# CNMV BULLETIN

Quarter I

2007

# CNMV Bulletin

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2007

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Publishing advice of the Quarterly Bulletin of the CNMV: Julio Segura (CNMV), Vicente Salas (Universidad de Zaragoza), Belén Villalonga (Harvard Business School) y Nieves García Santos (CNMV).

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# 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 |
| NPISH | Non-profit institutions serving households |
| OECD | Organization for Economic Co-operation and Development |
| PER | Price Earnings Ratio |

| | |
|---|---|
| PtoP | Public to Private |
| 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 report has been made by the staff of the Studies and Statistics Directorate of the CNMV.

# 1 Overview

In the first months of 2007 stock markets around the world were hit by the end of the international bull market they had enjoyed since 2005. But rather than being based on fundamentals, the adjustment was for essentially technical and psychological reasons. The main factors of uncertainty which took over the markets were a possible slowdown in the Chinese economy, the risk of recession in the United States (U.S.), rising oil prices and geopolitical tension. This led to a significant increase in stock market volatility, which until then had been at record low levels.

The main international stock markets ended the first two months of 2007 with losses. The major correction registered at the end of February wiped off the gains accumulated up to that time. As a result, stock market gains in annual terms were considerably reduced to below 10%, except in Spain and Germany where there were still significant gains.

The fall in prices also affected other international stock markets, with significant losses in the Indian, Russian, Argentinean and Brazilian markets. These falls significantly cut what had until then been significant accumulated gains.

Monetary conditions remained unchanged in January and February, both in the euro zone and in the U.S.. In March, the European Central Bank confirmed market expectations by announcing a 25-point rise in official interest rates. In the United States the markets continued to anticipate that the next change in interest rates in 2007 would be a cut. Given these expectations, the dollar maintained its depreciation against the euro.

To avoid risk, investors moved out of the equity markets and bought bonds, interrupting the recovery in medium and long-term profitability which the public debt markets had experienced in the euro zone and the United States since the start of 2007.

The Spanish stock market continued to post the best results in Europe. In January-February its losses were below the average of the main European stock exchanges, and the Ibex 35 once more outperformed them all. The dynamism of the economy and the favourable prospects for company results continued to push share prices up for many listed companies in Spain. Trading increased on what were already high levels, although there was only a slight upturn in the price-earnings ratio.

## Summary of financial indicators

TABLE 1

| | Dec 2004 | Dec 2005 | Dec 2006 | 2007* |
|---|---|---|---|---|
| **Short-term interest rates (%)** [1] | | | | |
| Official interest rate | 2.00 | 2.25 | 3.50 | 3.50 |
| Euribor 3 month | 2.17 | 2.47 | 3.69 | 3.75 |
| Euribor 12 month | 2.30 | 2.79 | 3.93 | 4.06 |
| **Exchange rates** [2] | | | | |
| Dollar /euro | 1.362 | 1.180 | 1.317 | 1.316 |
| Yen / euro | 139.65 | 138.90 | 156.93 | 153.90 |
| **Medium and long-term interest rates (%)** [3] | | | | |
| Public debt yields | | | | |
| 3 year | 2.62 | 2.99 | 3.83 | 4.13 |
| 5 year | 3.01 | 3.05 | 3.81 | 4.19 |
| 10 year | 3.73 | 3.37 | 3.82 | 4.11 |
| **Risk premium of private fixed-income (basis points)** [3] | | | | |
| 3 year | 19 | 16 | 21 | 10 |
| 5 year | 37 | 43 | 33 | 16 |
| 10 year | 42 | 52 | 44 | 39 |
| **Equity markets** | | | | |
| Performance by the world's major stock indexes (%) [4] | | | | |
| Euro Stoxx 50 | 6.9 | 21.3 | 15.1 | -2.6 |
| Dow Jones | 3.1 | -0.6 | 16.3 | -2.8 |
| Nikkei | 7.6 | 40.2 | 6.9 | 0.0 |
| Other indexes (%) | | | | |
| Merval (Argentina) | 28.3 | 12.2 | 35.5 | -4.4 |
| Bovespa (Brazil) | 17.8 | 27.7 | 32.9 | -4.7 |
| Shanghai Comp (China) | -15.4 | -8.3 | 130.4 | 5.8 |
| BSE (India) | 16.4 | 38.3 | 41.0 | -7.1 |
| Spanish market | | | | |
| Ibex 35 (%) | 17.4 | 18.2 | 31.8 | -1.3 |
| PER of the Ibex 35 [5] | 13.8 | 12.9 | 14.3 | 14.8 |
| Volatility of the Ibex 35 (%) [6] | 10.0 | 10.6 | 13.1 | 20.3 |
| Trading on the SIBE [7] | 2,536.1 | 3,311.2 | 4,513.3 | 6,073.8 |
| Results of listed companies [8] | 7.3 | 23.1 | 25.8 [7] | n/a |

