securities markets and investment service providers, made a single legal framework necessary which would harmonise the different national legislations through regulation of such service providers.

The ISD created a common legal framework based on two basic pillars: firstly, the mutual recognition of supervisory authorities of Member States and, secondly, the European passport. The possibility for investment service providers (as from this legislation investment firms – IFs) to operate in a single European securities market pursuant to the authorisation granted by one Member State from a theoretical point of view gave effect to the principles of freedom of establishment and provision of services but, from a practical point of view, afforded important new business possibilities to IFs.

In just 32 articles the Directive regulated the conditions for access to the activities and practice of IFs. Undertakings authorised in accordance with these common criteria had the capacity to operate without restriction in EU countries without further procedures other than simple communication between supervisory authorities, and it is this communication process between authorities and relationship with third party countries which was regulated by the ISD in detail.

The ISD laid down requirements based on the principle of capacity by which the provision of investment services was conditional on having minimum own capital and resources, suitable shareholders, qualified management in terms of experience and integrity and an adequate organisational structure. It did not, however, define the principal parameters which an organisational structure had to comply with in order to be considered adequate.

Neither did it regulate other fundamental aspects of the provision of securities market investment services, such as the structure of securities markets or rules of conduct which IFs must comply with in providing services to third parties.

The ISD was transposed into the Spanish legal system by Act 37/1998 on Reform of the Securities Market Act, 24/1988 (SMA) and constituted the biggest legislative change with respect to Securities Dealers and Brokers and Portfolio Management Companies since publication of the SMA.

This Act, amongst others, introduced two liberalising elements which altered the structure of securities intermediaries in Spain. Firstly, the possibility for foreign IFs to gain access to the Spanish market pursuant to the passport by means of permanent establishments, in some cases gave rise to the restructuring of their presence in Spain, transferring the business and activities provided through securities brokers and dealers specifically formed for the purpose to such establishments. In addition, freedom of access to Spanish secondary markets as members by IFs and Credit Institutions authorised in other European Union countries was also the cause of the restructuring processes of financial groups which reorganised their presence in the Spanish securities market through a single entity¹.

Having established the basic scheme designed by the ISD in 1993, the evolution experienced by financial markets in recent years has given rise to a legislative reform of huge scale. An international context characterised by more efficient but also more complex markets to which a higher number of investors resort demanding increasingly sophisticated products and services with more cross-border activity, in a more harmonised European legislative framework than that existing before 1993, has led to a legislative development with a much broader regulatory scope.

Directive 2004/39/EC on markets in financial instruments (MiFID)² which came into force on 1 November last, and its subsidiary legislation, came about with a three-fold objective:

1 Extending the common legal framework:

- The MiFID is a Directive on markets in financial instruments, and therefore its scope of application is broader than that of the ISD which was limited to the provision of investment services. The development of new securities trading mechanisms outside regulated markets (multilateral trading facilities and systematic internalisation) makes it essential to harmonise and regulate the manner of operation of IFs in this context, establishing clear mechanisms for transparency in relation to both other markets or systems and their clients.
- The growing diversity and complexity of financial instruments (particularly in the field of derivatives) and the services demanded by investors make it necessary to extend the catalogue of financial instruments subject to the provisions of the Directive and to give new consideration to certain activities, which up to now were considered as complementary but whose growing importance and diffusion determines their consideration as investment services.
- An increasingly complex scenario requires a greater degree of investor protection. For this reason the MiFID for the first time at Community level deals with the harmonisation of rules of conduct.

¹ On evolution of the IF sector, see the article "*Evolución y características del sector de sociedades, agencias de valores y sociedades gestoras de carteras*" by Paloma Hernández Cienfuegos, published in the CNMV Bulletin for the first quarter of 2007.

² At the date of preparation of this article, publication is pending of the modification of the SMA which amongst others incorporates the MiFID and its subsidiary development. This modification was approved by the Spanish Congress on 13 December 2007.

2 Furthering the reforms already begun by the ISD:

The requirements governing authorisation and conditions for IFs to operate are defined with greater precision. An increasingly complex and sophisticated panorama in a European Union enlarged to 27 Member States makes it essential to enter in more depth into the definition and harmonisation of the structures of governance and control of IFs.

3 Resolving various deficiencies which have come to light in application of the ISD:

In short the MiFID clarifies the regime of supervision of IFs which operate in another Member State under the regime of free provision of services, allocating to the country of origin full supervision of the operations of authorised IFs. It also deals with regulation of agents tied to IFs, an aspect which, although announced in the ISD, was not effectively implemented as a result of lack of legislative development. This lacuna prevented IFs from exploiting the business possibilities offered by free provision of services to their full capacity.

This Directive is a broad and complex law which provides several novelties at European level and somewhat less at Spanish level, where the intensive legislative development which has taken place since publication of the SMA has already anticipated some of the principal aspects introduced by the Directive.

Since publication of the SMA in 1988, as well as transposition of the ISD by Act 37/1998 and its development by Royal Decree 867/2001 on the Legal Regime of Investment Services Undertakings, legislative developments have focused on regulation of rules of conduct to which IFs are subject in providing their services (Royal Decree 629/1993, of 3 March, on rules for operation in securities markets and mandatory registration and their subsidiary development), and definition of organisational requirements specially linked to control of the activities which these entities engage in (CNMV Circular 1/98, of 10 June, on internal control systems, ongoing risk assessment and monitoring).

Consequently, an initial conclusion is that many of the principles regulated for the first time by the MiFID at European level have already been incorporated to a greater or lesser extent into the Spanish legal system and are being applied by Spanish IFs. Some of them do not thus constitute a novelty as such, although the Directive does establish new requirements in relation to them which Spanish IFs will have to comply with.

In conclusion, the MiFID will, as with the ISD, constitute a substantial change in the panorama in which IFs operate. The intention of this article is to analyse the principal novelties for Spanish IFs and the effects which the new regulation could have for the national investment services industry. The remainder of the article is structured as follows: section 2 deals with novelties in the field of IF business, examining the consequences which may result, amongst others, from the extension of investment services and the financial instruments in relation to which IFs can operate, and section 3 will review the novelties in relation to the activities of these entities. Section 4 finally summarises the principal conclusions reached in the article.

2 Novelties in the business field

Annex I of the MiFID lists the services, activities and financial instruments which IFs can offer to their clients.

Compared with the catalogue offered by the ISD, the MiFID includes, as a new investment service, the management of multilateral trading facilities and classifies advice in the investment field as an investment service which the ISD considered a complementary activity. It also includes new financial instruments such as financial derivatives in raw materials, climatic variables, transport costs, emission authorisations and inflation rates, and financial contracts for difference.

2.1 Investment services

The MiFID eliminates the principle of concentration in securities markets and regulates the action of different trading centres (regulated markets, multilateral trading facilities and systematic internalisation), encouraging competition between them and introducing conditions to safeguard the integrity of the market as a whole.

In this context, Spanish IFs have the possibility of developing new areas of business acting as multilateral trading facility managers (the list of investment services under the MiFID is extended to include the management of multilateral trading facilities as a new service), or as systematic internalisers³ of client orders.

These activities are novel in the Spanish legal system and therefore it is difficult to assess the impact they will have on IFs as a whole. Nevertheless, development of these new areas of business will require that IFs create solid business organisations with human resources, operating and control procedures and in particular a heavy investment in technology, and therefore their success will depend on the creation of trading centres which are sufficiently attractive for investors enabling them to obtain adequate financial returns in relation to the investment made in financial resources. In this context the competition will have a particular influence which arises at national level with regulated markets, solidly established in the Spanish market, and at European level with IFs authorised in other Member States which benefit from the passport in order to provide these investment services in Spain.

The activity of advising in the investment field is given a different treatment in the MiFID and which, covered by both Directives is raised in status to investment service and undertakings which provide this service are made subject to authorisation. The third recital to the MiFID justifies this change: *“Due to the increasing dependence of investors on personal recommendations, it is appropriate to include the provision of investment advice as an investment service requiring authorisation”*.

³ IFs have traditionally acted as internalisers in certain markets, providing a counterparty against their own account for client orders. In order to be considered as such, the new activity requires that the execution of client orders against own account takes place in a systematic, orderly and frequent manner, and that certain requirements of transparency in trading, amongst others, are complied with.

Engaging in advisory activities in the investment field in Spain has been a scantily regulated activity and not subject to prior authorisation, the exercise of which has also not been subject to supervision. Apart from various references in Royal Decree 629/1993 which makes the activities of those engaged in activities of advice and dissemination of information subject to the general code of conduct contained in the annex to this legislation, this activity has been unrestricted.

Advice in the investment field for IFs which have incorporated this into their activity programme as a complement to the investment services which they provide has had a different treatment. In these cases, authorised IFs have complied with the requirements as to resources and qualifications for activities included in their activity programme and have been subject to supervision in these activities. Furthermore, Spanish IFs have benefited from the possibility of ancillary activities (including advice) in instruments other than those described in the legislation.

From the point of view of Spanish financial intermediaries, IFs already authorised to provide this service will have to adapt their procedures to the new requirements (including rules of conduct) which are laid down in this respect and undertakings which engage in this activity without a licence will have to obtain the corresponding authorisation, likewise adapting their structures to the requirements of the legislation. It is not consequently expected that “regularisation” of the sector will give rise to a substantial change in terms of competition to the current panorama.

The legislation will clarify a scope of activities in which for a long time IFs subject to compliance with multiple requirements (organisational, transparency, supervisor information, etc.) have coexisted with undertakings not subject to them. The levelling of requirements will in short bring about a levelling in operating costs such that this investment service will be provided under equality of conditions.

Nevertheless the effect of the said “regularisation” will depend on the conditions for authorisation and exercise laid down by the legislation. The establishment of requirements which in practice constitute an entry barrier to the IF sector will firstly restrict access solely to those undertakings which have more solid financial and operating structures, and furthermore require some entities to redefine the strategy of their business. It is possible that some entities for which advice constitutes a complementary activity to their principal business will decide to abandon this service, and therefore there could be a transfer of advised clients to regulated entities.

A further question which can be examined is the effect which the European passport will have in relation to this activity at national level. As already mentioned, freedom of establishment has affected domestic and foreign entities and therefore the benefit of the passport will have an effect in those countries which imposed restrictions on the free provision of this activity beyond their borders.

The existence of requirements for authorisation and engaging in advisory activities in the investment field will in any event be of clear benefit to clients advised: firstly, because their advisers will have to demonstrate qualification to

provide the service and their activities will be subject to supervision by the CNMV, and furthermore because greater competition will without doubt improve the quality of the service provided.

2.2 Financial instruments

In recent years the financial sector has been characterised by the development of new financial instruments. The need to meet new investor requirements in a changing global economic environment, the evolution and improvement of risk measurement systems and enhanced financial culture and experience of investors has led to the provision of increasingly sophisticated financial instruments.

In response to this trend, the MiFID states in Recital 4 that *“It is appropriate to include in the list of financial instruments certain commodity derivatives and others which are constituted and traded in such a manner as to give rise to regulatory issues comparable to traditional financial instruments”* and in Annex 1 includes new financial instruments not covered by the previous ISD.

This will without doubt constitute a major novelty in the European system, but is not so novel at Spanish level where legislation has provided for a broader supply of financial instruments than those under the ISD, and in some instruments close to the MiFID.

As well as traditional products, Royal Decree 867/2001 makes provision in subsections d) and f)⁴ of Section 3 for a broad range of products, amongst others commodity derivatives, and moreover in Section 10 grants IFs the ability to engage in ancillary activities relating to instruments not covered by the said Section 3.

The principal practical effect of extending the list of financial instruments is consequently that IFs will be able to benefit from the passport to provide services in other Member States.

From the point of view of the domestic market, it should be taken into account that Spain has traditionally been an importer country of investment services (compared with 29 Spanish IFs which operate in other Member States, approximately 1,100 foreign IFs operate in Spain under the regime of free provision of services or through a branch). In this context, the available supply of products for clients resident in Spain will be broader and will consequently increase competition for Spanish IFs.

2.3 Commercial networks

Despite the fact that Recital 8 of the ISD provided for the possibility that IFs could carry out their activities throughout the European Union by resorting to agents, absence of an effective regulation prevented development of this concept as a key element in the provision of investment services by IFs in other Member States.

⁴ d) Contracts of any type which are the subject of trading on an official secondary market or not. f) Contracts or transactions in instruments not covered by the previous subsections, provided that they are susceptible to trading on a secondary market, whether official or not, and even if their underlying asset is not financial, comprising for these purposes, amongst others, goods, raw materials and any other fungible goods.

The activities of an IF in another Member State by means of a permanent presence thus had to be necessarily articulated through the establishment of a branch which increased the cost of developing cross-border business and to a certain extent conditioned it. This restriction prevented full development of the regime of free provision of services which IFs articulated by the use of new technologies and periodic visits to clients located in other Member States.

The MiFID for the first time regulates at European level the concept of the tied agent, granting each Member State the ability to permit IFs to use this concept. This is configured as a representative of an entity in promoting its business, enabling it furthermore to provide intermediary and advisory services on behalf of the principal. The requirements of knowledge and integrity, publicity of relations with clients and registration in a public register makes it possible to harmonise this figure at European level and, more importantly, permit IFs to operate in other Member States under the regime of free provision of services through tied agents established in them.

The concept of the tied agent, which has been the principal channel through which Spanish IFs have expanded their commercial activity within the country, has been fully acknowledged in the Spanish legal system since publication of the SMA on terms very similar to those laid down by the Directive. From the legislative point of view, major changes cannot therefore be expected in the regime of Spanish tied agents.

From the business point of view of Spanish IFs, it should be taken into account that, as mentioned, Spain is an importer of investment services and therefore an increase can be expected in the presence in Spain, and consequently of competition, of entities authorised in other Member States which operate under the regime of free provision of services through agents established in Spain. In this respect, it is undeniable that the strong presence of resident expatriates on the Spanish coast will lead to foreign entities under the free provision of services contracting tied agents resident in Spain to meet the requirements of this group.

3 Novelties in the activities of IFs

The MiFID introduces numerous novelties in relation to the ISD in the manner in which IFs must engage in their activities.

In the fields of both organisational requirements and operating conditions, the MiFID lays down obligations which have never been developed in European legislation. The ISD, in Title II on conditions for access to the activity, scarcely covered any requirements that Member States had to lay down for IFs in order to authorise them.

Consequently, the obligations summarised below constitute a series of novelties to which Spanish IFs will have to adapt. This summary does not aim to be exhaustive or reproduce all novelties which will affect Spanish IFs⁵.

⁵ Regarding the organisational requirements of IFs see the article "*Los requisitos organizativos de las empresas que prestan servicios de inversión*" by Antonio Moreno Espejo, published in the CNMV Bulletin for the third quarter of 2007.

3.1 Organisational requirements

Within the Chapter on organisational requirements the MiFID deals with the regulation of key elements which define the structure of an undertaking. IFs must thus have an adequate organisational structure proportionate to the nature, scale and complexity of their business activities and the nature and range of investment services and activities they intend to engage in.

In this context it is necessary to have a clear definition of functions and responsibilities and therefore it will be essential to develop adequate information channels, maintain a suitable register of activities and have sufficient resources and capabilities. A logical consequence of a scheme of this nature is the importance which the Directive accords to control functions in the different areas of activity. It firstly requires that there be an independent body which verifies compliance by IFs with their legislative obligations and further provides procedures and policies for the identification, assessment and management of the risk associated with the activities they carry out, and finally that there be mechanisms to assess the adequacy and efficacy of internal control systems. The existence of independent risk management and internal audit bodies is subject to the nature, scale and complexity of activities.

Responsibility to provide resources and capabilities logically lies with senior management which must periodically evaluate the efficacy of policies, provisions and procedures which are implemented.

As part of the control system IFs will need to have continuity plans for their activities which guarantee the preservation and recovery of data and essential functions and adequate control mechanisms when the IF entrusts essential or important functions or activities or investment services or activities to third parties.

Aspects are of particular importance within this chapter relating to organisation linked to client protection. The Directive regulates the requirements in detail which IFs must comply with to protect the rights of funds and financial instruments of their clients. This protection is articulated by requiring records which permit the monitoring and identification at all times of client positions, separation of positions of the IF itself and permanent assessment by the IF of entities to which they entrust the deposit of securities and cash of their clients and the legislative provisions to which these entities are subject in the course of their activities.

The MiFID also accords special importance to the management of conflicts of interest. IFs will have to develop a conflict of interest management policy in writing which guarantees identification of the circumstances which could result in harm to client interests and establishes procedures which must be followed to manage such conflicts. IFs must furthermore maintain a register of the types of investment or ancillary services or investment activities carried out by the undertaking in which a conflict of interest has or could arise.

The summary given reveals the extent of the novelties in the European legal system, and Spanish IFs will without doubt have to revise and adapt their organisation. It should be emphasised however that Spanish IFs have carried out their activities through solid business structures, adequately provided with

resources and capabilities and therefore their adaptation should take place in a highly favourable environment.

The reasons which have led to this favourable environment are varied:

- Desde el punto de vista jurídico, las ESI españolas han adoptado la figura de sociedades anónimas, en las que la estructura de gobierno societario está claramente definida.- From the legal point of view Spanish IFs have adopted the form of joint stock companies in which the structure of corporate governance is clearly defined.
- Specific securities market legislation has affected most aspects which constitute novelties under the MiFID.

