Presentation of the CNMV 2019 Annual Report

10 June 2020

2019, the year to which this report refers, was a signal year in terms of how the markets evolved and new trends seen in them, and also a year in which both the CNMV and the various international cooperation bodies in the area of securities markets were particularly active, pushing a large number of initiatives. While the scale and severity of the crisis caused by COVID-19 may have put analysis of the implications and effects of the pandemic in the spotlight, this should not detract from the interest and usefulness of the main content of this report, which focuses on the development of the markets and the activities carried out by the CNMV during 2019.

However, given the impact of the crisis during the first few months of 2020, it has been considered appropriate to include an overview of the effects of the pandemic on the markets in the areas under the supervision of the CNMV and on the CNMV itself at the end of this presentation.

The **reference context** in which to place the situation of the markets and the CNMV's actions in 2019 was marked by the persistence of certain sources of uncertainty – some of them of a political nature, which tended to decrease in the final stretch of the year – and by a slowdown in economic activity, which in Spain was proving less intense than in other European countries.

Brexit was another major uncertainty that persisted throughout 2019. As the initial Brexit date approached (29 March 2019) without an agreement having been reached that would allow an orderly exit by the United Kingdom, Royal Decree-Law 5/2019, of 1 March, adopting contingency measures to prepare for a withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union without the conclusion of the agreement provided for in Article 50 of the Treaty on European Union, was published. The CNMV also opened a new section on its website called "After Brexit: issues relating to the financial sector", which sets out information that may be useful for market participants and investors. After the withdrawal agreement was signed, the United Kingdom ceased to be a Member State of the European Union on 31 January 2020, although it will continue to observe EU rules and agreements until 31 December 2020. At the time of writing this report, uncertainty remains high, as it is possible, even probable, that the parties will not agree on an extension of the transition period and that 2020 will end with no agreement in place on the terms of the future relationship between the United Kingdom and the European Union.

The **performance of the financial markets in 2019**, the second year of the MiFID II regulations, was to some extent a reflection of some of the uncertainties present. In **equity** markets, quoted prices fell in the first half of the year and subsequently increased, closing the year with significant gains. The Ibex 35 gained around 12%, in a context of very low volatility, with gains observed in most sectors, with the exception of the financial sector, which was affected by the environment of lower interest rates. This interest rate environment was intensified in the middle of the year by the decisions of the European Central Bank (ECB) to resume the expansionary tone of its monetary policy due to the economic slowdown in the area and the persistently low rate of inflation. Securities trading was at lower levels than in previous years and the proportion of trades made through external trading venues continued to increase. Primary market activity was thin, and there were no significant IPOs, a trend that is also being observed in other markets and to which the CNMV is giving special attention, as it is desirable to increase financing for Spanish companies through the markets. In **fixed income markets,** gross debt issues were just over €400 billion in 2019, a slight decrease compared with 2018. This was a result of the lower number of issues by public authorities and financial institutions, due to the process of budgetary consolidation in the first case, and to the availability of other attractive sources of financing in the second. The volume of debt issues by non-financial companies increased, as they took advantage of the favourable market conditions in a context in which issues carried out in foreign markets continued to play a major role.

The **collective investment industry** grew once again in 2019, resuming an expansionary trend that had started in 2013 and had been temporarily halted in 2018. Investment fund assets grew by almost 8% in the year, mainly due to portfolio returns. Investors subscribed to units in these funds, but to a lesser extent than in previous years, no doubt due to the uncertainties affecting the markets. Furthermore, assets of collective investment schemes marketed in Spain continued to grow, as did their relative importance; at the end of the year they accounted for more than a third of the total number of schemes of this type marketed in the country.

Credit institutions remained the main **providers of investment services,** accounting for most income from fees from these activities. In particular, the proportion of income received by entities related to what we might call "commercial banks" (as opposed to non-bank entities and credit institutions specialising in securities-related services) has held relatively steady at around 70% for several years. In the specific case of broker-dealers and brokers – over which the CNMV carries out a comprehensive supervisory activity that includes solvency and rules of conduct – 2019 was a complex year, in view of the fall in sector profits. These entities are progressively changing their business models as a result of several factors, among which the increased competition from credit institutions stands out. This has led them to shore up segments such as investment advice, which were of little importance years ago.