Source: CNMV, Thomson Datastream, Reuters, Bank of Spain, Madrid Stock Exchange, MEFF (Spanish market in financial futures and options) and AIAF (Spanish brokers' association).

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

n/a: data not available.

1. Average daily data. Data for 2007 are for January. The official rate of interest is the marginal rate at the weekly auction.
2. Data at the end of the period. The 2007 data are for 2 March.
3. Average daily data. Data for 2007 are for January.
4. Annual average except for 2007, which is the accumulated rate until 2 March.
5. Price-earnings ratio. The 2007 data are for 2 March.
6. Implied ATM volatility of first expiration date. The 2007 data are for 2 March.
7. Daily average in millions of euros. The 2007 data are accumulated January and February figures.
8. The annual change in EBITDA of companies listed on the continuous market. In 2006 the data are for the first half-year.

# 2 The International Financial Background

## 2.1 Short-term interest rates

The European Central Bank raised official interest rates again in March. The decision had already been priced in by the markets. The increase was 25 basis points, leaving the marginal rate established at the weekly auction at 3.75%. The rise in March followed five in 2006 (the last in December), which together pushed the rate up by 1.25 basis points.

Monetary policy was tightened in the euro zone against the background of inflation unexpectedly remaining below 2%, as the 3% rise in German VAT had not yet worked its way through to prices. Markets expect a further rise of 25 basis points to 4% in the second quarter of 2007. Most analysts agree that this level will be maintained at least until the second quarter of 2008.

**Short-term interest rates [1]** TABLE 2

| % | Dec 04 | Dec 05 | Dec 06 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Feb 07 |
|---|---|---|---|---|---|---|---|---|
| **Euro zone** | | | | | | | | |
| Official [2] | 2.00 | 2.25 | 3.50 | 2.50 | 2.75 | 3.00 | 3.50 | 3.50 |
| 3 month | 2.17 | 2.47 | 3.69 | 2.72 | 2.99 | 3.34 | 3.69 | 3.82 |
| 6 month | 2.21 | 2.60 | 3.79 | 2.87 | 3.16 | 3.53 | 3.79 | 3.94 |
| 12 month | 2.30 | 2.79 | 3.93 | 3.11 | 3.40 | 3.72 | 3.93 | 4.09 |
| **U.S.** | | | | | | | | |
| Official [3] | 2.25 | 4.25 | 5.25 | 4.75 | 5.25 | 5.25 | 5.25 | 5.25 |
| 3 month | 2.50 | 4.49 | 5.36 | 4.92 | 5.38 | 5.38 | 5.36 | 5.36 |
| 6 month | 2.72 | 4.67 | 5.35 | 5.05 | 5.49 | 5.41 | 5.35 | 5.39 |
| 12 month | 3.02 | 4.84 | 5.24 | 5.19 | 5.60 | 5.38 | 5.24 | 5.38 |
| **Japan** | | | | | | | | |
| Official [4] | 0.15 | 0.15 | 0.25 | 0.15 | 0.15 | 0.25 | 0.25 | 0.50 |
| 3 month | 0.05 | 0.07 | 0.56 | 0.11 | 0.33 | 0.42 | 0.56 | 0.60 |
| 6 month | 0.07 | 0.08 | 0.63 | 0.15 | 0.42 | 0.48 | 0.63 | 0.65 |
| 12 month | 0.09 | 0.12 | 0.74 | 0.29 | 0.58 | 0.60 | 0.74 | 0.75 |

Source: Thomson Datastream.