As examples of detailed legislation we can cite CNMV Circular 1/98 on internal control systems, ongoing risk monitoring and assessment, which established the minimum content which general risk monitoring and control policies designed by IFs must have and the requirement of resources enabling them to ascertain the risks which they assume and internal bodies responsible for verifying compliance with such control policies. Responsibility for determining this policy lies with the Board of Directors, which must furthermore within the organisation create a control unit, authorise a structure of operating limits and powers to contract and settle transactions, ensure that the organisation has the means to ensure efficient management of the business and adequate separation of functions, and finally define the criteria for preparing procedure manuals. In particular, the Circular is concerned with the protection of ownership rights of clients and control of the operation of branches and representatives.

Furthermore, the Act on Reform of the Financial System went further into the organisational structures of IFs in order to prevent a flow of privileged information between their different areas of activity and created customer protection bodies, obliging IFs to resolve claims through customer care services.

Finally, the rules of conduct which were intensively developed as from Royal Decree 629/1993 defined the obligations of IFs to adequately document relations with clients and in particular the existence of mandatory recording which enables adequate monitoring of client transactions.

- Spanish IFs have a strong connection with the domestic and foreign banking sector through shareholdings or as a result of the origin of their principal executives. Forming part of large business structures in which the development of control mechanisms has particular importance has enabled highly developed control procedures and policies to be exported to a large part of Spanish IFs.
- The function of the CNMV, in particular in procedures for the authorisation of new IFs in which an important element in the assessment of each project has been the required provision of resources, in particular in critical areas such as control and supervision on site of organisational structures.

The adaptation of Spanish IFs will each of them to make an in-depth analysis of organisational structures and a comparison exercise in order to respond to the new organisational requirements.

The actions of IFs will be directed towards the creation of new records and the recording of services or activities which give rise to conflicts of interest, the modification of policies, procedures and functions, verifying that they clearly define the obligations and responsibilities of members of the organisation, redefining the responsibilities of the control unit and risk control departments present in IFs to the new control bodies provided for, such that the functions are developed of legislative compliance, adapting the system of personal transactions in accordance with the definition of “relevant person”, and consequently adapting internal codes of conduct, formalising contingency and business continuity plans and evaluating whether services outsourced are carried out in accordance with the criteria laid down.

This process will require the full involvement of senior management which will have to clearly define the parameters in which their future activities will take place.

3.2 Operating conditions

The MiFID raises investor protection to the category of a fundamental principle, a protection which is achieved in two ways: firstly, by intensifying transparency in relation to IFs with their clients or potential clients (hereinafter clients), and secondly, requiring that the activities of IFs are aimed at a supply of services and instruments which is suitable for the needs, experience and financial capacity of their clients. This requirement is modulated, however, on the basis of the different qualifications of investors, and therefore the MiFID provides for a greater degree of protection for retail clients and a lesser degree for professional clients and eligible counterparties. An outstanding novelty of the MiFID is thus that IFs will have to classify their clients in accordance with these categories.

In general terms transparency takes the form of informing clients, particularly at the marketing or pre-contract stage, in order that they can take grounded decisions, and in the post-contract stage providing information on the services actually provided and the evolution of positions of each client with the IF. The catalogue of information to be provided is very broad and amongst other matters covers data identifying the entity, the services it provides, the risks of products which it offers and the cost of transactions, but of particular importance as a result of its novelty is the need for IFs to inform their clients of the different policies they implement, for example in the field of executing transactions and custody of assets.

The obligation for IFs to offer clients the services and products which are best adapted to their needs, experience and financial capacity, covers two-fold activities for these entities: they must firstly evaluate each client who requests a service by questionnaires designed for the purpose (questionnaires on suitability and appropriateness), and they must secondly classify the instruments which they offer in accordance with certain criteria. Combination of the two tasks will permit the services and products to be defined which are best suited to the profile of each client, such that the IF at all times acts in the interests of its clients.

In the analyses and procedures which IFs carry out they must clearly consider the nature of the services to be provided (advice, management or simply execution), the greater or lesser complexity of the financial instruments and the prior classification which they have made of their clients.

In all certainty the obligations developed by the MiFID in considerable detail in the scope of rules of conduct will give rise to great efforts in adaptation by Spanish IFs. Even though Royal Decree 629/1993 had already laid down general principles of action in the interests of clients, developed the information to be provided to clients, and established the need to formalise contracts for certain activities, and the legal system provided for the concept of the qualified investor and legislation relating to the provision of discretionary portfolio services for individuals obliged IFs to ascertain the profile of the client managed, there can be no doubt that the scope of the MiFID is far greater.

As made clear, the changes in organisational requirements and operating conditions require a substantial effort in adaptation on the part of Spanish IFs; despite having operated in an adequate legal environment in which primacy has been given to protecting client interests by organisational structures adequately provided with control procedures, policies and resources.

It is in particular clear that Spanish IFs will have to adapt their policies, procedures and practices to the new requirements: it suffices as an example to recall that the existence of new trading centres, the need to formulate an order execution policy in writing, and the obligation of IFs to act on the principle of best execution, will without doubt involve the need for senior management to take measures, redesign order execution procedures and redefine control and supervision mechanisms. This same work will lead to the need to classify and evaluate clients, etc.

Also, as it must be, IFs will have to evaluate the functions of each of the units which make up their organisational structure. In the control field they will have to reallocate the functions of the control unit in accordance with the new requirements and assess whether the resources allocated are sufficient to meet the new obligations (for example, verifying client classification, that questionnaires are adequately applied, that the IF complies with the principle of best execution or that the register of conflicts of interest includes the services and persons susceptible to generating such conflicts). There is no doubt that in the control field IFs will have to strengthen their mechanisms in relation to the commercial activities of their agents so that marketing procedures for products are adequately complied with.

The organisational structure and policies of Spanish IFs will doubtless be affected by the possibility of outsourcing certain important functions, particularly investment services. Although Spanish IFs have traditionally resorted to subcontracting certain activities (e.g. operating functions in accounting and control areas, or in supplementary activities such as the deposit of securities), for the first time the possibility is provided for and regulated of subcontracting investment services. It can be expected that subcontracting will be concentrated in the field of discretionary private portfolio management and that consequently Spanish IFs will assess this greater flexibility when defining operating procedures and organisational structures. This assessment must necessarily take into account the

costs involved in subcontracting, both in terms of fees and cost of strengthening control and supervision of the activities delegated. In some cases IFs could even consider again taking on the direct provision of certain functions.

In the current technological environment most of the novelties described will require substantial IT developments. Special attention will have to be paid to the sales area in which IFs will have to develop tools permitting clients to be classified and a virtually immediate assessment of them when offering services and products which are best adapted to their knowledge, experience and financial capacity. Those IFs which are capable of servicing their clients in a more agile manner will have a competitive advantage. Those entities capable of creating IT systems which can easily be adapted to the changing environment will also be at an advantage.

Finally, perhaps one of the most important aspects will be the training of employees and sales networks. Training will have to be aimed at the organisational sphere (new policies and procedures, new IT applications, etc.), and in particular training personnel who are in contact with clients. The training will thus have to pay particular attention to the agent network which in the case of many Spanish IFs constitutes the network for gaining retail clients.

4 Conclusions

Over the course of this article it has been clear that the MiFID provides several novelties whose effect on Spanish IFs will be seen with the passage of time.

In particular the principal substantial novelty is the possibility for Spanish IFs to act as multilateral trading facility managers or as systematic internalisers, since the remaining novelties in the European sphere have already been incorporated into the Spanish legal system in one manner or another and formed part of the normal activities of some IFs. Extension of the European passport to new instruments and in particular the possibility for European IFs to act under the regime of free provision of services in Spain through tied agents will in any event bring competition for Spanish IFs. It is possible in fact that after a cost/benefit analysis some IFs will redefine their business and abandon the provision of services to certain groups which provide a marginal contribution to their profits.

From the point of view of adaptation to new organisational requirements and operating conditions it is clear that IFs will have to meet a cost either through internal developments or by contracting advisers.

The IF sector has a very diversified structure in that undertakings coexist of small size, highly specialised and providing a single investment service to professional clients, alongside other multidisciplinary undertakings with a mixed clientele (retail and professional) and with large networks for attracting business through tied agents. Although the cost of adaptation will be different for each type of entity, it is clear that the costs will be higher for those IFs whose business base is formed

by retail clients attracted through the agent network and which have a broad range of services and products. After the business strategy has been defined, however, IFs will have to meet the cost of adaptation. Adaptation costs must necessarily be tackled as an investment which provides them with the opportunity to improve their image with clients and other financial institutions, both domestic and foreign, which provide investment services. Investment in control procedures and policies, technological developments which enable IFs to operate with clients in a more flexible manner and permit their rapid adaptation to a dynamic environment, will strengthen the image of the sector as a whole and may consequently attract a higher number of investors. It should not be overlooked that the MiFID pays particular attention to pre-contract information which IFs must provide to their clients. IFs will thus have a magnificent tool in this information to demonstrate to their clients their solvency in general terms: order execution or protection of client asset policies rigorously drawn up will permit IFs to demonstrate their capacity and increase investor confidence in the sector as a whole.

And this is particularly important in a market in which an increase in competition by foreign entities can be expected. Spanish IFs must not only provide themselves with the tools to meet this increase in internal competition but project their presence abroad, which without doubt is a pending assignment.

The Markets in Financial Instruments Directive. An analysis from the perspective of the Spanish securities market

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1 Introduction

The Directive on Markets in Financial Instruments (MiFID in the English acronym by which it is better known) is the principal Community legislation regulating the area of securities markets and replaces the Investment Services Directive (ISD) which has been the main European law on financial markets and intermediaries in force since 1993.

The MiFID constitutes an attempt to respond to the changes which have taken place in world financial markets. Phenomena such as the order internalisation and the existence of centralised trading systems separate from regulated markets developed after entry into force of the ISD and made a new regulation necessary which takes them into account.

Apart from the changes in the regime of cross-border activities and authorisation of financial intermediaries and their organisational structure and rules of conduct, the MiFID constitutes an important change in the structure and functioning of markets, particularly in those, such as ours, in which the principle governs of concentration of orders and in which certain concepts were not provided for such as systematic internalisation.

In order to incorporate the MiFID into Spanish law, the Securities Market Act, 24/1988, of 28 July (SMA)¹, was partially modified, although this modification also transposed European Parliament and Council Directive 2006/49/EC of 14 June 2006 on the capital adequacy of investment firms (IFs) and credit institutions.

The principles underlying the new SMA could be summarised as follows:

- Modernisation of financial markets in order to adapt them to the new trading environment.
- Strengthening investor protection measures.
- Adaptation of the organisational requirements of IFs.
- Improvement in the supervisory powers of the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores – CNMV*) and the strengthening of instruments to promote cross-border cooperation between supervisors.

At the present time the Royal Decree on subsidiary regulation of the MiFID is still pending approval, regulating the legal regime governing undertakings which provide investment services. In parallel with the efforts being made by

¹ Act 47/2007, of 19 December, modifying the Securities Market Act, 24/1988, of 28 July, (*Ley 24/1988, de 28 de julio, del Mercado de Valores*), published in the Official State Gazette on 20 December 2007.

different countries to transpose the MiFID and its subsidiary rules, the European legislative procedure established by the Lamfalussy process continues its course and the Committee of European Securities Regulators (CESR) has drawn up and continues to draw up new level 3² regulation on aspects considered most relevant and on which it is considered necessary to shed more light for participants in the industry. These level 3 recommendations from the CESR, of a non-binding nature, are essentially configured as guidelines for the European financial industry in complying with the requirements of the MiFID.

In the second section of this article the new trading structure under the MiFID is examined, highlighting the implications which it could have on the organisation of our securities markets. Subsequently, in the third section, the principle consequences are dealt with deriving from this new trading environment, focusing on requirements for transparency of trading information and rules governing best execution. Section four is devoted to the principle of best execution. Section five deals with the rules governing the reporting of transactions and mechanisms for exchange of transaction reporting with the implications which they may have for supervision of our securities markets. Finally, section six contains various conclusions.

2 The new trading structure under the MiFID

In this section the new trading environment under the MiFID is examined, which is without doubt one of the principal novelties of the Directive. Although it could be said that some of the organisational requirements and rules of conduct for investment firms (IFs) brought in by the MiFID are already to a greater or lesser extent contained in our legal system, the fact is that the innovations in the field of structure, organisation and functioning of markets are genuinely innovative and will constitute a “big bang” for our financial system.

The MiFID identifies three types of trading systems in European markets: regulated markets, multilateral trading facilities (MTFs) and systematic internalisers (SIs). The MiFID furthermore enshrines the principle of freedom of choice of clearing and settlement systems.

2.1 Regulated markets. Regimes for admission, suspension and exclusion from trading.

Regulated markets are a concept well known in our financial system, where they have traditionally been referred to as “official secondary markets”. The MiFID and its subsidiary rules grant a special status to regulated markets with various

² Level 3 regulation, in the terminology of the Lamfalussy process, relates to principles of interpretation of rules or recommendations for their application. Level 1 regulation relates to European Parliament and Council directives or regulation of principles, and level 2 regulation comprises European Commission directives or regulations to develop level 1 legislation.

specific regimes governing authorisation, regulation and supervision. The rules for transparency, both before and after trading, is nevertheless common to that laid down for MTFs, given that they share various functional characteristics.

The regime introduced by the MiFID for regulated markets does not differ substantially from the regime which existed previously. A further aspect to consider is the possible impact on Spanish regulated markets.

Firstly, there can be no doubt that the break with the order concentration rule (which made it obligatory to execute transactions in markets and systems managed by the Spanish market, BME) will give rise to competition as a result of the flow of orders between regulated markets, MTFs and the SIs. In turn, it is foreseeable that there will be an increase in OTC trading volume (over the counter, i.e. transactions between financial institutions outside regulated markets) and therefore the impact on the liquidity of regulated markets could be enhanced even further.

One relevant and novel aspect of the legislation applicable to regulated markets consists of the rules for admission to trading, suspension and exclusion from trading.

Regulation 1287/06 specifies the requirements which different types of financial instruments must fulfil in order to be admitted to trading on a regulated market. Only general requirements are described which ensure that instruments are freely negotiable and that contracting them takes place in a fair, orderly and efficient manner. It should be indicated that the requirements proposed do not overlap with the rules regulated by the Prospectus Directive or the Transparency Obligations Directive.

The provisions relating to the admission of securities are applied to all types of financial instruments and not only equity securities. Regulation 1287/06 describes the general requirements for admission to trading of shares, derivatives and holdings in investment funds. No specific development is included relating to bonds or money market instruments whose rules for admission must be circumscribed by the general requirements set out in the MiFID itself.

One novelty with respect to the current regime is the possibility of admitting securities in different markets without the consent of the issuer. In these cases the issuer will not be obliged to comply with the requirements of regulated dissemination of information but it will have to be the governing body of the market which has admitted the issuer without its consent which is responsible for obtaining the information and publicising it amongst participants in the said market.

With respect to suspension from trading the MiFID distributes power to suspend and exclude between the competent authorities and the governing bodies of regulated markets. In order to adapt this dual regime to practice in our markets it has been decided that the CNMV should suspend securities when special circumstances arise which could disrupt the normal course of transactions in the instrument or when advisable for the protection of investors. Governing bodies may for their part suspend when the instrument ceases to comply with the market rules set out in the market regulation itself. In other words, the ability for governing bodies to suspend is limited to a very technical sphere relating to contracting circumstances as such.

In parallel, the exclusion of securities from trading can also be ordered by the CNMV or by the governing bodies of regulated markets. The CNMV will be responsible for the exclusion of securities which either fail to comply with the requirements for frequency and liquidity or similar laid down by regulations or for which the obligations to supply and publish information are not complied with. Governing bodies for their part may bring about the exclusion of a security for the same reason as that for which it can suspend it, i.e. as a result of failure to comply with contracting rules, although in the case of exclusion we consider that this non-compliance must be recurrent, unlike the case with suspension.

Since the new trading environment under the MiFID will give rise to trading of the same security on different regulated markets (in some of which, as we have seen, the security may be admitted without the consent of the issuer) in many MTFs and SIs coordinated action becomes necessary in the case of suspensions and exclusions in order to ensure that the different authorities and trading systems in which a security is traded are aware when the said security has been suspended or excluded in one or more of the systems in which it is traded.

A two-stage procedure has thus been laid down:

- a As soon as the competent authority suspends/excludes a security on a regulated market, it must publish the suspension such that other trading systems (other regulated markets, MTFs or SIs) under its jurisdiction are under an obligation to suspend/exclude the security.
- b The competent authority which has brought about the suspension/exclusion of a security must notify the other competent authorities (Community, and non-Community if necessary) which in turn must resolve to suspend/exclude the security on the trading systems under their jurisdiction (unless this gives rise to serious prejudice to investors or the orderly functioning of their market).

Within the CESR the implementation is being examined of a system for notifying suspensions and exclusions between competent authorities. At the date of preparation of this article the competent authorities have provisionally provided a series of e-mail addresses for the exchange of this type of information and have designated contact persons in each authority who will be responsible for centralising the sending and receipt of communications relating to suspension and exclusion of securities.

2.2 Multilateral trading facilities (MTFs)

MTFs are configured as systems of any type (basically electronic trading platforms) which are operated by an IF or by the operator of a regulated market and which permit multiple purchase and sale interests to be matched up in respect of the assets traded on them.

The structure, functionality and operation of MTFs proposed by the MiFID and its subsidiary rules are very similar to those of regulated markets, although regimes of admission and exclusion from trading are not regulated.

The pre-MiFID legal regime had already provided for the concept of MTFs under the name of ATSS (Alternative Trading Systems) although the Directive regulates these systems in more detail establishing the content of their functional regulations, the rules for permitting remote access to foreign members and transparency rules in relation to trading shares on the system.

Participants in Spanish markets will be able to decide to establish an MTF or join an existing MTF, and therefore, as mentioned, there will be a drain of liquidity from the regulated markets themselves.