In the area of **market supervision**, the tools available to the CNMV functioned normally in 2019: with regard to transaction reporting, more than 165 million reports were received of transactions executed on financial instruments, 50% more than in 2018. This increase was due to the special files (REQ) for reporting omitted or corrected transactions and also to the decision taken by some financial institutions to centralise their operations in Europe through their Spanish investment firms due to Brexit. Throughout 2019, the CNMV also focused particularly on the quality of the reference data, such as the issuer's LEI (legal entity identifier), the financial instruments classification code (CFI) and the correlation between the instruments reported to the Financial Instruments Reference Data System (FIRDS) and to the transparency system. For this purpose, it maintained ongoing contact with trading venues in order to correct any incidents detected. The use of the channel established by the CNMV to report suspicious transactions (STOR, Suspicious Transaction and Order Report) continued to increase, with 345 reports in 2019, 49% more than in 2018.

As in previous years, most of the STORs were related to the possible use or attempted use of inside information (66%) and the rest to possible market manipulation.

In 2019, the CNMV carried out the tasks set out in the supervision plan for the Spanish stock market management companies operated by Bolsas y Mercados Españoles (BME), established in the CNMV Activity Plan. This plan focused on market microstructure features such as algorithmic trading, the obligations of market makers and the publication of data on quality of execution.

The supervision of **derivative instruments** focused on three lines of action: analysing and monitoring daily trading, preventing and detecting situations of market abuse, and carrying out certain specific control actions.

In addition, since the start of operations of the **two Spanish organised trading facilities (OTFs)** in January 2018, supervision tasks have been carried out on a daily basis in the three lines of action indicated above, both for CAPI OTF (managed by CM Capital Markets Brokerage, S.A., AV) and CIMD OTF (managed by CIMD SV, S.A., of the CIMD Corretaje e Información Monetaria y de Divisas, S.A. Group).

Through its **Market Monitoring Unit,** the CNMV continued to investigate possible actions contrary to market integrity. As a result of these investigations, four disciplinary proceedings were initiated in 2019 affecting one investment firm, one broker and one natural person.

In relation to the **supervision of entities,** the CNMV continued to pay special attention to compliance with the rules of conduct in the provision of investment services. As a result of these supervisory actions, the CNMV sent out a total of 898 deficiency letters to supervised entities, 691 of which originated from off-site supervision. Another standout was the horizontal review of the online operations of a selection of entities that provide investment services. Specifically, it verified appropriate compliance with the main rules of conduct that apply in online transactions, prior to the execution of transactions of or on behalf of the client, whether through the website, mobile apps or specific investment platforms.

Likewise, further reviews were performed with the specific objective of analysing the quality and consistency of the information obtained from clients to assess their **suitability and appropriateness.** The CNMV detected deficiencies in various cases, and therefore considers it important that entities adopt measures and carry out controls aimed at ensuring that the information they obtain from retail clients to assess the appropriateness and suitability of their transactions is consistent, accurate and up to date. Along the same lines, the CNMV and other European supervisors took part in the first joint supervisory action in this area, coordinated by ESMA. This was the first action of this type aimed at sharing experiences and supervisory criteria in order to help achieve greater supervisory convergence.

Regarding **collective investment schemes,** in addition to the usual supervisory tasks, which seek to ensure management companies' fulfilment of their obligations, the appropriate resolution of conflicts of interest and the receipt of sufficient information by unitholders, recurring analyses were conducted of the **degree of liquidity** of the assets held by these entities in their portfolios. Using a predefined methodology that combines information from a variety of market sources, a liquidity level is assigned to each asset, and this allows institutions and managers with the greatest exposure to relatively illiquid assets to be identified. This is particularly important given that most of these institutions allow redemptions to be carried out on a daily basis. If these redemptions were to increase substantially, institutions should be in a position to meet them easily and to do this they must have an appropriate volume of sufficiently liquid assets. In the current crisis, management companies have seen a rise in redemptions, which has been handled without any difficulty, as mentioned above.