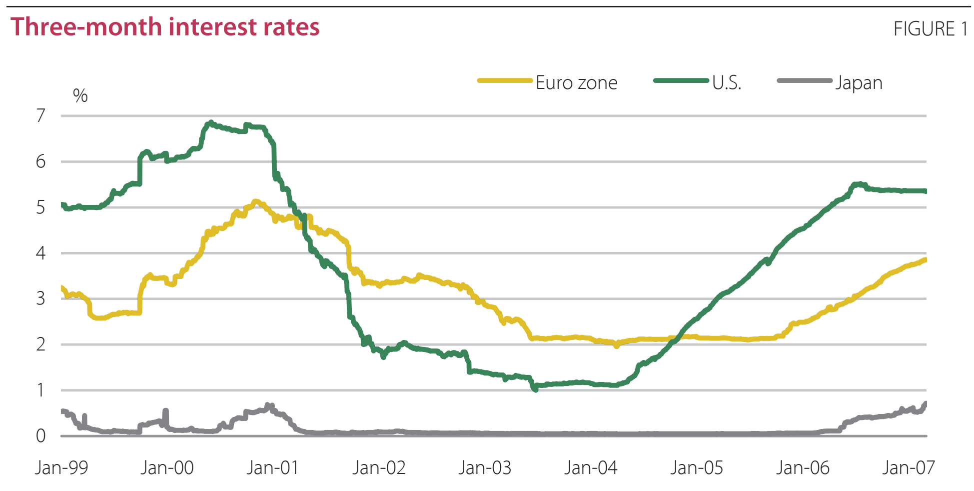
1. Average of daily data, except for official rates, which correspond to the last day of the period.
2. Marginal rate at the weekly auction.
3. Federal fund rates.
4. Monetary policy rate.

The U.S. Federal Reserve maintained the official interest rate at 5.25% in the first two months of 2007. It had remained at this level since mid-2006. Given a lack of clear and consistent signs regarding economic growth and inflation, the market consensus continues to expect a change in monetary policy starting in the second quarter of 2007, with the Fed lowering the official rate to 4.75% in two steps of 25 basis points in the second and third quarter of 2007.

The bank of Japan (BoJ) decided to increase the price of money in February 2007 to 0.50% from 0.25%, where it had remained since July 2006. The new rate is the highest for a decade. This decision was adopted despite weak domestic consumption and continuing low inflation, because an upturn in inflation is expected in the short term. Market expectations suggest that there will be no more official interest rate increases in the short term, but further rises are expected at the end of 2007 and the start of 2008.

In keeping with the monetary policies, the money market three-month interest rates continued to increase in the euro zone, remained stable in the United States and picked up in Japan (see table 2).

**Three-month interest rates** FIGURE 1




Source: Thomson Datastream.

The difference between expected changes in interest rates in the euro zone and the United States can be seen in the three-month forward rates included in table 3. An increase of 25 basis points is expected in Europe up to September, leaving the three-month interest rate at 4.10%. In the United States a drop of 50 basis points is expected over a year to levels slightly higher than the expected official interest rate of 4.75%.

**Three-month forward (FRA) rates [1]** TABLE 3

| % | Dec 04 | Dec 05 | Dec 06 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Feb 07 |
|---|---|---|---|---|---|---|---|---|
| **Euro zone** | | | | | | | | |
| Spot | 2.16 | 2.49 | 3.73 | 2.82 | 3.06 | 3.42 | 3.73 | 3.85 |
| FRA 3x6 | 2.23 | 2.74 | 3.94 | 3.11 | 3.38 | 3.69 | 3.94 | 4.01 |
| FRA 6x9 | 2.36 | 2.91 | 4.07 | 3.35 | 3.63 | 3.78 | 4.07 | 4.07 |
| FRA 9x12 | 2.49 | 3.00 | 4.13 | 3.48 | 3.78 | 3.81 | 4.13 | 4.10 |
| FRA 12x15 | 2.64 | 3.07 | 4.13 | 3.57 | 3.86 | 3.79 | 4.13 | 4.06 |
| **U.S.** | | | | | | | | |
| Spot | 2.56 | 4.54 | 5.36 | 5.00 | 5.48 | 5.37 | 5.36 | 5.35 |
| FRA 3x6 | 2.95 | 4.81 | 5.31 | 5.21 | 5.59 | 5.30 | 5.31 | 5.23 |
| FRA 6x9 | 3.22 | 4.84 | 5.21 | 5.25 | 5.60 | 5.15 | 5.21 | 5.06 |
| FRA 9x12 | 3.41 | 4.81 | 5.06 | 5.23 | 5.57 | 4.99 | 5.06 | 4.91 |
| FRA 12x15 | 3.57 | 4.76 | 4.94 | 5.18 | 5.53 | 4.85 | 4.94 | 4.79 |

Source: Thomson Datastream.