It is also foreseeable that MTFs will arise at European level, as in the case of *Turquoise*, which in November 2006 was configured as an MTF in which the principal investment banks form part (*Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, Merrill Lynch, Morgan Stanley and UBS*). Another potential competitor of regulated markets is the so-called Chi-X which was registered with the British Financial Services Authority (FSA) as MTF for shares of pan-European scope using the *Instinet* technology. Share trading began on 30 March 2007, with a plan to introduce 7,500 traded securities in November 2007.

2.3 Systematic internalisation (SI)

The MiFID defines SIs as IFs which in an organised, systematic and frequent manner execute orders of their clients against their own account outside regulated markets and MTF. This practice again constitutes a potential loss of liquidity for regulated markets and a source of conflicts of interest between regulated markets and their participants.

Since SIs compete with the remaining trading systems (regulated markets and MTF) it became necessary for their operating regime to permit fair competition between them. Consequently, a series of obligations are imposed on SIs (basically the duty to list prices on a continuous basis during their normal trading hours, a general obligation to reflect market conditions in their quotations and a series of conditions on updating and withdrawing their quotations).

In addition, by operating against their own account SIs place their own capital at risk and therefore their operating regime proposed by the Regulation also allows them a series of reasonable safeguards to prevent excessive risk in their operation. This competitive advantage in relation to the remaining trading systems which the MiFID grants to internalisers basically relates to the existence of an own pre-trade transparency regime different from that which is applied to regulated markets and MTFs. Nevertheless, the rules governing transparency post trading brought in by the MiFID are the same for SIs, regulated markets, and MTFs.

The internalisation of transactions can raise conflicts of interest between IFs and their clients and also constitutes a potential threat to market efficiency since, if not adequately regulated, it could undermine the process of price formation and endanger best execution of orders. Consequently, the MiFID and its subsidiary regulation limit the internalisation of client orders to those cases in which this operating procedure constitutes better execution of their clients' orders; in other

words, those situations in which internal execution improves the existing conditions in the remaining trading systems (regulated markets or MTFs). It is further proposed that potential conflicts of interest be limited by strict rules for handling orders which oblige IFs to execute their clients' orders in a suitable manner, avoiding advantage being taken by the IF itself or by other clients. The execution of transactions is thus specifically regulated in relation to securities portfolio management (orders received from professional clients which are separated into orders in different securities) the execution of transactions subject to conditions other than the strict trading conditions existing in the market and means are put in place to protect the operation of SIs from "multiple executions" permitting the SI to decide in a prudent manner on the orders which it can meet taking into account the volume of positions, market situation and its risk position. Systematic internalisers will be able to execute orders received from professional clients at better prices than those offered solely for orders exceeding the typical size of a retail order which has been fixed by regulations at 7,500 euros.

With respect to publicity of the status of SI, the competent authorities in each country are under an obligation to publicise and update a list of the SIs under their jurisdiction and the SIs must publish to the market by the means laid down by regulations when they cease to act as SI in one or more securities.

CESR has been entrusted with management of the centralised SI database. A format has been agreed within the CESR for this database with a common content which will enable all investors to identify the activities of different market members as SIs.

2.4 Brief considerations regarding the regime of clearing and settlement of transactions.

It must be emphasised that the MiFID does not deal exhaustively with aspects relating to clearing and settlement of transactions, even though the general provisions or principles which it establishes are of great importance. The MiFID basically lays down the right of Community investment firms and managers of regulated markets or of MTFs to participate directly in the settlement systems of other Member States subject to complying with the appropriate operating and commercial requirements for joining in as well as measures of prudence in order to maintain the harmonious and orderly functioning of financial markets.

On the other hand, it should be pointed out that potential competitors of regulated markets are also making progress in matters connected with clearing and settlement of the transactions in which they will mediate. In April 2007 the MTF *Turquoise* announced that it had selected *EuroCCP* to provide a European clearing and settlement solution on a single platform. *EuroCCP*, European Central Counterparty Ltd., is a subsidiary of the Depository Trust & Clearing Corporation (DTCC). Subject to receiving approval from the Financial Services Authority, *EuroCCP* will be a clearing house recognised in the United Kingdom, based in London and regulated by the FSA.

3 The transparency regime

The regime of transparency in trading proposed by the MiFID seeks to ensure that investors have an adequate level of information regarding purchase and sale interests (pre-trade transparency) and transactions carried out (post-trade transparency) in respect of securities admitted to trading on regulated markets irrespective of where they are traded (regulated market, MTFs or SIs). In turn, it is a question of guaranteeing that the levels of information made public do not prejudice intermediaries who provide liquidity to the system, preventing information which it is obligatory to disseminate from placing their positions and strategies at risk.

3.1 Pre-trade transparency

a The requirements of pre-trade transparency of regulated markets and MTFs.

The regime of pre-trade transparency proposed by the MiFID and its subsidiary rules aims insofar as possible to make the requirements uniform for disseminating information prior to trading but taking into account the diversity of forms of disseminating purchase-sale interests which exist, distinguishing between order-driven markets, price-driven markets and periodic auction markets.

It should be indicated on this point that the requirements of pre-trade transparency currently in force in our equity markets would comply with the requirements laid down by the MiFID and its subsidiary rules, in some cases providing an even greater degree of transparency. It would be desirable, however, to review the single price fixing segment in which the price and balance volume should be clearly indicated at which the auction would be resolved (at the present time the balance price and volumes are disseminated on the buy side and on the sell side).

On the other hand, the Regulation provides for various waivers from the obligation to disseminate information regarding purchase and sale interests, being:

- Crossing systems, i.e. those market models which are based on a trading methodology pursuant to which the price is determined in accordance with a reference price generated by another system.
- “Negotiated transactions³”, provided that they are executed within the limits of the band of prices weighted for the size of the transaction when

³ In accordance with the level 2 regulation, negotiated transaction means “a transaction involving members or participants of a regulated market or an MTF which is negotiated privately but executed within the regulated market or MTF and where that member or participant in doing so undertakes one of the following tasks: (a) dealing on own account with another member or participant who acts for the account of a client; (b) dealing with another member or participant, where both are executing orders on own account; (c) acting for the account of both the buyer and seller; (d) acting for the account of the buyer, where another member or participant acts for the account of the seller; (e) trading for own account against a client order.”

the share is not traded continuously within a percentage of a suitable reference price, or when the said negotiated transaction is subject to conditions other than the market price of the share in force.

- High volume orders compared with normal market volume (blocks). The rules for blocks proposed by the level 2 Regulation divides securities into five liquidity classes (based on their average daily turnover), allocating a minimum size to each class in order to consider the order as high volume.

The regulation of block transactions could have an impact on the organisation and functioning rules of Spanish markets. In the Spanish stock exchange continuous market (SIBE) there is currently a high volume transaction trading segment which distinguishes between agreed blocks and parametised blocks. The block trading segment which the SIBE operates will have to make some changes to adapt to the new block regime laid down by Regulation 1287/06, developing the MiFID.

It is also foreseeable that a regime will be developed for negotiated transactions. At the present time these transactions are normally articulated by applications in which the same market member must introduce two orders of opposite direction in the order book in order to ensure execution.

b The pre-trade transparency requirements for SIs

The scope of operation of SIs is provided by the shares which are considered liquid for these purposes. SIs place their own capital at risk and provide liquidity to the system and therefore it seems necessary that when defining their operating regime it be taken into account that they must be capable of undoing or covering their positions in order to avoid risks, for which securities will have to be sufficiently liquid. To this end, the operating requirements are restricted in terms of scope of application (they must only disseminate buy-sell intentions in liquid securities) and size (they must only disseminate buy-sell intentions based on a certain volume known as “normal market volume”).

Furthermore each competent authority will have to publish and maintain a list of liquid securities under its jurisdiction. It must further determine the average value of transactions of each security considered liquid in order to place it within its corresponding liquidity class, thus defining the scope of action of SIs in the liquid securities under their supervision.

The database of liquid securities is being organised by CESR. Start-up took place on 1 July 2007. It was subsequently updated on 1 October, as from when it must be adjusted daily. CESR has made a document available for public consultation (until 15 January 2008) in which certain improvements are proposed to the database of liquid securities and SIs in order to facilitate consultation and the search for securities in the said databases.

3.2 Post-trade transparency

The MiFID provides that IFs, regulated markets and entities which manage an MTF will have to publicise information on prices and volumes together with the identity of the instrument traded and the trading system in which the transaction has been concluded.

Information post-trading must be made public as soon as possible with a deadline established of three minutes for those situations in technical conditions which so require (assuming a reasonable level of efficiency and expense in the systems by the corresponding entity).

The rules governing deferred publication of high volume transactions present a scale of maximum publication deferrals based on the liquidity of the securities (being determined on the basis of the daily average turnover). In this manner, for each liquidity category (the liquidity categories range from those securities traded with a turnover of less than 100,000 euros daily to those traded at over 50,000,000 euros daily) deferrals vary based on the volume of the transaction (turnover) and on some occasions based on the percentage which the transaction represents of the daily average turnover in the security.

4 The best execution regime

The MiFID sets out the obligation of IFs to obtain the best possible result when executing their clients' orders, taking into account price, costs, speed, the possibility of execution and settlement, size and nature and any other characteristic of the order.

This obligation is configured as an essential part of the Community legislation, not only from the point of view of investor protection but it also plays a central role in guaranteeing the integrity of securities markets.

Before offering an investment service IFs must thus take the following aspects into account:

- a) The characteristics of the client, including his status as retail or professional client.
- b) The nature of the client's order.
- c) The characteristics of the financial instrument traded.
- d) The characteristics of the trading system to which the order is directed.

As well as the aspects referred to IFs will have to take into account the express instructions of the client, since these instructions, by determining certain execution conditions (price, market in which it must be executed, settlement

conditions, etc.), will condition best execution. It should be clarified however that the fact that the client indicates a series of express instructions does not mean that the obligation disappears of IFs to execute the order on the best terms for the client but that the client's instructions define a new framework for executing the orders in which best execution must be sought.

4.1 The particular case of retail clients

In those market structures or situations in which there is a concentration of the flow of orders in a single trading system it is relatively simple to determine and assess the execution of orders. When trading is fragmented into multiple trading systems however, verifying that the best execution requirements have been fulfilled becomes more complicated (particularly for retail clients) and the selection of a reference parameter is required which simplifies this "self-supervision" of best execution of orders.

To this end the MiFID has fixed a predominant parameter when determining best execution of retail client orders. In the absence of specific instructions from the client which establish the preponderance of another factor (speed of execution, conditions which facilitate liquidity, etc.) the net price (including all costs directly attributable to execution of the order) must thus be considered as the most important factor when determining the best possible result on executing retail orders.

4.2 Subjective scope of application. Market members and trading for own account

The MiFID provides that the obligation to execute orders on the most favourable terms for the client does not relate solely to the execution of orders in the strict sense but includes all steps in the chain of executing an order from when it is received until it is executed in a trading system. The duty of best execution thus also extends to intermediaries who receive and transmit orders for execution by another intermediary and to entities who manage portfolios and which therefore also give buy-sell orders to other intermediaries.

Entities which manage portfolios and those which mediate by receiving and transmitting orders to other intermediaries to execute can therefore delegate the execution of orders but may not delegate or avoid their obligation of best execution to their clients.

4.3 Objective scope of application. Instruments traded

It is also necessary to take into account that best execution is qualified by the nature of the instruments traded and the different trading structures.

For example, OTC transactions normally involve the design of personalised or made-to-measure contracts which make a comparison with other trading systems very difficult. This is so because these personalised contracts are based on a series of judgments which include, for example, the counterparty risks

associated with each client. With an OTC contract or made-to-measure agreement by an IF with its client, other IFs would only be able to provide a more or less theoretical or approximate price since they do not have the specific risk conditions of the client in question.

The absence of an element of more or less precise comparison does not mean that IFs are exempt from the duty of best execution for more or less personalised instruments nor for those markets or trading structures in which the client could be considered a direct counterparty (price-driven markets with mediation in its different forms: intermediary markets, liquidity creator markets, etc.), but that IFs, when assessing “made-to-measure” products must reasonably take into account market valuation or valuation in similar contracts or instruments to those which are being offered to clients.

4.4 Obligations of IFs. Best execution policy and obligations to give information to clients

IFs will have to draw up and revise their best execution policy at least annually (or whenever significant changes take place to it), which will have to contain all those contracting systems which, in accordance with their own business model and internal organisation, enable them to consistently obtain best execution of their clients’ orders.

IFs will furthermore have to provide their clients, before providing services, with the procedure by which the IF prioritises the best execution factors referred to (price, speed of execution, etc.), and details of how aspects will affect this categorisation which condition execution of the order (type of client, nature of the order, type of instrument traded and trading systems in which the order is executed), list of markets in which the IF considers that best execution is consistently obtained and a warning that the specific instructions given by the client himself could mean that the IF does not follow the procedure which it would normally follow in the absence of such instructions in order to obtain best execution of the said orders.

4.5 The new trading environment and regime of best execution

In centralised systems such as the SIBE in general terms best execution is ensured by the functioning of the system itself and by the general rules of conduct of intermediaries, set out in particular in Royal Decree 629/93, of 3 May, on operating rules in securities markets and mandatory registration.

On the one hand, trading during the SIBE open session is governed by the principles of “price-time priority” and “best price from the other side” which ensure that orders are executed on the best possible conditions on the basis of the orders which exist in the order book. Furthermore, the annex to Royal Decree 629/93 (general code of conduct of securities markets) contains a series of measures aimed, amongst other matters, at correct management and execution of client orders.

With the new environment introduced by the MiFID in which liquidity can be fragmented between different trading systems, this system has partly changed such that obtaining best execution of client orders is not as clear a process as in a centralised order market such as the SIBE with rules which guarantee that orders are always executed at the best price which exists in the order book.

5 Communication of transactions and exchange of information between authorities

The regulation of reporting transactions and exchange of information between authorities is a very important aspect for ensuring an adequate level of supervision by competent authorities enabling it to ensure that the integrity of markets and protection of investors continues in the light of the challenges of the new trading structure brought in by the MiFID.

Regulation 1287/06 proposes a series of information contents common to Member States which must be sent by IFs.

5.1 The definition of "transactions"

Firstly, in order to guarantee consistent application in all Member States, the Regulation proposes a common definition of what must be understood by "transactions" which will have to be reported by IFs in the manner laid down in the said regulation.

The definition of "transaction" (which will be applicable not only to the scope of reporting transactions but also in the field of transparency previously examined) solely includes the purchase or sale of financial instruments in the strict sense, excluding other transactions even though they may involve acquisitions or transactions in financial instruments in an incidental manner. The definition of "transaction" specifically excludes so-called "securities financing transactions", i.e. loans of securities or other financial instruments, repurchase or inverse repurchase transactions and sale transactions with repurchase agreement or purchase transactions with resale agreement.

5.2 Content of the information to be reported. Identity of the final client

With respect to information content, Regulation 1287/06 establishes two levels of detail set out in its Annexes 1 and 2.

Annex 1 sets out the fields which must be completed by IFs for each transaction. In addition, Annex 2 incorporates three supplementary fields to those of Annex 1 which must be completed by the competent authorities before sending the information as a whole to the authority of the most liquid market, and which are

intended to provide the identity of the IF which makes the report, its counterparty and the instrument traded.

One relevant aspect is inclusion or otherwise of the identity of the final clients of transactions. This information is not finally amongst the mandatory fields to be sent by IFs but the possibility is left open for Member States to also require the necessary information to identify the clients on whose behalf the investment firm has executed the transaction. In our country the manner, details and periods for communicating the necessary information to identify the final client has been left for subsequent regulatory development.

5.3 Additional content to be reported

The content of the information to be reported agreed at European level comprises 23 information fields. Section 13.3 of Regulation 1287/2006 permits additional information to be requested when it is necessary for the competent authority to supervise the activities of investment undertakings. It is expressly permitted to request the identity of the client pursuant to Section 13.4 of the said Regulation 1287/2006.

On the other hand, Paragraph 4 of the Preamble to Regulation 1287/2006 states that it is necessary to ensure that all investment undertakings collect and report a single data set with minimum variation between Member States. There are countries which at the present time request substantially more information than the 23 fields agreed in CESR (including up to 60 information fields in some cases).

The European Commission has expressed its concern at this potential lack of harmonisation which could give rise to regulatory arbitrage, given that IFs would attempt to subject themselves to the less rigorous regimes with respect to information content, even if solely for the cost saving reasons. In principle, we consider that there must be a certain flexibility which permits countries to determine additional fields at domestic level, at least initially, in order to adapt the different existing supervisory focuses, as mentioned in the previous section.

On the other hand, the information which must be sent to other countries could consist of the minimum CESR content (23 fields) or all fields which the host country receives, as agreed by the authorities involved.

In our country Act 47/2007 of 19 December amending the Securities Market Act, 24/1988 of 28 July, authorises the Ministry of Economy and Finance to establish additional information requirements when considered necessary for correct exercise of the supervisory functions which have been entrusted to the CNMV.

5.4 Determination of the most important market in terms of liquidity

Article 25 of the MiFID provides that authorities must exchange information on transactions such that it is guaranteed that the competent authority of the most relevant market in terms of liquidity for each security receives information on transactions in it.

The focus adopted by the level 2 Regulation for determining the most relevant market in terms of liquidity is based on the use of different proxies depending on the type of security (for example in the case of shares the most important market in terms of liquidity will be that in which the security is admitted to trading for the first time, whilst for fixed income securities the most market will be where the registered office is located of the parent entity of the issuer). Alternatively, in the event that it is not possible to determine a single most relevant market in liquidity terms using proxies, it will be taken that the most liquid market is that in which turnover in the security is highest.