The CNMV is the competent authority in Spain for the application of the regulations on **benchmarks**, laid down in Regulation (EU) 2016/1011 of the European Parliament and of the Council. 2019 was the last year of the transition period for the full application of the Regulation[1] and for the authorisation and registration of existing index administrators at the time of their approval. For this reason, during the year, part of the CNMV's work in this area focused on processing the registration of the benchmark administrators set up in Spain to include them in the central registry overseen by ESMA.

The work directly related to **investors** was also significant. In addition to the usual complaint management tasks, attention to enquiries and warnings about unauthorised entities, the *Economic Psychology for Investors* guide was published. This guide establishes various recommendations for investors to facilitate the practical application of the main premises of behavioural economics to investment decision-making. This guide continues the work started in 2017 with the publication of the *Psychological mechanisms involved in investment decision-making* sheet.

In relation to **disciplinary actions**, in 2019 the CNMV Executive Committee initiated 18 new disciplinary proceedings, investigating a total of 26 possible infringements. The proceedings opened included six infringements for the incorrect communication of significant holdings in listed companies, one for non-compliance with reporting obligations by issuing companies, five for market abuse (market manipulation), two for operating without authorisation, five for breach of rules of conduct in relations with clients or investors, one for resisting the CNMV's inspection and the rest for violations of the general regulations on investment firms, collective investment schemes and crowdfunding platforms. In addition, 39 fines were imposed for a total amount of just under €4 million.

For the second year, the CNMV's **key performance indicators (KPIs)** are published in this annual report. The publication of these indicators aims to increase transparency regarding the activities carried out by the Commission, to provide a means of assessing its performance and to serve as a basis for improving the efficiency of the processes. Furthermore in 2019 other key indicators were identified, including those related to information systems, the number of requests sent and reports prepared in the markets area.

Lastly, two major priority tasks of a horizontal nature were undertaken: the CNMV's **Digital Transformation Plan**, which is envisaged in the Activity Plan referred to at the beginning of this presentation, and its work on **social responsibility**. The Digital Transformation Plan aims to incorporate available new technologies into the Commission's everyday tasks, to increase its effectiveness, efficiency, transparency and security. This Plan, which becomes even more relevant in the current crisis context,

1 Regulation (EU) 2019/2089 of the European Parliament and of the Council, of 27 November, extends the transition period for critical indices and for third-country indices by two years, until 31 December 2021.

seeks to rely on more intensive use of data, implementing new work tools and evolving towards more digital channels to access information and interact with both investors and the entities it supervises.

Equally relevant are the CNMV's initiatives in the area of social responsibility, which form part of its aspiration to reach an optimal level of development without compromising its capacity for future progress. In this context, the securities markets have an important job to do, through sustainable action in relation to aspects such as the corporate governance of listed companies and certain characteristics of investment products. The CNMV is aware of this and actively participating in various national and international forums related to sustainable finance. At the international level, it is worth noting that the CNMV chairs two international working groups through its vice-chair: the IOSCO Sustainable Finance Network and, at European level, the Coordination Network on Sustainability (CNS), created by ESMA.

After reviewing the content of this annual report, given the impact and topicality of COVID-19, it makes sense to mention the implications and effects of this crisis, which has led to a drastic change in the way of working of this institution, and of many others, and has affected the priorities that had been established. This has given rise to a revision of the CNMV's **Activity Plan** for 2020, involving the postponement of some objectives and the addition of some new ones, such as adapting the institution's contingency plan to a model based on teleworking.

The **CNMV** has carried out multiple actions related to the crisis triggered by COVID-19. The main decisions and measures adopted since the beginning of March are briefly described below, and relate to its **organisation**, the **supervision of markets and the entities** that participate in them, and **interaction with other institutions**, including international ones. In relation to the latter, a description will be given of the most important work carried out to date, in which the CNMV has actively participated.

From a purely **organisational** standpoint, with regard to **human resources,** the first significant measures implemented, following health guidelines, were aimed at ensuring that CNMV employees could continue to work normally from home. The process began on 11 March, when approximately half the workforce began to work from home, and teams especially important for CNMV operations were divided in two. On the day the Royal Decree announcing the State of Alarm came into force (published on 14 March) practically all employees were already working from home.