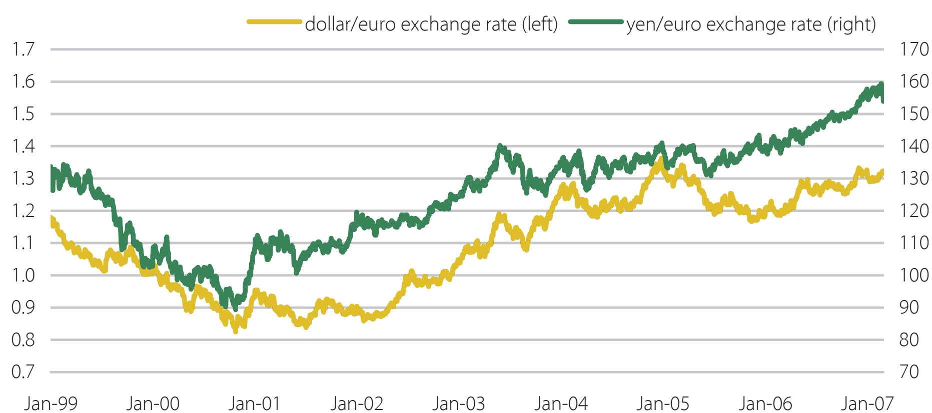
1. Data at the end of month.

## 2.2 Exchange rates

The dollar's depreciation against the euro continued into 2007, although slower than in 2006. The loss of value in the first two months of 2007 was 0.3%. In January, the exchange rate improved to $1.29, though it subsequently slid back leaving it at $1.32 at the end of February.

The yen maintained its fall against the dollar because of the continuing significant volume of carry trade transactions[1] (see figure 2). Some positions closed at the end of February due to the fall in international stock markets, allowing the yen to recover slightly. As a result, the yen's exchange rate against the euro was ¥153.9 at the start of March, 1.9% down on the figure for December 2006.

**Euro exchange rate against the dollar and yen** FIGURE 2




Source: Thomson Datastream.

1 Borrowing in low-interest currencies and investing the money in more profitable currencies.

## 2.3 Long-term interest rates

The average levels of medium and long-term public debt yields in the euro zone and United States in January and February were significantly higher than the levels at the close of 2006 (see table 4). However, the increase was not consistent during the whole period. Yields rose in January and much of February, mainly because of the acceleration of the economy in the euro zone and certain signs of a possible upturn in inflation in the United States.

Nevertheless, bond buying dominated the final sessions in February as investors sold in the equity markets. This led to a significant fall in yields until the first sessions in March, particularly in the United States, where they were 20-25 basis points below the levels for December 2006, at around 4.45%-4.50% in the three, five and ten-year terms. In the euro zone, yields were around 3.85%-3.95% in the first March sessions, a fall of 5-10 basis points on the end of 2006. As a result, the long-term interest rate spreads between the United States and the euro zone, which had remained at around 75 basis points in January and for nearly all of February, narrowed considerably in the final February sessions and at the start of March to 55 basis points.

In Japan, the situation was more stable and yields remained below the maximums registered in the second quarter of 2006 for all terms (see table 4).