The Regulation also includes a corrective mechanism in the event that mechanisms for designating the most relevant liquid market do not function adequately or if a change takes place in the most relevant liquid market. In January of each year a competent authority may thus notify the relevant competent authority of a particular financial instrument of its intention to challenge the determination of most relevant liquid market for the instrument. Within four weeks after notification the two authorities must calculate the volume of trading in that instrument in the respective markets during the previous year and if the results of the calculation reveal that the volume of trading is highest in the market of the competent authority which indicates its disagreement, the latter market will become the most relevant market in terms of liquidity for that financial instrument.

5.5 Reporting of transactions by branches

The regime proposed by the MiFID gives rise to shared supervision between the authority of the country of origin (responsible for supervising the organisational requirements of the branch and transactions carried out outside the host country) and the authority of the host country (which will supervise transactions carried out by the branch within the host country).

In the specific case of reporting transactions, given the major problems which this shared regime could cause for intermediaries (from the point of view of costs, technical requirements, etc.) and taking into account that the authority of the country of origin (in the event that it is the authority of the most relevant liquid market as laid down by Article 25 of the MiFID) will receive the trading information previously gathered by the authority of the host country, a practical solution has been agreed consisting of permitting all information on transactions carried out by the branch, either in the host or in any other country to be communicated to the authority of the host country.

Consequently, the regime for reporting by branches is simplified such that they can report transactions only to the host country, ensuring that the country of origin will receive all information through the transaction reporting system (Article 25.5 of the MiFID).

5.6 Exchange of information between supervisory authorities

Article 25.3 of the MiFID provides that the competent authority of the most relevant market in terms of liquidity for a particular financial instrument must

receive all information on trading in the said instrument. In order to guarantee that each authority has the necessary information to supervise the financial instruments under its supervision, Article 58 of the MiFID develops a system of cooperation and information exchange between authorities.

There can be no doubt that implementation of this information exchange system for supervision also brings with it major challenges of a technical nature. To this end, within CESR a working group was established consisting of IT experts, known as *CESR-Tech*, which provides support to the different CESR working groups and which developed the so-called TREM project (Transaction Reporting Exchange Mechanism) which attempts to harmonise the technical aspects necessary to facilitate this information exchange between competent authorities.

The TREM project is focused solely on aspects connected with the exchange of trading information between authorities of different countries, establishing protocols for reception, storage and sending of information. It is consequently intended to complement the different national transaction reporting systems. It should be indicated in this respect that since Article 14 of Regulation 1287/06 provides that States may request the information necessary to identify the clients for whom the investment undertaking has executed the transaction, the TREM protocol also provides that the IF which acts as agent must report that the order is for account of a client (through a client code which just states "client"); if the competent authority which receives the transactions requires the identity of the clients, the IF would have to also provide a field entitled "*Client Code Type*" which provides the identity of the client.

6 Conclusions

The MiFID came into force on 1 November 2007 and its incorporation into Spanish law took place by Act 47/2007 which amended the Securities Market Act. This directive is the key European legislation for construction of an integrated securities market. The new regulation seeks to modernise financial markets and improve the system of investor protection.

Several novelties are raised by the MiFID, particularly in the field of the structure and functioning of markets, such that it can be anticipated that it may give rise to a "big bang" in financial systems. The change may be particularly significant for countries in which the order concentration system is applied, as in the case of Spain.

The MiFID identifies three types of trading systems in European markets: regulated markets, multilateral trading facilities, and systematic internalisation. This constitutes a break with the rule of order concentration which means competition for the flow of orders between the three types of system. The possibility which the Directive opens up of admitting securities in different markets without the consent of the issuer will contribute to this. The fact that the MiFID lays down the principle of freedom of choice of clearing and settlement system will also assist.

There are also many new transparency requirements. The aim is to ensure that investors have an adequate level of information regarding purchase and sale interest and transactions carried out in the securities admitted to trading on regulated markets, irrespective of where they are traded (regulated markets, MTFs or SIs). In the case of Spain, the transparency requirements prior to trading which currently exist in the organised BME market in general comply with the MiFID, although some adjustments may be required. Furthermore, SIs have lesser pre-trade transparency requirements, taking into account that their operation involves placing their own capital at risk.

A further important novelty is the principle of best execution. The MiFID sets out an obligation for IFs to obtain the best possible result in executing client orders. Various parameters must be taken into account to satisfy this principle, such as price, cost, speed, the possibility of execution and settlement, the size and nature of the order, etc. IFs must define a policy to achieve best execution which must be communicated to clients. In the case of retail investors the MiFID provides that the principal factor for ascertaining whether an order has been executed in the best possible manner is the price, unless there are specific instructions indicating another factor.

This concept is difficult to apply however, particularly when clients have different requirements, when different intermediaries are involved in channelling the order, or when there are different possible trading mechanisms. In other words, achieving best execution is complicated precisely when financial markets become more complex.

A final novelty of the MiFID in respect of markets which is mentioned in this article relates to the reporting of transactions by IFs and information exchanged between authorities. The aim is that IFs have similar reporting obligations in all Member States, preventing their move to locations with lesser requirements. In turn, supervisory authorities must exchange information on transactions such that the competent authority of the most liquid market for each security receives information on transactions in it. The aim is to ensure that each authority has the necessary information to supervise the financial instruments under its supervision.

As indicated, the changes made by the MiFID have been developed in a fair degree of detail in subsidiary legislation, both level 2 and in interpretation principles and recommendations (level 3). Many of these requirements are not yet fully operative in the majority of countries, either by firms or supervisory authorities. The consequence is that the forecast impact which the MiFID will have on markets and entities, liberalising their activities and promoting competition, will still take time to emerge.

V Statistics Annex

1 Markets

1.1 Equity

Share issues and public offerings¹

TABLE 1.1

	2004	2005	2006	2006		2007		
				IV	I	II	III	IV ²
CASH VALUE³ (Million euro)	21,735.6	2,960.5	5,021.7	941.4	803.9	11,218.1	4,337.2	7,124.1
Capital increases	18,748.0	2,803.4	2,562.9	497.5	696.1	9,896.5	4,273.8	6,560.6
Of which, primary offerings	1,101.9	0.0	644.9	99.7	0.0	334.2	3,485.2	4,683.3
With Spanish tranche	537.9	0.0	303.0	99.7	0.0	334.2	2,449.6	2,037.5
With international tranche	564.0	0.0	342.0	0.0	0.0	0.0	1,035.6	2,645.8
Secondary offerings	2,987.6	157.1	2,458.8	443.9	107.8	1,321.6	63.4	563.5
With Spanish tranche	1,664.4	54.7	1,568.1	277.2	107.8	913.5	63.4	420.2
With international tranche	1,323.2	102.5	890.7	166.7	0.0	408.1	0.0	143.3
NO. OF FILES⁴	42	27	30	7	7	10	6	10
Capital increases	37	25	23	6	6	8	6	7
Of which, primary offerings	4	0	10	2	0	2	3	5
Of which, bonus issues	15	6	0	0	0	0	0	0
Secondary offerings	7	2	15	3	1	3	1	6
NO. OF ISSUERS⁴	37	24	23	6	7	10	6	9
Capital increases	31	23	18	5	6	8	6	6
Of which, primary offerings	3	0	6	1	0	2	3	4
Secondary offerings	6	1	10	2	1	3	1	5

¹ Total files registered with the CNMV (including supplements of initial files).

² Available data: November 2007.

³ Does not include registered amounts that were not carried out.

⁴ Includes all registered offerings, including the issues that were not carried out.

Primary and secondary offerings. By type of subscriber

TABLE 1.2

Million euro	2004	2005	2006	2006		2007		
				IV	I	II	III	IV ¹
PRIMARY OFFERINGS	1,101.9	0.0	644.9	99.7	0.0	334.2	3,485.2	4,683.3
Spanish tranche	536.4	0.0	303.0	99.7	0.0	334.2	2,277.0	2,035.0
Private subscribers	348.1	0.0	8.7	0.0	0.0	112.0	1,898.5	830.5
Institutional subscribers	188.3	0.0	294.3	99.7	0.0	222.2	378.5	1,204.5
International tranche	564.0	0.0	342.0	0.0	0.0	0.0	1,035.6	2,645.8
Employees	1.5	0.0	0.0	0.0	0.0	0.0	172.6	2.6
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SECONDARY OFFERINGS	2,987.6	157.1	2,458.8	443.9	107.8	1,321.6	63.4	563.5
Spanish tranche	1,657.9	54.7	1,565.0	275.7	107.8	903.6	63.4	418.7
Private subscribers	657.4	27.3	390.0	81.7	16.2	289.4	0.0	88.4
Institutional subscribers	1,000.5	27.3	1,175.0	194.0	91.7	614.3	63.4	330.3
International tranche	1,323.2	102.5	890.7	166.7	0.0	408.1	0.0	143.3
Employees	6.5	0.0	3.1	1.5	0.0	9.9	0.0	1.6
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

¹ Available data: November 2007.

Admission to listing. Files registered at the CNMV

TABLE 1.3

	2004	2005	2006	2006		2007		
				IV	I	II	III	IV ¹
NOMINAL VALUE (Million euro)								
With issuance prospectus	1,909.6	498.0	963.4	53.5	69.1	91.2	171.8	3,447.1
Capital increases	1,699.3	494.0	575.9	28.4	69.1	6.6	171.8	3,324.9
Of which, primary offerings	45.4	0.0	145.3	0.1	0.0	4.5	0.0	3,305.1
Secondary offerings	210.3	4.0	387.5	25.1	0.0	84.6	0.0	122.2
Without issuance prospectus	564.6	167.3	564.7	118.6	320.4	1,166.4	440.9	6,361.9
NO. OF FILES								
With issuance prospectus	36	26	18	4	5	5	4	6
Capital increases	34	25	13	3	5	3	0	5
Of which, primary offerings	2	0	5	1	0	2	0	3
Secondary offerings	3	1	9	2	0	3	0	3
Without issuance prospectus	16	27	61	20	17	19	20	10

¹ Available data: November 2007.

Companies listed¹

TABLE 1.4

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ²
Total electronic market ³	128	126	135	135	135	137	136	140
Of which, without Nuevo Mercado	115	115	124	124	124	127	126	130
Of which, Nuevo Mercado	13	11	11	11	11	10	10	10
Of which, foreign companies	6	5	6	6	6	6	6	5
Second Market	17	14	12	12	12	11	11	11
Madrid	2	2	2	2	2	2	2	2
Barcelona	12	10	9	9	9	8	9	9
Bilbao	0	0	0	0	0	0	0	0
Valencia	3	2	1	1	1	1	0	0
Open outcry ex SICAV	53	47	38	38	34	33	32	31
Madrid	28	22	16	16	15	14	14	13
Barcelona	31	28	24	24	21	20	20	20
Bilbao	15	14	10	10	9	9	9	9
Valencia	21	18	13	13	11	11	10	9
Open outcry SICAV	3,086	3,111	744	744	81	23	9	8
MAB ⁴	-	-	2,405	2,405	3,096	3,193	3,241	3,275
Latibex	30	32	34	34	34	34	34	34

1 Data at the end of period.

2 Available data: November 2007.

3 Without ETF (Exchange Traded Funds).

4 Alternative Stock Market.

Capitalisation¹

TABLE 1.5

Million euro	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ²
Total electronic market ³	525,695.1	616,684.7	813,764.7	813,764.7	885,715.3	895,117.8	840,333.3	921,535.3
Of which, without Nuevo Mercado	511,770.8	607,062.8	800,144.5	800,144.5	870,815.3	884,128.1	829,721.5	911,281.2
Of which, Nuevo Mercado	13,924.3	9,621.9	13,620.2	13,620.2	14,900.0	10,989.7	10,611.9	10,254.1
Of which, foreign companies	54,734.6	64,312.7	105,600.9	105,600.9	137,859.2	137,570.4	104,807.9	127,169.0
Ibex 35	344,240.2	407,797.4	502,828.0	502,828.0	533,589.0	537,038.9	527,210.1	544,612.0
Second Market	292.5	307.4	392.7	392.7	713.3	610.3	295.7	300.8
Madrid	11.0	9.2	18.9	18.9	32.6	37.3	24.6	34.1
Barcelona	184.1	154.4	184.2	184.2	404.2	234.2	271.1	266.7
Bilbao	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valencia	97.3	143.8	189.6	189.6	276.4	338.8	0.0	0.0
Open outcry ex SICAV	5,311.3	6,142.5	7,905.3	7,905.3	8,989.9	8,713.0	8,890.0	7,558.8
Madrid	2,411.2	2,754.4	2,698.1	2,698.1	3,159.6	3,050.6	2,796.4	1,850.0
Barcelona	2,517.2	3,129.2	4,966.3	4,966.3	5,333.9	5,159.5	5,247.4	4,819.8
Bilbao	317.1	405.9	59.5	59.5	56.2	137.1	137.1	126.5
Valencia	1,556.7	836.1	741.9	741.9	767.6	777.8	1,145.5	1,191.1
Open outcry SICAV	28,972.7	33,997.6	9,514.9	9,514.9	2,168.0	1,289.6	990.1	242.6
MAB ⁴	-	-	29,864.4	29,864.4	38,711.9	41,072.2	41,259.2	41,827.2
Latibex	124,754.8	222,384.1	271,641.8	271,641.8	278,554.2	305,994.0	342,549.9	346,162.1

1 Data at the end of period.

2 Available data: November 2007.

3 Without ETF (Exchange Traded Funds).

4 Alternative Stock Market.

Trading

TABLE 1.6

Million euro	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Total electronic market ²	636,527.4	847,663.7	1,144,562.9	349,801.5	414,929.6	438,830.9	369,572.5	324,075.1
Of which, without Nuevo Mercado	618,574.3	817,834.7	1,118,546.1	341,252.0	399,828.6	432,131.5	363,370.3	319,603.0
Of which, Nuevo Mercado	17,953.1	29,829.0	26,016.8	8,549.6	10,872.5	5,386.2	5,262.9	3,689.5
Of which, foreign companies	6,165.7	15,115.1	11,550.3	2,378.8	4,228.5	1,313.2	939.4	782.6
Second Market	21.3	25.9	49.3	18.6	121.9	21.4	37.7	9.5
Madrid	4.7	1.8	7.2	1.8	4.7	2.4	0.9	0.7
Barcelona	16.1	22.9	41.6	16.5	116.6	18.7	36.0	8.8
Bilbao	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valencia	0.6	1.3	0.5	0.2	0.6	0.3	0.7	0.0
Open outcry ex SICAV	423.9	860.6	736.3	267.2	316.4	152.4	65.4	235.2
Madrid	122.6	187.8	257.6	75.9	66.6	55.4	21.3	75.2
Barcelona	293.3	667.0	297.8	174.3	239.2	94.5	40.1	23.5
Bilbao	1.7	1.1	159.2	0.5	0.0	0.0	0.0	0.0
Valencia	6.2	4.6	21.8	16.5	10.6	2.5	3.9	136.5
Open outcry SICAV	4,770.0	5,037.9	4,581.9	1,090.9	257.6	56.4	32.4	11.6
MAB ³	-	-	1,814.2	1,704.5	1,770.9	1,604.9	1,369.1	1,435.5
Latibex	366.4	556.7	723.3	158.0	217.0	226.5	209.1	157.3

1 Available data: November 2007.

2 Without ETF (Exchange Traded Funds).

3 Alternative Stock Market.

Trading on the electronic market by type of transaction¹

TABLE 1.7

Million euro	2004	2005	2006	2006		2007			
				IV	I	II	III	IV ²	
Regular trading	599,874.2	798,934.5	1,080,117.5	331,649.8	401,231.1	423,056.8	359,745.1	293,057.4	
Orders	353,532.0	488,416.3	658,839.2	203,310.4	255,425.4	247,466.7	232,805.5	185,698.1	
Put-throughs	71,360.1	82,403.1	105,910.7	32,102.3	39,297.4	42,731.3	34,295.0	29,247.7	
Block trades	174,982.0	228,115.1	315,367.7	96,237.1	106,508.3	132,858.9	92,644.6	78,111.5	
Off-hours	26,037.3	27,863.0	11,651.6	6,847.5	3,644.2	5,191.6	3,563.2	5,078.3	
Authorised trades	1,367.2	4,773.4	4,052.0	2,975.6	1,455.1	1,789.6	304.6	355.6	
Art. 36.1 SML trades	826.0	1.3	6,439.7	0.0	0.0	0.0	0.0	0.0	
Tender offers	1,698.8	6,682.8	18,094.6	3,922.5	4,158.7	50.0	1,995.7	20,079.8	
Public offerings for sale	3,057.2	226.3	3,264.0	576.8	0.0	5,314.0	0.0	4,568.4	
Declared trades	278.5	2,298.9	10,347.9	215.0	2,280.0	268.3	172.5	1.2	
Options	3,388.3	5,268.0	8,279.8	3,073.3	1,608.2	2,609.6	2,795.7	332.9	
Hedge transactions	-	1,615.4	2,315.7	541.1	552.3	550.9	995.9	601.5	

1 Without ETF (Exchange Traded Funds).

2 Available data: November 2007.

Margin trading for sales and securities lending

TABLE 1.8

Million euro	2004	2005	2006	2006		2007			
				IV	I	II	III	IV ¹	
TRADING									
Securities lending ²	306,056.7	393,964.1	550,850.4	162,875.2	196,697.8	245,021.9	179,969.9	168,060.0	
Margin trading for sales of securities ³	139.2	152.2	379.9	94.2	129.3	123.2	166.6	110.1	
Margin trading for securities purchases ³	401.8	465.0	511.9	152.3	146.1	108.2	72.5	63.5	
OUTSTANDING BALANCE									
Securities lending ²	54,518.5	66,737.5	62,058.2	62,058.2	75,199.6	103,293.4	92,265.1	87,136.4	
Margin trading for sales of securities ³	18.2	28.5	73.6	73.6	103.8	94.6	133.7	106.8	
Margin trading for securities purchases ³	46.7	52.3	70.1	70.1	74.5	64.0	45.3	52.4	

1 Available data: November 2007.

2 Regulated by Article 36.7 of the Securities Market Law and Order ECO/764/2004.

3 Transactions performed in accordance with Ministerial Order dated 25 March 1991 on the margin system in spot transactions.