According to a survey carried out among **CNMV staff**, to which more than 300 employees responded, more than two thirds consider that the CNMV's activity is similar to the level it was before, and their assessment of how the systems and the institution in general have worked during this phase is favourable. Factors such as the importance that the CNMV has long attached to information systems and its experience with teleworking schemes played a role in this, but the key factor has undoubtedly been the effort and dedication of all CNMV staff, who have demonstrated great adaptability. Its governing bodies, the Board, the Executive Committee and the Management Committee have also functioned normally, and the frequency of their meetings has even increased. Meetings are generally held by video conference, a system that has also been widely used in other areas of the organisation. The experience has reinforced the perceived importance of technology and communications in the CNMV's work and has involved the use of new tools, servers and equipment.

Furthermore in mid-March, on the sixteenth to be exact, the CNMV announced the closure of its **General Register** for the physical presentation of documents. To ensure continuity in the presentation and registration of documents, several channels were enabled: the open area and the investors' area of the CNMV's electronic office and the electronic offices of the registries of the various public administrations. On 20 March the CNMV announced the approval of a Resolution on the **suspension of administrative deadlines** as provided in Royal Decree 463/2020, on the State of Alarm, published in the *Official State Gazette (BOE)* on 25 March. Thanks to this Resolution, the suspension of deadlines provided in the Royal Decree has not affected activities such as the CNMV's supervisory activity in general (requirements and other supervisory actions) or authorisations processed by the Institutions or Markets Directorates General likely to benefit interested parties.

The **Spanish financial markets**, which had ended 2019 with gains, started to experience some instability in early February this year when the scale of the spread of the coronavirus became apparent. This instability grew substantially in March, when several European governments, including Spain's, adopted strict lockdown measures to prevent the further spread of the virus. The financial markets saw some extremely volatile weeks in March (the Ibex 35 marked the largest fall in its history in that month and volatility reached levels not observed since the global financial crisis in 2008), which caused the CNMV to shore up its activities relating to **supervision of markets**, infrastructures and agents participating in them. The most notable decisions in this area in March related to **restricting short positions** in securities listed on Spanish securities markets. These are exceptional measures that can be taken under Regulation (EU) No. 236/2012 of the European Parliament and of the Council, in situations of very significant price falls or, more generally, when circumstances arise that constitute a serious threat to financial stability or market confidence.

The first measure, implemented on 13 March, consisted in banning the short selling of 69 shares which had seen price falls on 12 March, the date of the largest drop in the history of the Ibex 35 (of over 10% or 20% in some cases). The second measure, prohibiting the creation or increase of net short positions, was agreed on 16 March for a period of one month, and applied to all listed Spanish shares. It was subsequently extended for a further month (and lifted on 18 May). Similar decisions were taken in the days following by other European securities supervisors, specifically those of France, Italy, Belgium, Austria and Greece. Restrictions on short-selling affect the efficiency of the markets by reducing the speed at which prices adjust to available information and adversely affect some liquidity measures or actual trading volumes, but may be advisable under certain circumstances. The CNMV is carrying out specific analyses to assess the impact of the measures adopted, and for the time being has not identified any significant impact other than a slight deterioration of liquidity in the securities affected by the ban in the first few days.

In the field of **market infrastructures**, in addition to verifying that the trading systems have functioned normally despite the severe bout of volatility and price falls, special attention was given to the central counterparty (CCP), BME Clearing. This entity activated its contingency plans and had to make extraordinary margin calls, in numbers and amounts higher than usual, although no particular incidents were detected. In addition, it has been carrying out back-testing and has brought forward the review of the parameters for margin calls. Special attention has also been paid to settlements, with some increase in inefficiency observed (failures in the delivery of securities on the agreed date) as a consequence, according to the entities, of the increase in activity at certain times and a decreased capacity to respond to and resolve incidents due to staff working from home. This trend, which has also been observed in other European countries, has partially reversed as tensions in the markets decrease.

In the area of **listed companies**, criteria were published – on two occasions jointly with the Spanish College of Registrars – on various issues raised in the situation of health emergency and restrictions on mobility deriving from COVID-19 in relation to the holding of general shareholders' meetings, the formulation of annual financial statements and proposals for the appropriation of companies' profits, and the institution has collaborated in the preparation of the provisions related to these matters included in the Royal Decree-Laws approved by the government.