**Medium and long-term public debt yields [1]** TABLE 4

%

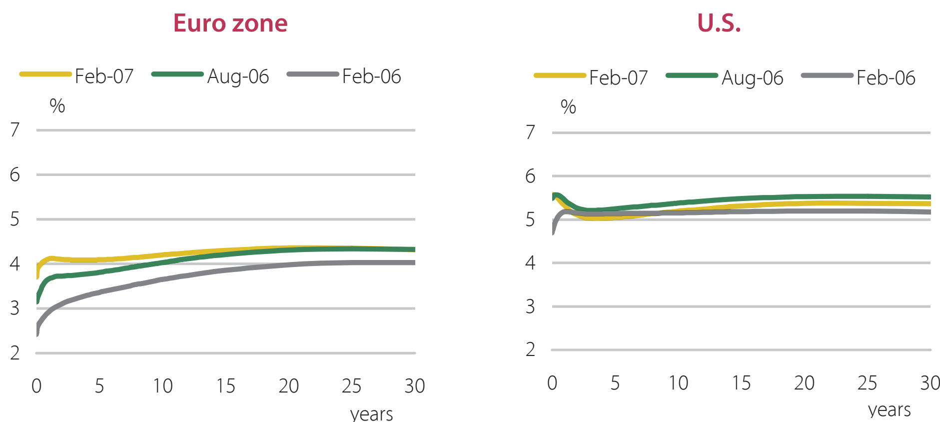
| | Dec 04 | Dec 05 | Dec 06 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Feb 07 |
|---|---|---|---|---|---|---|---|---|
| **Euro zone** | | | | | | | | |
| 3 year | 2.51 | 2.86 | 3.75 | 3.28 | 3.56 | 3.60 | 3.75 | 3.97 |
| 5 year | 2.92 | 3.06 | 3.77 | 3.44 | 3.73 | 3.63 | 3.77 | 3.99 |
| 10 year | 3.65 | 3.37 | 3.80 | 3.65 | 3.99 | 3.76 | 3.80 | 4.06 |
| **U.S.** | | | | | | | | |
| 3 year | 3.20 | 4.39 | 4.59 | 4.74 | 5.09 | 4.69 | 4.59 | 4.77 |
| 5 year | 3.60 | 4.39 | 4.54 | 4.71 | 5.06 | 4.67 | 4.54 | 4.72 |
| 10 year | 4.23 | 4.46 | 4.57 | 4.72 | 5.11 | 4.72 | 4.57 | 4.73 |
| **Japan** | | | | | | | | |
| 3 year | 0.24 | 0.46 | 0.93 | 0.79 | 0.99 | 0.81 | 0.93 | 0.89 |
| 5 year | 0.57 | 0.86 | 1.22 | 1.19 | 1.36 | 1.15 | 1.22 | 1.23 |
| 10 year | 1.40 | 1.53 | 1.64 | 1.69 | 1.86 | 1.66 | 1.64 | 1.70 |

Source: Reuters.

1. Average daily data.

The European interest rate curve continued to flatten as short-term interest rates maintained their rise (see figure 3). The spreads between 10 and 3-year rates was sustained under 10 basis points. In the United States, this spread has been slightly negative since October 2006.

**Zero-coupon rate curve** FIGURE 3




Source: Reuters.

The improved economic growth expectations in the euro zone appear to have led to a fall in credit risk premiums at the start of 2007 as against the levels at the close of 2006 (see table 5). European premiums remained noticeably below those in the United States, where they were volatile in the first two months of 2007, although they were more stable than the levels in 2004 and the first half of 2005 (see figure 4).

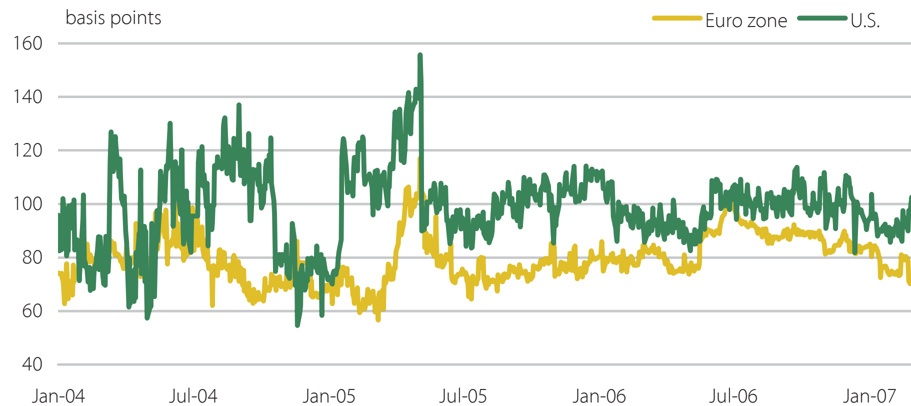
**Credit risk premium: BBB-AAA spread [1]** TABLE 5

| basis points | Dec 04 | Dec 05 | Dec 06 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Feb 07 |
|---|---|---|---|---|---|---|---|---|
| **Euro zone** | | | | | | | | |
| 3 year | 49 | 43 | 37 | 42 | 38 | 41 | 37 | 32 |
| 5 year | 61 | 53 | 53 | 55 | 57 | 56 | 53 | 46 |
| 10 year | 68 | 77 | 84 | 83 | 95 | 89 | 84 | 75 |
| **U.S.** | | | | | | | | |
| 3 year | 63 | 37 | 54 | 43 | 51 | 54 | 54 | 69 |
| 5 year | 71 | 63 | 68 | 59 | 68 | 71 | 68 | 79 |
| 10 year | 81 | 108 | 96 | 92 | 104 | 103 | 96 | 92 |

Source: Reuters.