1.2 Fixed-income

Gross issues registered¹ at the CNMV

TABLE 1.9

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ²
NO. OF ISSUERS	157	155	159	69	60	66	53	53
Mortgage covered bonds	9	9	11	6	6	4	6	2
Territorial covered bonds	2	2	5	3	2	1	2	0
Non-convertible bonds and debentures	50	49	46	18	20	18	15	3
Convertible bonds and debentures	2	4	1	0	0	0	0	0
Backed securities	48	53	61	28	13	22	16	21
Commercial paper	58	68	68	20	28	22	18	28
Of which, asset-backed	3	3	3	0	0	2	1	0
Of which, non-asset-backed	55	65	65	20	28	20	17	28
Other fixed-income issues	4	1	0	0	1	3	3	0
Preference shares	12	6	9	6	2	1	2	0
NO. OF ISSUES	257	263	335	98	88	86	76	59
Mortgage covered bonds	17	21	37	7	8	10	9	3
Territorial covered bonds	2	3	6	3	2	1	4	0
Non-convertible bonds and debentures	95	93	115	26	30	23	19	3
Convertible bonds and debentures	3	4	1	0	0	0	0	0
Backed securities	48	54	82	34	17	25	19	25
Commercial paper	62	80	83	20	28	23	20	28
Of which, asset-backed	3	3	3	0	0	2	1	0
Of which, non-asset-backed	59	77	80	20	28	21	19	28
Other fixed-income issues	5	1	0	0	1	3	3	0
Preference shares	26	7	11	8	2	1	2	0
NOMINAL AMOUNT (Million euro)	329,962.3	414,253.9	523,131.4	146,023.2	173,448.3	156,957.4	163,782.9	107,291.5
Mortgage covered bonds	19,074.0	35,560.0	44,250.0	5,030.0	8,400.0	7,245.5	6,525.0	700.0
Territorial covered bonds	1,600.0	1,775.0	5,150.0	3,200.0	1,450.0	1,500.0	2,000.0	0.0
Non-convertible bonds and debentures	38,123.6	41,907.1	46,687.5	8,272.0	9,632.0	9,342.0	7,400.0	257.0
Convertible bonds and debentures	67.4	162.8	68.1	0.0	0.0	0.0	0.0	0.0
Backed securities	50,524.8	69,044.3	91,607.7	39,766.4	39,392.2	31,517.5	17,898.3	38,691.6
Spanish tranche	38,099.5	63,908.3	85,099.9	34,207.8	39,392.2	31,517.5	17,898.3	38,691.6
International tranche	12,425.3	5,136.0	6,507.8	5,558.6	0.0	0.0	0.0	0.0
Commercial paper ³	214,602.8	264,359.5	334,457.0	88,970.8	114,144.1	106,967.4	122,464.6	67,642.9
Of which, asset-backed	3,723.6	2,767.5	1,992.7	137.0	156.0	138.8	85.0	85.0
Of which, non-asset-backed	210,879.2	261,592.0	332,464.3	88,833.8	113,988.1	106,828.6	122,379.6	67,557.9
Other fixed-income issues	428.1	89.3	0.0	0.0	350.0	310.0	7,425.0	0.0
Preference shares	5,541.5	1,356.0	911.0	784.0	80.0	75.0	70.0	0.0
Pro memoria:								
Subordinated issues	8,871.2	11,078.5	27,361.5	13,157.2	14,481.7	3,777.6	12,702.1	12,120.7
Underwritten issues	97,791.9	94,368.0	92,213.5	40,066.4	39,392.2	31,616.5	17,898.3	24,450.2

1 This Includes the volume of issues admitted to trading without register issuance prospectuses.

2 Available data: November 2007.

3 The figures for commercial paper refer to the amount placed in the year.

Issues admitted to trading on AIAF

TABLE 1.10

Nominal amount in million euro	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Total	353,772.2	425,137.4	507,525.3	135,910.4	175,388.7	147,084.9	172,663.4	101,015.6
Commercial paper	211,984.5	263,728.9	332,328.4	88,120.0	115,064.7	105,314.5	120,587.0	71,790.1
Bonds and debentures	63,878.7	56,771.5	45,155.4	6,454.0	10,632.0	7,295.0	9,375.0	2,610.0
Mortgage covered bonds	20,550.0	31,600.0	43,720.0	6,500.0	9,550.0	6,495.5	8,575.0	750.0
Territorial covered bonds	2,300.0	1,775.0	2,650.0	2,200.0	2,950.0	1,000.0	3,500.0	0.0
Backed securities	50,884.7	67,480.5	83,042.5	32,127.5	36,830.0	26,904.9	30,556.5	25,865.5
Preference shares	4,174.3	3,781.5	629.0	509.0	362.0	75.0	70.0	0.0
Matador bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

1 Available data: November 2007.

AIAF. Issuers, issues and outstanding balance

TABLE 1.11

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
NO. OF ISSUERS	324	384	438	438	448	457	472	486
Commercial paper	63	66	69	69	68	66	71	71
Bonds and debentures	76	82	80	80	93	92	92	92
Mortgage covered bonds	10	12	14	14	15	15	14	14
Territorial covered bonds	3	3	5	5	7	7	7	7
Backed securities	163	211	257	257	268	280	297	311
Preference shares	33	42	46	46	49	49	50	50
Matador bonds	20	20	20	20	18	17	16	15
NO. OF ISSUES	2,459	2,836	3,681	3,681	3,985	4,143	4,293	4,319
Commercial paper	1,593	1,724	2,242	2,242	2,451	2,539	2,552	2,512
Bonds and debentures	271	329	398	398	423	430	452	453
Mortgage covered bonds	41	54	83	83	90	98	106	109
Territorial covered bonds	5	8	11	11	14	15	19	19
Backed securities	468	631	856	856	916	971	1,074	1,137
Preference shares	47	58	65	65	69	70	71	71
Matador bonds	34	32	26	26	22	20	19	18
OUTSTANDING BALANCE² (million euro)	307,428.8	448,679.3	588,942.3	588,942.3	645,466.6	675,996.4	729,774.6	748,988.5
Commercial paper	45,176.7	57,719.4	70,778.6	70,778.6	77,054.5	81,591.4	97,795.9	101,106.9
Bonds and debentures	68,044.8	103,250.7	131,107.8	131,107.8	138,282.1	136,090.3	142,655.3	141,615.3
Mortgage covered bonds	57,324.5	90,550.0	129,710.0	129,710.0	139,260.0	145,755.5	151,330.5	149,080.5
Territorial covered bonds	5,800.0	7,575.0	9,525.0	9,525.0	12,475.0	13,475.0	16,375.0	16,375.0
Backed securities	109,862.5	164,810.0	222,866.1	222,866.1	253,378.5	274,173.0	297,196.9	316,510.0
Preference shares	18,705.1	22,486.6	23,115.6	23,115.6	23,417.6	23,492.6	23,062.6	23,062.6
Matador bonds	2,515.1	2,287.6	1,839.2	1,839.2	1,598.8	1,418.5	1,358.4	1,238.2

1 Available data: November 2007.

2 Nominal amount.

AIAF. Trading

TABLE 1.12

Nominal amount in million euro	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
BY TYPE OF ASSET. Total	572,030.0	877,812.1	910,493.9	270,334.3	286,592.8	262,799.2	287,044.2	193,773.3
Commercial paper	291,902.6	408,185.0	489,069.5	140,827.7	153,727.0	140,611.4	148,715.3	86,308.2
Bonds and debentures	51,263.3	86,585.7	82,421.1	19,567.1	27,157.8	25,082.6	19,214.4	9,637.9
Mortgage covered bonds	46,014.4	60,060.9	70,113.5	21,803.3	21,036.3	19,535.9	16,042.3	14,054.9
Territorial covered bonds	3,356.9	2,740.1	3,659.1	2,588.9	1,216.9	568.4	4,315.0	1,101.8
Backed securities	171,724.6	313,778.5	257,628.9	83,470.8	81,489.8	75,463.1	97,548.2	81,720.4
Preference shares	4,139.4	4,046.2	4,647.8	1,512.0	1,409.7	1,031.7	897.7	949.2
Matador bonds	3,628.8	2,415.7	2,954.1	564.7	555.2	506.2	311.4	0.9
BY TYPE OF TRANSACTION. Total	572,030.0	877,812.0	910,493.9	270,334.3	286,592.8	262,799.2	287,044.2	193,773.3
Outright	242,333.0	322,819.0	386,368.8	118,623.9	114,617.8	100,039.0	104,013.7	63,151.9
Repos	197,778.0	284,520.0	330,839.9	98,597.3	120,468.5	117,077.4	109,684.9	67,681.6
Sell-buybacks/Buy-sellbacks	131,919.0	270,473.0	193,285.1	53,113.1	51,506.4	45,682.8	73,345.6	62,939.8

1 Available data: November 2007.

AIAF. Third-party trading. By purchaser sector

TABLE 1.13

Nominal amount in million euro	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Total	430,127.3	591,837.2	702,608.8	213,205.3	231,736.2	211,982.4	209,271.8	125,316.7
Non-financial companies	176,479.7	218,139.5	260,108.1	78,073.8	88,151.6	102,730.2	91,476.3	58,103.1
Financial institutions	138,401.6	218,381.1	247,876.4	68,679.6	68,858.1	71,023.9	73,910.0	48,283.0
Credit institutions	43,446.8	71,118.9	83,999.1	26,313.7	20,027.7	26,406.4	26,507.9	17,402.7
CIS ² , insurance and pension funds	90,163.8	138,580.4	145,911.5	37,714.5	40,317.3	38,310.3	39,606.4	25,079.7
Other financial institutions	4,790.9	8,681.8	17,965.8	4,651.4	8,513.2	6,307.3	7,795.7	5,800.7
General government	1,695.9	5,629.4	7,058.9	2,317.3	2,514.1	2,195.6	1,944.6	792.3
Households and NPISHs ³	16,100.1	14,433.3	23,675.9	7,080.9	16,310.4	4,427.7	4,047.5	2,712.2
Rest of the world	97,450.1	135,253.9	163,889.4	57,053.7	55,902.0	31,605.1	37,893.3	15,426.1

1 Available data: November 2007.

2 Collective Investment Schemes.

3 Non-profit institutions serving households.

Issues admitted to trading on equity markets. Files registered with the CNMV

TABLE 1.14

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
NOMINAL AMOUNTS (Million euro)	113.3	1,234.6	68.1	0.0	0.0	0.0	0.0	7,000.0
Non-convertible bonds and debentures	50.0	1,140.0	0.0	0.0	0.0	0.0	0.0	0.0
Convertible bonds and debentures	63.3	94.6	68.1	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7,000.0
NO. OF FILES	3	6	1	0	0	0	0	1
Non-convertible bonds and debentures	1	3	0	0	0	0	0	0
Convertible bonds and debentures	2	3	1	0	0	0	0	0
Others	0	0	0	0	0	0	0	1

1 Available data: November 2007.

Equity markets. Issuers, issues and outstanding balances

TABLE 1.15

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
NO. OF ISSUERS	52	56	57	57	56	53	51	65
Private issuers	35	39	40	40	40	38	38	39
Non-financial companies	12	12	10	10	10	8	8	7
Financial institutions	23	27	30	30	30	30	30	32
General government	17	17	17	17	16	15	13	13
Regional governments	3	3	3	3	3	3	3	3
NO. OF ISSUES	264	267	264	264	252	247	244	245
Private issuers	113	122	131	131	129	121	121	126
Non-financial companies	28	22	18	18	17	14	14	13
Financial institutions	85	100	113	113	112	107	107	113
General government	151	145	133	133	123	126	123	119
Regional governments	87	92	89	89	87	91	89	86
OUTSTANDING BALANCES² (Million euro)	14,460.0	16,323.0	17,105.4	17,105.4	16,952.6	16,594.7	6,055.4	14,019.2
Private issuers	4,533.2	5,507.3	6,784.3	6,784.3	6,596.0	6,183.0	6,055.4	14,019.2
Non-financial companies	1,244.7	835.4	492.1	492.1	486.3	454.0	454.0	454.4
Financial institutions	3,288.5	4,671.9	6,292.2	6,292.2	6,109.7	5,729.0	5,601.4	13,564.8
General government ³	9,926.8	10,816.1	10,321.1	10,321.1	10,356.6	10,411.7	10,862.8	10,945.5
Regional governments	7,198.2	8,457.2	8,319.8	8,319.8	8,665.6	8,721.4	8,788.0	9,111.1

1 Available data: November 2007.

2 Nominal amount.

3 Without public book-entry debt.

Trading on equity markets

TABLE 1.16

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Nominal amounts in million euro								
Electronic market	227.0	220.0	257.3	37.7	87.2	23.5	17.8	162.0
Open outcry	490.1	4,538.3	5,009.9	1,899.0	2,067.1	592.6	471.1	1,793.0
Madrid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Barcelona	50.4	4,404.2	4,879.6	1,867.8	2,033.0	563.6	445.3	1,777.7
Bilbao	309.2	9.2	24.8	2.6	1.6	2.0	1.7	1.6
Valencia	130.5	124.8	105.5	28.5	32.4	27.0	24.1	13.7
Public book-entry debt	40.8	36.1	35.6	9.9	7.7	10.4	6.9	6.0
Regional governments debt	76,258.8	83,204.0	84,443.6	18,365.4	20,980.3	21,295.2	20,750.1	15,624.9

1 Available data: November 2007.

Organised trading systems: SENAF y MTS. Public debt trading by type

TABLE 1.17

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Nominal amounts in million euro								
Total	381.1	219.5	175.1	36.4	26.1	22.9	14.1	21.7
Outright	104.1	71.0	94.3	19.1	17.3	14.1	12.0	10.8
Sell-buybacks/Buy-sellbacks	274.8	148.5	80.2	17.3	8.8	8.8	2.0	10.9
Others	2.2	0.1	0.6	0.0	0.0	0.0	0.0	0.0

1 Available data: November 2007.

1.3 Derivatives and other products

1.3.1 Financial derivatives markets: MEFF

Trading on MEFF

TABLE 1.18

NO. OF CONTRACTS	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Debt products	98	46	15	3	1	4	4	2
Debt futures ²	98	46	15	3	1	4	4	2
Ibex 35 products ^{3,4}	4,767,871	5,490,958	7,119,853	1,998,653	2,246,165	2,443,146	2,423,272	1,562,555
Ibex 35 plus futures	4,354,868	4,935,648	6,408,961	1,755,309	2,056,808	2,235,602	2,211,103	1,401,789
Ibex 35 mini futures	118,250	114,563	159,830	46,228	62,981	70,034	78,006	56,239
Call mini options	148,119	232,825	288,542	116,334	48,028	53,850	43,365	40,277
Put mini options	146,634	207,922	262,521	80,783	78,348	83,661	90,798	64,250
Stock products ⁵	20,255,113	29,728,916	33,655,790	8,397,012	6,916,993	6,818,146	8,141,493	5,800,109
Futures	12,054,799	18,813,689	21,229,811	4,888,296	3,777,996	3,773,666	5,105,492	3,080,587
Call options	5,226,872	6,803,863	7,664,125	2,587,277	1,624,490	1,655,261	1,398,403	1,334,382
Put options	2,973,442	4,111,364	4,761,854	921,439	1,514,507	1,389,219	1,637,598	1,385,140
Pro-memoria: MEFF trading on Eurex								
Debt products ⁶	2,815,703	1,440,370	1,117,956	222,213	242,092	303,004	294,058	172,226
Index products ⁷	1,784,965	1,080,801	1,423,441	287,166	338,709	401,267	365,491	196,232

1 Available data: November 2007.

2 Contract size: 100 thousand euros.

3 The number of Ibex 35 mini futures (multiples of 1 euro) was standardised to the size of the Ibex 35 plus futures (multiples of 10 euro).