As regards the **supervision of entities,** it is worth highlighting the measures that have been adopted in relation to collective investment schemes, and in particular investment funds. The work has mainly focused on the liquidity conditions of the fund portfolios and movements in redemptions, maintaining contact with the management companies to monitor the situation and remind them of their obligations as well as the liquidity management tools available to them. In this regard, the CNMV has issued indications on the appropriateness in certain cases of valuation at bid prices or applying swing pricing schemes.

The **liquidity** conditions of the funds have been assessed based on various indicators such as trading volumes, time taken to unwind a position and the availability of prices. Attention has also been paid to the credit ratings of the debt assets held by these institutions and in particular to assets with a BBB rating, this being the lowest rating that still qualifies as investment grade. Based on the findings of these analyses, the CNMV is carrying out special monitoring of certain management companies.

In terms of **monitoring redemptions**, the cumulative net volume from the time the crisis flared up in early March until the end of that month is estimated at approximately €6 billion, which managers handled with no difficulty. Redemptions in the subsequent months were for much smaller amounts. Only in a small number of funds did they exceed 20% of assets, a percentage that requires a significant information notice to be filed. The only notable incident involved a fund of funds which had invested 7.1% of its portfolio in a Luxembourg SICAV that suspended the calculation of net asset value.

Lastly, it is worth noting in this area of collective investment, the inclusion, by virtue of Royal Decree-Law 11/2020, of 31 March, adopting urgent complementary measures in the social and economic area to deal with COVID-19, of a new macroprudential tool consisting of the possibility of establishing, with the authorisation of the CNMV, prior notice periods for redemptions without these being subject to the requirements that are normally applicable regarding term, minimum amount and being provided for in the management regulations. These terms can be established by the manager or by the CNMV itself.

To manage this crisis, **coordination with other** national and foreign **institutions** has proved to be essential. At the national level we would highlight the meetings taking place within the Macroprudential Authority Financial Stability Board (**AMCESFI**), the frequency of which has increased. These bring together representatives of the Ministry of the Economy, the Bank of Spain, the CNMV and the General Directorate of Insurance and Pension Funds, to analyse the situation of the Spanish financial system from the point of view of financial stability and the possible increase in systemic risk. In times of market turmoil it is important for financial supervisors to exchange information to understand the extent of the risks involved and to take such measures as may be necessary.

At the **international** level, the CNMV has actively participated in several working groups created as a result of the crisis to assess different aspects and has intensified the exchange of information with institutions of which it is a member or with which it maintains regular contact, such as the European Securities and Markets Authority (ESMA), the International Organisation of Securities Commissions (IOSCO), the Financial Stability Board (FSB), the European Systemic Risk Board (ESRB) and the Ibero-American Institute of Securities Markets (IIMV).

At **ESMA**, numerous remote extraordinary meetings have been held of the various permanent committees and the governing bodies, the Management Board and the Board of Supervisors, to monitor market performance during the crisis and the measures adopted by the various members have been shared. The most significant developments include measures related to short selling adopted by ESMA itself (reducing the threshold for the obligation to report net short positions to 0.10% of the capital) and by certain national authorities, including the CNMV – measures on which ESMA issued a favourable report –, as well as all aspects concerning trends in ratings and collective investment schemes.

At **IOSCO**, in addition to the meetings and mechanisms developed to share information on the measures adopted by the various members of the organisation, it is worth noting the relaunch of the group's work on rating agencies (to assess the possible increase in credit ratings downgrades in the context of the crisis, and the effects of this) and the creation of a new high-level committee, the **FSEG** (Financial Stability Engagement Group), of which the CNMV is a member and which, among other tasks, collaborates with two working groups created by the FSB as a result of the crisis: one of which addresses investment funds and the other margin calls.

Lastly, the **ESRB** has launched five lines of work as a consequence of the crisis: implications for the financial system of public guarantees and other fiscal measures adopted to protect the real economy; liquidity in the markets and implications for asset managers and insurers; procyclical impact of credit rating downgrades on the markets and entities in the financial system; restrictions on dividend payments, share buybacks and other disbursements, and the possibility of mitigating the liquidity risk generated by margin calls.