1. Average daily data.

**Credit risk premium: ten-year BBB-AAA spread** FIGURE 4




Source: Reuters.

## 2.4 International markets

The main international markets had negative results at the start of 2007 as the knock-on effect from the Chinese and U.S. markets led to major corrections at the end of February (see figure 5). The fear of a cooling of the Chinese economy and a recession in the United States, together with political tensions in Iran and an upturn in oil prices, have led to massive sales in nearly all the main international stock markets, cancelling out the significant gains which had accumulated since the start of 2007.

The losses were across the board in the main international markets. Only Japan and Germany maintained positive results in the first two months of 2007 (see table 6). The performance of the German market can be explained by favourable growth figures and inflation results which countered the continued negative effects of the January rise in VAT. The average losses in other markets were 2%.

The fall in the main stock market indexes made a considerable dent in the gains over the previous 12 months, although there were still notable rises which were higher than the public debt yields. As in 2006, the Spanish stock market continued to outperform the European markets with a rise of 18.2%. The next best performer was the German market, at 14.2%. None of the other markets had annual gains of more than 10%.

The price adjustment also affected emerging country markets, although this pattern was not evenly spread. The worst results in the January-February period were in the markets in India, Hungary, Russia, Argentina and Brazil. However, other markets saw significant gains, as in the case of Croatia and Peru (see table 7). In addition, the Chinese market continued to rise, although at a lower rate than in 2006, and with greater volatility. Annual increases were still high, and way above 100% in cases such as the Chinese and Peruvian markets.

## Performance of the major stock market indexes

TABLE 6

annual % unless otherwise indicated

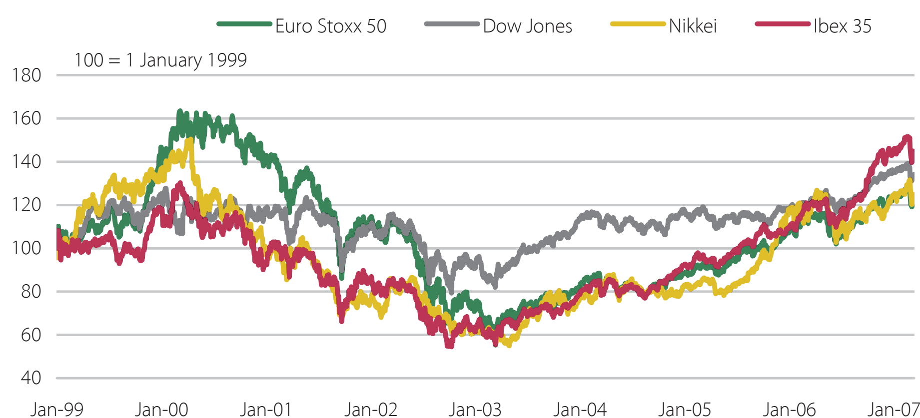
| | Index | 2004 | 2005 | 2006 | 2007 - Mar [1] % Q | 2007 - Mar [1] % change on Dec 06 | 2007 - Mar [1] annual % |
|---|---|---|---|---|---|---|---|
| **World** | | | | | | | |
| | MSCI World | 12.8 | 7.6 | 18.0 | -0.9 | -0.9 | 11.9 |
| **Euro zone** | | | | | | | |
| | Euro Stoxx 50 | 6.9 | 21.3 | 15.1 | -2.6 | -2.6 | 6.6 |
| | Euronext 100 | 8.0 | 23.2 | 18.8 | -1.7 | -1.7 | 9.5 |
| Germany | Dax 30 | 7.3 | 27.1 | 22.0 | 0.1 | 0.1 | 14.2 |
| France | Cac 40 | 7.4 | 23.4 | 17.5 | -2.1 | -2.1 | 8.3 |
| Italy | Mib 30 | 16.9 | 13.3 | 17.5 | -2.5 | -2.5 | 8.3 |
| Spain | Ibex 35 | 17.4 | 18.2 | 31.8 | -1.3 | -1.3 | 18.2 |
| **United Kingdom** | | | | | | | |
| | FTSE 100 | 7.5 | 16.7 | 10.7 | -1.7 | -1.7 | 4.90 |
| **United States** | | | | | | | |
| | Dow Jones | 3.1 | -0.6 | 16.3 | -2.8 | -2.8 | 9.9 |
| | S&P 500 | 9.0 | 3.0 | 13.6 | -2.2 | -2.2 | 7.6 |
| | Nasdaq-Comp | 8.6 | 1.4 | 9.5 | -2.0 | -2.0 | 2.5 |
| **Japan** | | | | | | | |
| | Nikkei 225 | 7.6 | 40.2 | 6.9 | 0.0 | 0.0 | 8.2 |
| | Topix | 10.2 | 43.5 | 1.9 | 2.4 | 2.4 | 5.5 |