4 Contract size: Ibex 35 * 10 euros.

5 Contract size: 100 Stocks.

6 Bund, Bobl and Schatz futures.

7 Dax 30, DJ EuroStoxx 50 and DJ Stoxx 50 futures.

1.3.2 Warrants, option buying and selling contracts, and ETF (Exchange Traded Funds)

Issues registered at the CNMV

TABLE 1.19

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
WARRANTS²								
Premium amount (Million euro)	1,525.3	1,840.0	5,144.3	1,713.0	1,942.1	1,492.9	2,971.6	2,332.4
On stocks	929.0	1,180.8	3,697.6	1,243.1	1,411.9	1,077.8	1,888.6	1,737.1
On indexes	553.8	559.9	1,064.9	414.2	449.4	380.9	951.7	447.6
Other underlyings ³	42.5	99.3	381.8	55.6	80.7	34.2	131.2	147.8
Number of issues	1,600	1,720	4,063	1,652	1,667	1,404	1,808	2,037
Number of issuers	7	6	8	7	7	6	7	6
OPTION BUYING AND SELLING CONTRACTS								
Nominal amounts (Million euro)	247.7	112.2	206.8	42.0	61.0	45.0	25.0	10.0
On stocks	195.3	87.8	196.2	32.0	55.0	45.0	25.0	10.0
On indexes	48.7	16.4	0.6	0.0	0.0	0.0	0.0	0.0
Other underlyings ³	3.8	8.0	10.0	10.0	6.0	0.0	0.0	0.0
Number of issuers	31	13	12	4	4	2	1	1
Number of issues	8	4	4	2	3	1	1	1

1 Available data: November 2007.

2 Includes issues not requiring a prospectus by application of the new regulations.

3 Includes the following underlying: baskets of stocks, exchange rates, interest rates and commodities.

Equity markets. Warrants and ETF trading

TABLE 1.20

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
WARRANTS								
Trading (Million euro)	1,826.9	2,142.4	2,907.4	849.9	1,169.4	1,323.8	1,429.6	976.9
On Spanish stocks	1,141.7	1,431.7	1,803.9	603.3	784.1	823.3	805.4	635.1
On foreign stocks	95.1	155.8	294.7	97.8	120.8	133.6	115.1	84.9
On indexes	550.7	516.8	727.4	119.2	237.8	351.3	489.9	244.4
Other underlyings ²	39.3	38.0	81.4	29.6	26.8	15.6	19.3	12.5
Number of issues ³	2,207	2,520	4,284	2,475	3,073	3,440	3,848	3,670
Number of issuers ³	8	8	9	9	9	9	9	8
CERTIFICATES								
Trading (Million euro)	78.6	69.8	58.8	15.3	14.3	14.7	7.6	10.3
Number of issues ³	16	15	14	11	10	12	11	15
Number of issuers ³	5	5	5	4	3	3	3	3
ETF								
Trading (Million euro)	-	-	-	1,218.0	927.2	832.8	844.9	1,700.1
Number of funds	-	-	-	5	5	5	12	20
Assets ⁴ (Million euro)	-	-	-	376.8	507.8	521.6	511.8	na

1 Available data: November 2007.

2 Includes the following underlying: baskets of stocks, exchange rates, interest rates and commodities.

3 Issues or issuers which were traded in each period.

4 Foreign collective investment schemes including the investment volume marketed in Spain.

na: No available data.

1.3.3 Non- financial derivatives

Trading on MFAO¹

TABLE 1.21

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ²
Number of contracts								
On olive oil								
Extra – virgin olive oil futures ³	10,693	21,145	35,079	6,400	16,679	14,173	5,832	8,044

1 Olive oil futures market.

2 Available data: November 2007.

3 Nominal amount of the contract: 1,000 kg.

2 Investment services

Investment services. Spanish firms, branches and agents

TABLE 2.1

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Broker – dealers								
Spanish firms	48	46	47	47	45	46	46	47
Branches	90	96	108	108	95	97	100	101
Agents	6,453	6,562	6,610	6,610	6,466	6,614	6,618	6,594
Brokers								
Spanish firms	55	56	57	57	55	55	54	54
Branches	13	11	11	11	11	12	12	13
Agents	363	516	589	589	601	644	647	628
Portfolio management companies								
Spanish firms	21	17	15	15	14	13	12	12
Branches	4	4	4	4	4	4	4	4
Agents	3	14	5	5	5	5	6	6
Credit institutions²								
Spanish firms	207	206	204	204	204	202	202	202

1 Available data: November 2007.

2 Source: Banco de España.

Investment services. Foreign firms

TABLE 2.2

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Total	1,107	1,196	1,321	1,321	1,357	1,386	1,432	1,456
European Economic Area investment services firms	801	867	973	973	1,005	1,027	1,068	1,087
Branches	19	18	22	22	24	25	26	28
Free provision of services	782	849	951	951	981	1,002	1,042	1,059
Credit institutions ²	306	329	348	348	352	359	364	369
From EU member states	297	320	339	339	344	351	355	360
Branches	37	38	44	44	45	49	50	52
Free provision of services	259	281	294	294	298	301	304	307
Subsidiaries of free provision of services institutions	1	1	1	1	1	1	1	1
From non-EU states	9	9	9	9	8	8	9	9
Branches	8	8	8	8	7	7	8	8
Free provision of services	1	1	1	1	1	1	1	1

¹ Available data: November 2007.

² Source: Banco de España.

Intermediation of spot transactions

TABLE 2.3

Million euro	III 2006				III 2007			
	Spanish Stock Exchange	Other Spanish markets	Foreign markets	Total	Spanish Stock Exchange	Others Spanish markets	Foreign markets	Total
FIXED - INCOME								
Total	3,837	2,387,461	316,785	2,708,083	6,698	2,604,288	256,176	2,867,162
Broker-dealers	3,816	231,258	38,379	273,453	6,447	189,464	43,066	238,977
Brokers	21	2,156,203	278,406	2,434,630	251	2,414,824	213,110	2,628,185
EQUITY								
Total	381,916	1,380	18,661	401,957	520,627	1,737	32,452	554,816
Broker-dealers	357,067	841	15,868	373,776	490,105	843	29,459	520,407
Brokers	24,849	539	2,793	28,181	30,522	894	2,993	34,409

Intermediation of derivative transactions¹

TABLE 2.4

Million euro	III 2006				III 2007			
	Spanish organised markets	Foreign organised markets	Non-organised markets	Total	Spanish organised markets	Foreign organised markets	Non-organised markets	Total
Total	218,581	1,210,502	1,089,031	2,518,114	288,268	2,591,170	1,057,950	3,937,388
Broker - dealers	88,763	296,119	4,178	389,060	83,814	305,357	39,077	428,248
Brokers	129,818	914,383	1,084,853	2,129,054	204,454	2,285,813	1,018,873	3,509,140

¹ The amount of the buy and sell transactions of financial assets, financial futures on values and interest rates, and other transactions on interest rates will be the securities nominal or notional value or the principal to which the contract reaches. The amount of the transactions on options will be the strike price of the underlying asset multiplied by the number of instruments committed.

Portfolio management. Number of portfolios and assets under management

TABLE 2.5

	III 2006			III 2007		
	Total	IIC ¹	Other ²	Total	IIC ¹	Other ²
NUMBER OF PORTFOLIOS						
Total	16,958	92	16,866	19,522	98	19,424
Broker - dealers	9,044	21	9,023	10,942	26	10,916
Brokers	3,920	36	3,884	4,102	36	4,066
Portfolio management companies	3,994	35	3,959	4,478	36	4,442
ASSETS UNDER MANAGEMENT (thousand euro)						
Total	13,393,961	1,363,612	12,030,349	14,392,649	1,623,472	12,769,177
Broker - dealers	5,017,666	654,809	4,362,857	6,138,028	785,005	5,353,023
Brokers	4,465,009	439,257	4,025,752	3,476,861	548,258	2,928,603
Portfolio management companies	3,911,286	269,546	3,641,740	4,777,760	290,209	4,487,551

¹ IIC: Collective investment schemes.

² Includes the rest of clients, both covered and not covered by the Investment Guarantee Fund, an investor compensation scheme regulated by Royal Decree 948/2001.

Aggregated income statement. Broker – dealers

TABLE 2.6

Thousand euro ¹	2004	2005	2006	2006	2007	II	III	IV ²
				IV	I			
I. FINANCIAL INCOME	78,435	57,653	17,325	17,325	8,484	11,025	-15,840	-11,081
II. NET INCOME FROM SECURITIES TRADING	-44,315	200,360	48,335	48,335	38,135	-166,565	-214,615	-273,617
III. NET COMMISSION	539,154	653,273	775,377	775,377	240,751	485,244	680,927	765,495
Commission revenues	700,061	847,524	1,009,089	1,009,089	312,113	624,257	894,244	1,005,387
Brokering	449,067	526,241	629,952	629,952	215,607	409,875	588,741	659,739
Placement and underwriting	39,904	58,685	73,278	73,278	9,161	31,775	47,019	51,602
Securities deposit and recording	15,237	17,593	22,367	22,367	5,743	12,455	18,665	21,297
Portfolio management	14,141	20,599	23,883	23,883	6,757	14,570	20,388	23,109
Design and advising	35,131	52,180	55,918	55,918	20,736	40,110	51,793	60,806
Stocks search and placement	12	6	0	0	9	9	9	9
Market credit transactions	128	56	33	33	5	11	17	19
IIC subscription and redemption	104,909	118,871	141,312	141,312	34,771	70,425	105,659	118,508
Other	41,532	53,293	62,346	62,346	19,324	45,027	61,953	70,298
Commission expenses	160,907	194,251	233,712	233,712	71,362	139,013	213,317	239,892
IV. TOTAL NET REVENUES	573,274	911,286	841,037	841,037	287,370	329,704	450,472	480,797
V. OPERATING INCOME	207,113	498,362	395,105	395,105	173,463	98,455	113,320	103,856
VI. EARNINGS AFTER TAXES	215,903	266,734	430,651	430,651	280,510	482,067	674,057	710,369

1 Added amounts from the beginning of the year to the last day of every quarter. From 2005 it includes companies removed through out the year.

2 Available data: October 2007.

Results of proprietary trading. Broker – dealers

TABLE 2.7

Thousand euro ¹	Total		Financial income		Securities portfolio		Other charges	
	III 2006	III 2007	III 2006	III 2007	III 2006	III 2007	III 2006	III 2007
Total	159,678	-236,757	20,034	-15,840	138,978	-214,615	666	-6,302
Money market assets and public debt	3,796	-17,193	7,293	2,967	-3,497	-20,160	0	0
Other fixed – income securities	34,290	63,273	28,086	44,807	6,204	18,466	0	0
Domestic portfolio	32,407	62,276	25,695	41,276	6,712	21,000	0	0
Foreign portfolio	1,883	997	2,391	3,531	-508	-2,534	0	0
Equities	110,099	219,519	38,299	83,233	71,800	136,286	0	0
Domestic portfolio	91,169	140,601	10,169	33,345	81,000	107,256	0	0
Foreign portfolio	18,930	78,918	28,130	49,888	-9,200	29,030	0	0
Derivatives	74,644	-337,463	0	0	74,644	-337,463	0	0
Repurchase agreements	-10,432	-8,028	-10,432	-8,028	0	0	0	0
Market credit transactions	0	0	0	0	0	0	0	0
Deposits and other transactions with financial intermediaries	-78,530	-148,603	-78,530	-148,603	0	0	0	0
Other transactions	25,811	-8,262	35,318	9,784	-10,173	-11,744	666	-6,302

1 Added amounts from the beginning of the year to the last day of every quarter. From 2005 it includes companies removed through out the year.

Aggregated income statement. Brokers

TABLE 2.8

Thousand euro ¹	2004	2005	2006	2006	2007	II	III	IV ²
				IV	I			
I. FINANCIAL INCOME	7,677	10,665	12,934	12,934	3,275	6,899	10,500	12,813
II. NET INCOME FROM SECURITIES TRADING	622	3,306	3,906	3,906	437	1,120	651	760
III. NET COMMISSION	157,362	184,113	233,447	233,447	62,888	121,309	177,379	195,877
Commission revenues	191,091	229,752	297,030	297,030	81,545	159,573	233,859	258,271
Brokering	88,168	97,948	114,111	114,111	34,088	66,060	96,183	106,733
Placement and underwriting	1,355	3,821	3,183	3,183	465	1,470	2,409	2,547
Securities deposit and recording	1,389	1,357	1,520	1,520	683	1,005	1,294	1,449
Portfolio management	13,747	14,868	28,672	28,672	8,177	14,534	20,239	22,780
Design and advising	1,959	2,664	2,360	2,360	423	1,119	1,273	1,151
Stocks search and placement	0	0	0	0	0	0	0	0
Market credit transactions	0	0	0	0	1	1	1	0
IIC subscription and redemption	26,452	46,171	68,513	68,513	17,629	37,345	57,090	63,376
Other	58,021	62,923	78,671	78,671	20,079	38,039	55,370	60,235
Commission expenses	33,729	45,639	63,583	63,583	18,657	38,264	56,480	62,394
IV. TOTAL NET REVENUES	165,661	198,084	250,287	250,287	66,600	129,328	188,530	209,450
V. OPERATING INCOME	43,424	66,420	95,026	95,026	28,709	53,410	76,858	85,627
VI. EARNINGS AFTER TAXES	20,763	38,264	62,449	62,449	33,484	64,113	85,525	107,004

1 Added amounts from the beginning of the year to the last day of every quarter. From 2005 it includes companies removed through out the year.

2 Available data: October 2007.

Aggregated income statement. Portfolio management companies

TABLE 2.9

Thousand euro ¹	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ²
I. FINANCIAL INCOME	550	575	895	895	338	705	1,095	1,207
II. NET INCOME FROM SECURITIES TRADING	89	65	6	6	-1	-16	-8	68
III. NET COMMISSION	15,155	17,164	15,195	15,195	3,875	7,485	11,313	13,202
Commission revenues	15,868	25,508	27,625	27,625	7,435	14,804	22,411	25,006
Portfolio management	10,450	18,813	22,068	22,068	6,028	12,371	19,114	20,888
Design and advising	3,265	4,380	4,951	4,951	898	1,380	1,668	2,297
IIC subscription and redemption	320	592	261	261	393	820	1,281	1,434
Other	1,833	1,723	345	345	116	233	348	387
Commission expenses	713	8,344	12,430	12,430	3,560	7,319	11,098	11,804
IV. TOTAL NET REVENUES	15,794	17,804	16,096	16,096	4,212	8,174	12,400	14,477
V. OPERATING INCOME	4,528	6,051	6,352	6,352	1,661	3,171	4,967	6,192
VI. EARNINGS AFTER TAXES	1,730	3,465	4,112	4,112	1,420	2,477	3,597	4,455

¹ Added amounts from the beginning of the year to the last day of every quarter. From 2005 it includes companies removed through out the year.

² Available data: October 2007.

Surplus equity over capital adequacy requirements¹

TABLE 2.10

Thousand euro	Surplus		Number of companies according to its surplus percentage									
	Total amount	% ²	< 50 ³	<100	<150	<200	<300	<400	<500	<750	<1000	>1000
Total	1,177,288	323.44	12	26	7	6	19	8	7	8	6	13
Broker – dealers	1,040,544	371.88	2	8	1	0	10	5	5	3	4	8
Brokers	124,420	206.36	7	14	5	5	8	2	2	5	1	5
Portfolio management companies	12,324	51.59	3	4	1	1	1	1	0	0	1	0

¹ Available data: September 2007.

² Average percentage is weighted by the required equity of each company. It is an indicator of the number of times, in percentage terms, that the surplus contains the required equity in an average company.

³ Includes all registered companies, even if they have not sent information.

Return on equity (ROE) before taxes¹

TABLE 2.11

	Average ²	Number of companies according to its annualized return									
		Losses	0-5%	6-15%	16-30%	31-45%	46-60%	61-75%	76-100%	>100%	
Total	64.55	11	10	15	19	12	6	6	11	22	
Broker – dealers	67.66	1	1	6	8	7	2	4	4	13	
Brokers	53.07	8	8	6	7	5	3	2	6	9	
Portfolio management companies	13.80	2	1	3	4	0	1	0	1	0	

¹ Available data: September 2007.

² Average weighted by equity, %.

3 Collective investment schemes (IIC)¹

Number, management companies and depositories of collective investment schemes registered at the CNMV

TABLE 3.1

	2004	2005	2006	2006	2007			
				IV	I	II	III	IV ¹
Total financial IIC	5,717	5,841	6,006	6,006	6,071	6,169	6,245	6,291
Mutual funds	2,620	2,723	2,850	2,850	2,885	2,921	2,947	2,963
Investment companies	3,097	3,118	3,149	3,149	3,178	3,217	3,251	3,278
Funds of hedge funds	-	-	2	2	2	22	30	31
Hedge funds	-	-	5	5	6	9	17	19
Total real estate IIC	9	13	17	17	17	17	19	19
Real estate investment funds	7	7	9	9	9	9	10	10
Real estate investment companies	2	6	8	8	8	8	9	9
Total foreign IIC marketed in Spain	238	260	340	340	354	362	397	431
Foreign funds marketed in Spain	93	115	164	164	169	171	197	223
Foreign companies marketed in Spain	145	145	177	177	185	191	200	208
Management companies	116	112	114	114	116	116	121	120
IIC depositories	137	135	132	132	129	127	127	127

¹ Available data: November 2007.

¹ In this document, neither hedge funds nor funds of hedge funds are included in the figures referred to mutual funds.

Number of IIC investors and shareholders

TABLE 3.2

	2004	2005	2006	2006		2007			
				IV	I	II	III	IV ¹	
Total financial IIC	8,261,376	8,869,084	9,048,207	9,048,207	9,156,645	9,180,702	8,900,911	-	
Mutual funds	7,880,076	8,450,164	8,637,781	8,637,781	8,740,972	8,755,921	8,467,203	8,367,841	
Investment companies	381,300	418,920	410,403	410,403	415,539	423,142	430,315	-	
Funds of hedge funds ²	-	-	2	2	26	1,456	3,142	3,330	
Hedge funds	-	-	21	21	108	183	251	536	
Total real estate IIC	86,490	119,113	151,053	151,053	153,656	154,426	152,577	148,987	
Real estate investment funds	86,369	118,857	150,304	150,304	152,902	153,630	151,916	148,306	
Real estate investment companies	121	256	749	749	754	796	661	681	
Total foreign IIC marketed in Spain	321,805	560,555	779,165	779,165	782,020	825,771	834,914	-	
Foreign funds marketed in Spain	51,364	104,089	144,139	144,139	158,900	176,884	158,925	-	
Foreign companies marketed in Spain	270,441	456,466	635,026	635,026	623,120	648,887	675,989	-	

1 Available data: October 2007. Real estate investment companies and foreign IIC send this information quarterly.

2 Provisional data in case of funds of hedge funds

IIC total net assets

TABLE 3.3

Million euro	2004	2005	2006	2006		2007			
				IV	I	II	III	IV ¹	
Total financial IIC	261,191.7	289,810.7	300,584.0	300,584.0	305,058.2	310,144.3	303,306.6	300,927.2	
Mutual funds ²	236,088.4	262,200.9	270,406.3	270,406.3	273,412.8	276,600.4	269,907.0	266,686.6	
Investment companies	25,103.3	27,609.8	30,152.7	30,152.7	31,516.0	32,791.7	32,360.1	33,026.2	
Funds of hedge funds ³	-	-	0.6	0.6	9.5	600.2	829.2	882.0	
Hedge funds	-	-	24.4	24.4	119.9	152.0	210.2	332.4	
Total real estate IIC	4,434.4	6,690.8	9,052.0	9,052.0	9,240.8	9,416.8	9,409.6	9,467.9	
Real estate investment funds	4,377.9	6,476.9	8,595.9	8,595.9	8,781.7	8,929.4	8,905.3	8,959.4	
Real estate investment companies	56.4	213.9	456.1	456.1	459.2	487.4	504.3	508.6	
Total foreign IIC marketed in Spain	17,785.6	33,668.1	44,102.9	44,102.9	45,113.8	50,040.1	44,847.4	-	
Foreign funds marketed in Spain	3,498.1	8,267.3	12,099.3	12,099.3	12,464.3	14,194.5	10,530.7	-	
Foreign companies marketed in Spain	14,287.4	25,400.8	32,003.5	32,003.5	32,649.6	35,845.6	34,316.7	-	

1 Available data: October 2007. Real estate investment companies and foreign IIC send this information quarterly.

2 For the third quarter 2007, mutual funds investments in financial IIC reached 19 billion euro

3 Provisional data in case of funds of hedge funds

Mutual funds asset allocation^{1,2}

TABLE 3.4

Million euro	2004	2005	2006	2006		2007			
				IV	I	II	III	IV ³	
Asset	236,088.4	262,200.9	270,406.9	270,406.9	273,422.3	277,200.6	270,736.3	267,568.6	
Cash	6,506.5	8,207.5	10,462.9	10,462.9	11,228.2	11,578.9	14,698.8	13,669.9	
Portfolio investment	230,212.7	255,273.6	260,002.9	260,002.9	262,034.2	265,596.0	255,694.9	253,551.3	
Domestic securities	114,058.9	123,683.6	127,355.4	127,355.4	130,070.3	131,055.2	137,101.4	137,564.8	
Shares	9,578.3	11,602.1	13,806.8	13,806.8	14,389.8	14,196.3	12,619.2	13,020.5	
Mutual funds units	16,782.6	17,255.9	17,322.8	17,322.8	17,377.4	18,719.4	19,667.5	19,238.7	
Public money market assets	4,434.9	4,149.4	2,887.7	2,887.7	3,306.6	2,539.7	2,329.6	2,366.0	
Other public fixed-income	11,422.9	10,088.7	9,891.6	9,891.6	10,178.1	9,715.2	9,488.6	8,653.5	
Private money market assets	19,735.9	26,850.7	28,483.2	28,483.2	29,522.6	30,711.7	35,565.7	36,963.5	
Other private fixed-income	14,235.6	18,835.6	23,105.3	23,105.3	24,646.1	24,879.8	24,363.4	24,414.6	
Spanish warrants and options	157.0	483.1	603.3	603.3	578.1	675.3	569.1	732.6	
Repos	37,706.7	34,417.8	31,229.4	31,229.4	30,046.1	29,592.5	32,497.9	32,166.0	
Unlisted securities	5.0	0.2	25.4	25.4	25.4	25.4	0.2	9.3	
Foreign securities	116,153.8	131,590.0	132,647.4	132,647.4	131,963.9	134,540.7	118,593.5	115,986.5	
Euros	107,682.4	118,871.5	118,664.1	118,664.1	118,953.6	120,459.4	106,110.8	103,147.3	
Shares	7,065.6	8,925.1	11,418.0	11,418.0	12,823.3	14,247.4	12,735.6	12,580.7	
Mutual fund units	11,184.8	15,986.0	23,414.2	23,414.2	22,849.5	23,440.2	16,876.9	16,259.5	
Fixed-income	86,833.3	90,220.7	78,933.4	78,933.4	78,365.1	77,447.7	71,585.9	69,368.6	
Foreign warrants and options	2,598.8	3,739.7	4,898.7	4,898.7	4,915.7	5,324.0	4,912.4	4,938.5	
Unlisted securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other	8,471.4	12,718.5	13,983.3	13,983.3	13,010.3	14,081.3	12,482.7	12,839.2	
Shares	4,991.0	7,019.5	7,343.0	7,343.0	7,085.0	7,705.1	6,893.3	7,000.6	
Mutual fund units	2,576.7	4,395.6	5,491.5	5,491.5	4,812.2	5,343.0	4,774.1	5,026.3	
Fixed-income	875.9	1,204.8	1,011.7	1,011.7	978.0	888.4	675.9	666.0	
Foreign warrants and options	27.7	97.2	136.0	136.0	134.2	143.7	138.4	145.5	
Unlisted securities	0.0	1.4	1.2	1.2	1.0	1.1	1.1	0.9	
Net balance (Debtors -Creditors)	-630.9	-1,280.3	-58.8	-58.8	160.0	25.7	342.5	347.4	

1 Hedge funds are not included in these figures. The information is not available because hedge funds have different accounting regulation.

2 Provisional data in case of funds of hedge funds

3 Available data: October 2007.

Investment companies asset allocation

TABLE 3.5

Million euro	2004	2005	2006	2006		2007		
				IV	I	II	III	IV ¹
Asset	25,103.3	27,610.0	30,152.7	30,152.7	31,516.0	32,791.7	32,360.1	33,026.2
Cash	632.6	728.9	802.2	802.2	870.9	1,004.7	1,021.6	1,167.6
Portfolio investment	24,338.5	26,884.9	29,294.1	29,294.1	30,407.1	31,692.4	31,105.2	31,732.4
Domestic securities	13,710.4	13,851.1	15,553.8	15,553.8	15,929.3	15,905.8	16,841.4	17,385.3
Shares	4,831.2	5,906.5	6,727.3	6,727.3	7,050.5	7,191.8	6,528.1	6,834.3
Mutual funds units	755.2	941.2	1,095.0	1,095.0	1,143.6	1,309.5	1,392.5	1,437.8
Public money market assets	90.0	128.1	463.4	463.4	362.7	418.1	434.3	429.9
Other public fixed-income	754.8	897.0	678.2	678.2	737.3	802.0	755.0	716.0
Private money market assets	152.0	359.1	555.4	555.4	623.6	732.9	1,032.2	1,327.6
Other private fixed-income	339.5	397.3	554.8	554.8	571.5	534.9	548.8	568.2
Spanish warrants and options	7.3	15.3	19.7	19.7	21.1	23.0	25.2	26.2
Repos	6,779.2	5,206.2	5,459.1	5,459.1	5,418.1	4,892.7	6,121.4	6,040.7
Unlisted securities	1.2	0.3	0.8	0.8	0.8	0.8	4.0	4.6
Foreign securities	10,628.1	13,033.8	13,740.3	13,740.3	14,477.8	15,786.6	14,263.8	14,347.0
Euros	7,590.0	9,178.6	9,847.7	9,847.7	10,522.9	11,635.6	10,295.1	10,283.0
Shares	2,315.2	2,885.6	3,379.9	3,379.9	3,676.0	4,414.1	3,928.2	3,952.3
Mutual fund units	2,520.8	3,351.6	4,169.1	4,169.1	4,523.4	5,012.2	4,254.0	4,227.9
Fixed-income	2,642.5	2,755.8	2,041.5	2,041.5	2,061.5	1,984.2	1,877.3	1,865.3
Foreign warrants and options	109.8	185.7	257.2	257.2	262.0	225.1	235.7	237.6
Unlisted securities	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	3,038.0	3,855.2	3,892.6	3,892.6	3,954.9	4,151.0	3,968.7	4,064.0
Shares	1,888.0	2,173.9	2,104.7	2,104.7	2,080.2	2,086.3	1,923.8	1,945.3
Mutual fund units	934.1	1,403.7	1,517.7	1,517.7	1,672.9	1,852.7	1,816.5	1,888.5
Fixed-income	214.4	270.0	234.8	234.8	188.3	199.7	219.5	221.0
Foreign warrants and options	1.6	7.5	11.3	11.3	13.6	12.3	8.9	9.3
Unlisted securities	0.0	0.1	24.1	24.1	0.0	0.0	0.0	0.0
Net balance (Debtors - Creditors)	132.2	,3.8	56.4	56.4	238.0	94.7	233.3	126.3

1 Available data: October 2007.

Financial mutual funds: number, investors and total net assets by category¹

TABLE 3.6

	2004	2005	2006	2006		2007		
				III	IV	I	II	III
NO. OF FUNDS								
Total financial mutual funds	2,594	2,705	2,822	2,803	2,822	2,872	2,919	2,920
Fixed-income ²	627	624	606	613	606	609	606	604
Mixed fixed-income ³	231	217	212	210	212	207	211	203
Mixed equity ⁴	232	222	222	222	222	215	216	216
Spanish equity	110	116	118	118	118	118	118	121
Foreign equity ⁵	443	454	467	461	467	480	488	485
Guaranteed fixed-income	191	211	220	218	220	232	237	241
Guaranteed equity	474	514	559	559	559	577	586	589
Global funds	286	347	418	402	418	434	457	461
Funds of hedge funds	-	-	2	-	2	2	22	30
Hedge funds	-	-	5	-	5	6	9	17
INVESTORS								
Total financial mutual funds	7,880,076	8,450,164	8,637,781	8,924,673	8,637,781	8,740,972	8,755,921	8,467,203
Fixed-income ²	2,929,836	3,071,656	2,960,879	3,034,437	2,960,879	2,933,505	2,881,128	2,869,191
Mixed fixed-income ³	457,701	492,988	524,827	544,308	524,827	551,786	539,799	511,811
Mixed equity ⁴	447,452	408,757	357,013	377,923	357,013	374,508	376,559	359,667
Spanish equity	333,020	365,301	317,386	371,730	317,386	341,396	363,017	343,208
Foreign equity ⁵	1,091,711	1,199,460	1,258,426	1,284,729	1,258,426	1,274,138	1,263,619	1,184,871
Guaranteed fixed-income	459,047	455,237	497,540	482,550	497,540	518,940	541,442	540,637
Guaranteed equity	1,655,196	1,849,626	1,783,867	1,831,944	1,783,867	1,771,469	1,766,834	1,754,596
Global funds	506,113	607,139	937,843	997,052	937,843	975,230	1,023,523	903,222
Funds of hedge funds ⁶	-	-	2	-	2	26	1,456	3,142
Hedge funds	-	-	21	-	21	108	183	251
TOTAL NET ASSETS (Million euro)								
Total financial mutual funds	236,088.4	262,200.9	270,406.3	271,361.1	270,406.3	273,412.8	276,600.4	269,907.0
Fixed-income ²	120,466.7	123,890.7	116,511.9	118,494.2	116,511.9	116,963.0	116,344.7	118,489.4
Mixed fixed-income ³	11,795.7	14,625.8	15,314.5	15,103.3	15,314.5	15,755.0	15,329.1	14,142.3
Mixed equity ⁴	9,357.3	10,005.6	10,149.2	10,233.6	10,149.2	10,090.7	10,289.1	9,753.4
Spanish equity	8,042.1	9,741.7	10,416.4	10,421.2	10,416.4	11,238.3	9,523.4	8,353.3
Foreign equity ⁵	14,623.6	20,925.1	24,799.6	22,361.7	24,799.6	25,759.1	29,428.3	26,453.8
Guaranteed fixed-income	13,803.5	13,442.0	14,484.8	14,139.1	14,484.8	15,179.1	15,810.4	16,291.2
Guaranteed equity	39,658.2	45,839.8	44,796.6	45,642.4	44,796.6	43,998.9	44,140.0	43,365.6
Global funds	18,341.3	23,730.1	33,933.3	34,965.6	33,933.3	34,428.9	35,735.4	33,058.2
Funds of hedge funds ⁶	-	-	0.6	-	0.6	9.5	600.2	829.2
Hedge funds	-	-	24.4	-	24.4	119.9	152.0	210.2

1 Mutual funds that have sent reports to the CNMV (therefore mutual funds in a process of dissolution or liquidation are not included).

2 This category includes: Short-term fixed income, Long-term fixed income, Foreign fixed-income and Monetary market funds.

3 This category includes: Mixed fixed-income and Foreign mixed fixed-income.

4 This category includes: Mixed equity and Foreign mixed equity.

5 Until 2002 this category includes: Foreign equity and Foreign Equity Euro. From 2002 this category includes: Euro equity, Foreign equity Europe, Foreign equity Japan, Foreign equity USA, Foreign equity emerging countries and Other foreign equity.

6 Provisional data in case of funds of hedge funds

Financial mutual funds: Detail of investors and total net assets by type of investors

TABLE 3.7

	2004	2005	2006	2006		2007			
				IV	I	II	III	IV ¹	
INVESTORS	7,880,076	8,450,164	8,637,804	8,637,804	8,741,106	8,757,560	8,470,596	8,371,707	
Individuals	7,666,310	8,202,638	8,389,315	8,389,315	8,490,813	8,499,831	8,219,220	8,125,203	
Residents	7,558,501	8,101,310	8,292,264	8,292,264	8,394,044	8,402,736	8,123,347	8,029,257	
Non-residents	107,809	101,328	97,051	97,051	96,769	97,095	95,873	95,946	
Legal entities	213,766	247,526	248,489	248,489	250,293	257,729	251,376	246,504	
Credit Institutions	1,378	1,634	1,609	1,609	1,576	1,721	1,715	1,945	
Other resident Institutions	210,888	244,223	244,980	244,980	246,819	254,123	247,752	242,637	
Non-resident Institutions	1,500	1,669	1,900	1,900	1,898	1,885	1,909	1,922	
TOTAL NET ASSETS (Million euro)	236,088.4	262,200.9	270,431.3	270,431.3	273,542.2	277,352.6	270,946.4	267,901.0	
Individuals	172,068.9	193,948.6	201,411.0	201,411.0	202,506.4	204,173.3	200,464.5	198,859.8	
Residents	168,792.7	190,753.2	198,330.5	198,330.5	199,482.9	201,266.3	197,507.1	195,926.5	
Non-residents	3,276.2	3,195.4	3,080.5	3,080.5	3,023.5	3,086.8	2,957.4	2,933.2	
Legal entities	64,019.5	68,252.3	69,020.3	69,020.3	71,035.8	72,579.1	70,481.9	69,041.2	
Credit Institutions	5,128.8	4,253.2	5,318.0	5,318.0	5,569.0	5,422.3	5,116.4	5,445.6	
Other resident Institutions	54,271.1	62,749.8	61,646.6	61,646.6	63,305.8	65,248.3	63,190.9	61,442.5	
Non-resident Institutions	4,619.6	1,249.4	2,055.70	2,055.70	2,160.9	2,328.8	2,174.7	2,153.2	

1 Available data: October 2007.

Subscriptions and redemptions of financial mutual funds by category¹

TABLE 3.8

Million euro	2004	2005	2006	2006		2007		
				III	IV	I	II	III
SUBSCRIPTIONS								
Total financial mutual funds ²	144,489.9	169,807.0	194,787.4	37,435.8	46,864.6	52,761.5	44,063.4	42,610.5
Fixed-income	90,646.7	108,566.1	118,705.9	25,539.0	29,310.1	31,678.8	27,498.6	30,580.5
Mixed fixed-income	4,164.8	6,677.3	8,476.6	1,208.2	1,982.5	2,322.7	1,439.3	1,141.7
Mixed equity	1,513.1	2,065.2	2,783.6	375.6	708.7	908.8	753.2	635.6
Spanish equity	4,031.4	5,588.5	5,590.4	1,500.5	1,406.7	1,984.6	991.9	482.5
Foreign equity	8,166.6	14,006.2	17,662.3	2,688.1	4,850.4	5,518.9	4,925.4	3,215.9
Guaranteed fixed-income	7,700.7	6,923.9	6,126.2	1,450.3	1,798.7	2,073.6	1,915.3	2,191.3
Guaranteed equity	11,373.3	13,520.7	8,914.1	1,852.2	2,457.2	1,800.2	1,858.3	1,316.4
Global funds	16,893.3	12,459.2	26,528.3	2,821.7	4,350.2	6,474.0	4,681.2	3,046.3
Funds of hedge funds	-	-	0.6	-	0.6	8.9	614.0	232.8
Hedge funds	-	-	24.4	-	24.4	47.0	28.6	62.2
REDEMPTIONS								
Total financial mutual funds ³	125,168.6	155,304.2	198,600.1	41,714.4	52,565.8	52,566.6	45,164.4	48,647.5
Fixed-income	83,463.6	107,150.9	127,469.1	27,519.7	31,363.9	32,087.4	28,502.6	28,982.4
Mixed fixed-income	4,616.9	4,339.6	7,048.4	1,403.6	2,035.2	1,967.4	1,664.7	2,049.5
Mixed equity	2,581.1	2,602.5	3,644.7	723.8	1,166.2	1,023.0	893.9	999.2
Spanish equity	2,922.1	5,323.3	7,824.6	1,438.9	2,401.9	1,750.2	1,861.3	1,429.0
Foreign equity	7,594.2	11,390.2	16,490.9	2,794.5	3,852.6	4,986.4	4,010.5	5,242.4
Guaranteed fixed-income	5,723.2	7,014.0	5,029.3	695.1	1,444.6	1,452.0	1,369.5	1,897.1
Guaranteed equity	9,411.5	8,931.6	11,830.1	2,486.6	4,130.0	2,785.1	2,238.1	2,142.1
Global funds	8,856.1	8,552.1	19,263.1	4,652.3	6,171.5	6,515.1	4,623.8	5,905.5
Funds of hedge funds	-	-	0.0	-	0.0	0.0	1.6	11.1
Hedge funds	-	-	0.1	-	0.1	0.0	0.1	0.5

1 Estimated data.

2 For the third quarter 2007, mutual funds subscriptions in financial IIC reached 3.8 billion euro.

3 For the third quarter 2007, mutual funds redemptions in financial IIC reached 2.8 billion euro.

Financial mutual funds asset change by category: Net subscriptions/redemptions and return on assets

TABLE 3.9

Million euro	2004	2005	2006	2006		2007		
				III	IV	I	II	III
NET SUBSCRIPTIONS/REDEMPTIONS								
Total financial mutual funds	18,424.3	14,444.3	-4,524.5	-4,292.3	-6,469.2	231.8	-1,114.7	-5,995.4
Fixed-income	7,184.0	1,445.5	-9,423.4	-2,107.6	-2,625.5	-415.0	-1,009.7	1,601.6
Mixed fixed-income	-440.8	2,349.6	1,539.2	-36.0	-54.4	355.9	-224.7	-909.6
Mixed equity	-1,109.2	-546.5	-854.7	-369.7	-460.0	-112.4	-141.0	-367.8
Spanish equity	1,130.0	276.0	-2,219.4	92.4	-986.0	242.4	-871.0	-940.2
Foreign equity	514.8	2,652.4	1,133.8	-159.9	928.4	553.5	928.6	-2,007.2
Guaranteed fixed-income	1,853.1	-354.4	1,018.9	694.2	353.5	621.7	623.8	294.6
Guaranteed equity	1,222.3	4,693.6	-3,021.1	-589.7	-1,817.2	-982.8	-479.7	-802.2
Global funds	8,070.1	3,928.2	7,302.1	-1,816.0	-1,808.1	-40.6	58.9	-2,864.3
Funds of hedge funds	-	-	0.6	-	0.6	8.9	612.3	221.7
Hedge funds	-	-	24.3	-	24.3	47.0	28.5	61.8
RETURN ON ASSETS								
Total financial mutual funds	7,038.9	11,670.2	12,733.7	5,876.3	5,516.1	2,784.2	4,303.9	-696.7
Fixed-income	1,870.5	1,837.6	2,260.2	794.8	726.6	831.1	747.3	723.6
Mixed fixed-income	444.6	620.3	606.6	305.8	238.4	140.9	145.9	-30.6
Mixed equity	567.8	1,053.4	984.2	454.1	378.7	163.0	258.2	-120.3
Spanish equity	1,182.8	1,623.7	2,882.9	1,122.0	981.2	579.5	203.5	-229.8
Foreign equity	851.9	3,507.1	2,736.1	1,150.6	1,484.3	420.5	1,678.4	-942.1
Guaranteed fixed-income	334.0	222.8	112.3	101.0	34.6	87.2	40.7	164.0
Guaranteed equity	1,470.5	1,635.5	1,995.2	1,381.3	923.7	242.0	694.2	25.0
Global funds	316.8	1,169.8	1,156.2	566.5	748.6	320.0	535.8	-286.3
Funds of hedge funds	-	-	0.0	-	0.0	0.0	2.3	-16.7
Hedge funds	-	-	0.1	-	-	0.8	3.6	-3.9

Financial mutual funds return on assets. Detail by category

TABLE 3.10

% of daily average total net assets ¹	2004	2005	2006	2006		2007		
				III	IV	I	II	III
MANAGEMENT YIELDS								
Total financial mutual funds	4.31	5.87	5.73	2.44	2.15	1.31	1.87	0.02
Fixed-income	2.51	2.31	2.51	0.84	0.67	0.89	0.84	0.79
Mixed fixed-income	4.96	6.18	5.30	2.39	1.89	1.22	1.27	0.11
Mixed equity	7.46	12.96	11.31	4.94	4.14	2.03	2.94	-0.78
Spanish equity	19.40	20.10	30.10	11.94	9.65	5.77	2.54	-2.13
Foreign equity	7.80	22.82	13.82	5.80	6.75	2.09	6.42	-2.95
Guaranteed fixed-income	3.49	2.45	1.67	0.95	0.44	0.78	0.46	1.22
Guaranteed equity	5.47	5.26	5.86	3.43	2.39	0.91	1.95	0.44
Global funds	3.30	7.41	4.84	1.94	2.58	1.28	1.88	-0.52
Funds of hedge funds	-	-	ns	-	ns	-0.31	0.96	-1.83
Hedge funds	-	-	ns	-	ns	1.47	4.50	-1.64
EXPENSES, MANAGEMENT FEE								
Total financial mutual funds	1.08	1.07	1.04	0.27	0.26	0.26	0.27	0.25
Fixed-income	0.78	0.73	0.63	0.16	0.14	0.16	0.16	0.15
Mixed fixed-income	1.29	1.24	1.21	0.31	0.31	0.29	0.30	0.29
Mixed equity	1.64	1.69	1.63	0.42	0.42	0.40	0.40	0.39
Spanish equity	1.80	1.77	1.83	0.49	0.47	0.45	0.44	0.41
Foreign equity	1.65	1.80	1.78	0.46	0.49	0.43	0.48	0.41
Guaranteed fixed-income	0.84	0.77	0.75	0.19	0.18	0.17	0.17	0.17
Guaranteed equity	1.44	1.38	1.34	0.34	0.33	0.33	0.33	0.34
Global funds	1.26	1.41	1.26	0.32	0.37	0.32	0.35	0.25
Funds of hedge funds	-	-	ns	-	ns	0.37	0.29	0.42
Hedge funds	-	-	ns	-	ns	0.40	0.99	0.09
EXPENSES, DEPOSITORY FEE²								
Total financial mutual funds	0.10	0.10	0.09	0.02	0.02	0.02	0.02	0.02
Fixed-income	0.10	0.09	0.08	0.02	0.02	0.02	0.02	0.02
Mixed fixed-income	0.12	0.11	0.10	0.03	0.02	0.02	0.02	0.02
Mixed equity	0.11	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Spanish equity	0.11	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Foreign equity	0.12	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Guaranteed fixed-income	0.09	0.09	0.09	0.02	0.02	0.02	0.02	0.02
Guaranteed equity	0.10	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Global funds	0.09	0.09	0.10	0.03	0.03	0.03	0.03	0.03
Funds of hedge funds	-	-	ns	-	ns	0.04	0.01	0.02
Hedge funds	-	-	ns	-	ns	0.04	0.52	0.05

1 The % refers to monthly average total net assets for the Hedge fund category.

2 Instead of the depository fee, the figures for the Hedge fund category refers to the financial expenses.

ns: it is not significant.

Mutual fund quarterly returns. Detail by category

TABLE 3.11

In %	2004	2005	2006	2006		2007		
				III	IV	I	II	III
Total financial mutual funds	3.38	5.00	5.59	2.31	2.28	1.11	1.65	-0.15
Fixed-income	1.65	1.53	1.95	0.68	0.63	0.72	0.65	0.63
Mixed fixed-income	3.79	5.00	4.18	2.09	1.58	0.94	0.96	-0.16
Mixed equity	6.20	11.85	10.34	4.61	3.78	1.71	2.57	-1.17
Spanish equity	19.06	20.60	33.25	11.90	9.73	5.78	2.07	-2.42
Foreign equity	7.55	24.18	14.98	5.74	6.60	2.12	6.38	-2.80
Guaranteed fixed-income	2.62	1.66	0.83	0.75	0.24	0.59	0.29	1.03
Guaranteed equity	4.07	3.95	4.66	3.12	2.12	0.56	1.62	0.13
Global funds	2.17	6.16	4.01	1.61	2.21	0.99	1.57	-0.70
Funds of hedge funds	-	-	ns	-	ns	-0.55	1.08	-2.14
Hedge funds	-	-	ns	-	ns	1.26	3.18	-2.20

ns: it is not significant.

Management companies. Number of portfolios and assets under management

TABLE 3.12

	2004	2005	2006	2006		2007		
				IV	I	II	III	IV ¹
NUMBER OF PORTFOLIOS								
Mutual funds	2,620	2,723	2,850	2,850	2,885	2,921	2,947	2,956
Investment companies	2,962	2,989	3,049	3,049	3,073	3,112	3,143	3,170
Funds of hedge funds	-	-	2	2	2	22	30	30
Hedge funds	-	-	5	5	6	9	17	18
Real estate investment fund	7	7	9	9	9	9	10	10
Real estate investment companies	2	6	8	8	8	8	9	9
ASSETS UNDER MANAGEMENT (Million euro)								
Mutual funds	236,088.4	262,200.9	270,406.3	270,406.3	273,412.8	276,600.4	269,907.1	266,686.7
Investment companies	22,923.8	25,486.0	28,992.7	28,992.7	30,293.3	31,523.9	31,125.9	31,769.2
Funds of hedge funds	-	-	0.6	0.6	9.5	600.2	829.2	882.0
Hedge funds	-	-	24.4	24.4	119.9	152.0	210.2	332.4
Real estate investment fund	4,377.9	6,476.9	8,595.9	8,595.9	8,781.7	8,929.4	8,905.3	8,959.4
Real estate investment companies	56.4	213.9	456.1	456.1	459.2	487.4	504.3	508.6

1 Available data: October 2007.

Foreign Collective Investment schemes marketed in Spain

TABLE 3.13

	2004	2005	2006	2006		2007		
				III	IV	I	II	III
INVESTMENT VOLUME¹ (million euro)	17,785.6	33,614.7	44,102.9	41,595.1	44,102.9	45,113.8	50,141.4	44,847.4
Mutual funds	3,498.1	8,267.2	12,099.3	10,719.6	12,099.3	12,464.3	14,211.5	10,530.7
Investment companies	14,287.4	25,347.4	32,003.5	30,875.5	32,003.5	32,649.6	35,929.9	34,316.7
INVESTORS/SHAREHOLDERS	321,805	560,555	779,165	806,305	779,165	782,020	825,771	834,914
Mutual funds	51,364	104,089	144,139	141,164	144,139	158,900	176,884	158,925
Investment companies	270,441	456,466	635,026	665,141	635,026	623,120	648,887	675,989
NUMBER OF SCHEMES	238	260	340	312	340	354	362	397
Mutual funds	93	115	163	144	163	169	171	197
Investment companies	145	145	177	168	177	185	191	200
COUNTRY								
Luxembourg	164	161	189	183	189	190	196	210
France	25	47	83	68	83	90	92	105
Ireland	34	35	46	44	46	48	48	50
Germany	11	11	12	12	12	12	12	15
UK	3	5	6	3	6	9	9	11
The Netherlands	1	1	1	1	1	1	1	1
Austria	-	-	1	1	1	1	1	1
Belgium	-	-	1	-	1	2	2	3
Malta	-	-	1	-	1	1	1	1

¹ Investment volume: participations or shares owned by the investors/shareholders at the end of the period valued at that moment of time.

Real estate investment schemes

TABLE 3.14

	2004	2005	2006	2006		2007		
				IV	I	II	III	IV ¹
REAL ESTATE MUTUAL FUNDS								
Number	7	7	9	9	9	9	10	10
Investors	86,369	118,857	150,304	150,304	152,902	153,630	151,916	148,306
Asset (Million euro)	4,377.9	6,476.9	8,595.9	8,595.9	8,781.7	8,929.4	8,905	8,959.3
Return on assets (%)	6.65	5.35	6.12	0.80	1.31	1.10	1.53	0.50
REAL ESTATE INVESTMENT COMPANIES								
Number	2	6	8	8	8	8	9	9
Shareholders	121	256	749	749	754	769	661	681
Asset (Million euro)	56.4	213.9	456.1	456.1	459.2	487.4	504.3	508.6

¹ Available data: October 2007. In this case, the return on assets is monthly.

VI Legislative Annex (*)

(*) This annex has been drawn up by the Studies and Statistics Directorate of CNMV.

The legislative novelties of national scope approved in the fourth quarter of 2007 were as follows, in chronological order:

- **Order EHA/3011/2007**, of 4 October, amending Order ECO/805/2003, of 27 March, on rules for valuation of real estate and certain rights for certain financial purposes.

The Order has its origin in the plan of the Tax Authorities to fight fraud in the real estate market. The Order is applicable whenever the valuation is used as mortgage security for loans or facilities, as coverage for technical provisions of insurance entities, and in determining the net worth of real estate Collective Investment Institutions and Pension Funds.

As an anti-fraud measure the requirement is introduced that before calculation of the appraised value all necessary documentation must be available for full identification of the real estate. In particular, registry certification is required demonstrating ownership and local property survey office information on the property. The valuation rules for dwellings are also modified for determining the net worth of real estate Collective Investment Institutions in order to enhance the method of updating cash flows using rents which may exist. The Order specifically provides that if the dwelling is not let the appraised value must be calculated on the basis of comparable sales. In the case of real estate which is let the appraised value will be the minimum of comparable sales and that deriving from updating cash flows to the end of the lease plus the reversion value on the valuation date.

- **Royal Decree 1362/2007**, of 19 October, implementing the Securities Market Act, 24/1988 of 28 July in relation to transparency requirements concerning information regarding issuers whose securities are admitted to trading on an official secondary market or other European Union regulated market.

This Royal Decree completes incorporation into Spanish law of the Community regime of transparency of information of the issuers of securities which are listed on a Spanish official secondary market or other European Union regulated markets. The provisions also include obligations which already existed in our system without originating in Community legislation, such as the obligation of directors and executives of listed companies to notify the Spanish Securities Market Commission (Comisión Nacional del Mercado de Valores – CNMV) of grant of any system of remuneration with shares in the company or options over such shares.

The general provisions lay down an obligation for the issuer to publish and disseminate the regulated information as well as to send it simultaneously to the CNMV. The issuer may elect to disseminate this information directly or through a third party, which may be the CNMV or other means such as securities exchanges or the media. The applicable linguistic rules are also established. This will be Spanish when the issuer has its registered office in Spain. Otherwise the issuer must select the language from the following options: Spanish, a normal language in the field of international finance, or another language accepted by the CNMV.

Title One develops the obligations of issuers in the preparation and dissemination of annual financial reports, half-yearly financial reports and intermediate management statements. Title Two deals with information obligations in respect of significant holdings and holdings in own shares. It specifically provides that the percentages of voting rights treated as a significant holding will be 3%, 5% and all multiples of the latter, and 1% in the case of own shares.

- **Resolution of 24 October 2007**, of the Board of the Spanish Securities Market Commission on delegation of powers and functions to the Chairman, Deputy Chairman and Executive Committee.

The delegation of powers and functions covers several aspects: verification of requirements for admission of securities to trading, notification of significant holdings, exclusion of securities from trading, Collective Investment Institutions, Investment Services Undertakings, Public Offerings, risk-capital entities.

- **Royal Legislative Decree 1/2007**, of 16 November, promulgating the revised text of the General Consumer and User Protection Act and other complementary legislation.

This Royal Decree (RD) includes in a single text the General Consumer and User Protection Act and provisions transposing Community directives in the field of consumer and user protection. The provisions relating to contracts include standard form contracts for administration and deposit and management of portfolios registered with the CNMV. In this respect the RD incorporates the provisions introduced by the Act to improve consumer protection in the contract field. This Act prohibits contract provisions which establish limitations, and in particular the imposition of excessively long periods or restrictions which exclude or obstruct the right of the consumer to terminate contracts. In the field of prices provisions are incorporated to give greater clarity to calculation of the price of contracts, preventing the invoicing of services not effectively provided.

- **Act 41/2007**, of 7 December, amending the Mortgage Market Regulation Act, 2/1981 of 25 March, and other legislation on the mortgage and financial system, regulating inverse mortgages and dependency insurance and establishing certain tax provisions.

This Act in relation to the mortgage market includes amongst its objectives the modernisation of refinancing mechanisms of credit institutions through the issue of mortgage debentures and bonds “cédulas hipotecarias y bonos hipotecarios). To this end the Act eliminates administrative obstacles in mortgage bonds in order to achieve an administrative treatment similar to mortgage debentures. It also introduces regulatory improvements aimed at facilitating an increased sophistication in the two types of issue. The possibility is highlighted of including substitute liquid assets in the issue portfolio which contributes to covering the liquidity risk and strengthens the possibility of covering the interest rate risk with financial derivatives associated with an issue.

- **Act 43/2007**, of 13 December, on consumer protection in contracting goods with an offer to reimburse the price.

This Act complements the current information obligations set out in the Collective Investment Institutions Act, 35/2003 of 4 November in the case of direct sale of goods used as value generators or as value deposits provided that the said sale includes a provision to repurchase them. The aim is to construct a complete regulatory framework which protects consumers from the existing information asymmetry.

- **Act 47/2007**, of 19 December, amending the Securities Market Act, 24/1988 of 18 July.

This legislative text modifies the Securities Market Act (Ley del Mercado de Valores) to incorporate the following European directives into the Spanish legal system: the Markets in Financial Instruments Directive, the Directive on organisational requirements and operating conditions of investment undertakings, and the Directive on the adequacy of the capital of investment firms and credit institutions.

The Act extends the catalogue of investment services which entities can provide, extends the range of negotiable financial instruments, and recognises trading systems which are different to traditional systems. The Act also strengthens investor protection measures. It establishes a wide series of rules which must be complied with by those who provide investment services and adapts the organisational requirements of entities which provide a full range of services. In the solvency field entities will have to adapt to the new forms of risk management. Finally, the Act improves the supervisory powers of the CNMV in order to promote cooperation between supervisors, both national and international.