Source: Thomson Datastream.

1. Data through 2 March. The quarterly change (%Q) corresponds to the period between 2 March and the last day of the previous calendar quarter.

## Movements in the major stock market indexes

FIGURE 5

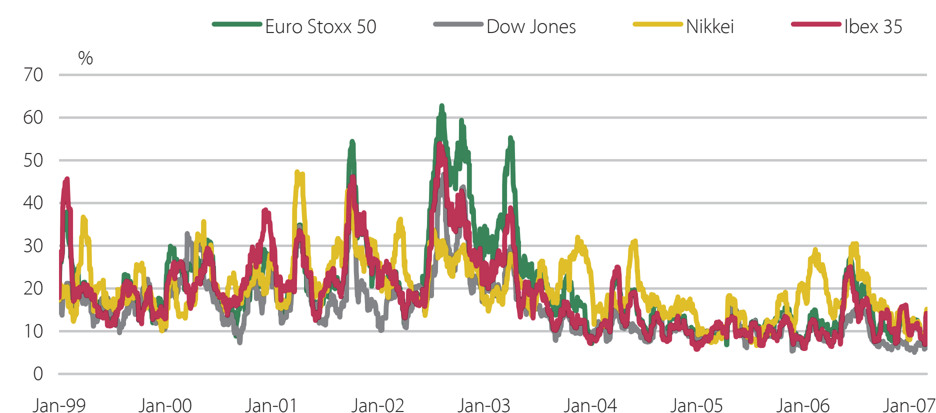



Source: Thomson Datastream.

The sessions in which prices were severely corrected or adjusted in some markets after the steep accumulated rises since 2006 resulted in a significant increase in volatility in the final sessions in February and the beginning of March. There was an average increase of 5% in the historical volatility of the Euro Stoxx 50, the Dow Jones, Nikkei 225 and Ibex 35. Nevertheless, it is worth remembering that volatility levels remained below the post-1999 average (see figure 6).

## Historical volatility of the major stock market indexes

FIGURE 6




Source: Thomson Datastream.

## Performance of other international markets

TABLE 7

annual % unless otherwise indicated

| | Index | 2004 | 2005 | 2006 | 2007 - Mar [1] % Q | 2007 - Mar [1] % change on Dec 06 | 2007 - Mar [1] annual % |
|---|---|---|---|---|---|---|---|
| **Latin America** | | | | | | | |
| Argentina | Merval | 28.3 | 12.2 | 35.5 | -4.4 | -4.4 | 11.3 |
| Brazil | Bovespa | 17.8 | 27.7 | 32.9 | -4.7 | -4.7 | 8.3 |
| Chile | IGPA | 22.2 | 2.7 | 34.4 | 4.9 | 4.9 | 33.8 |
| Mexico | IPC | 46.9 | 37.8 | 48.6 | -0.5 | -0.5 | 37.8 |
| Peru | IGRA | 52.4 | 29.4 | 168.3 | 18.3 | 18.3 | 145.8 |
| Venezuela | IBC | 34.9 | -31.9 | 156.1 | -0.8 | -0.8 | 74.3 |
| **Asia** | | | | | | | |
| China | Shanghai Comp | -15.4 | -8.3 | 130.4 | 5.8 | 5.8 | 120.2 |
| India | BSE | 16.4 | 38.3 | 41.0 | -7.1 | -7.1 | 16.7 |
| South Korea | Korea Comp Ex | 10.5 | 54.0 | 4.0 | -1.4 | -1.4 | 3.4 |
| Philippines | Manila Comp | 26.4 | 15.0 | 42.3 | 5.3 | 5.3 | 46.9 |
| Hong Kong | Hang Seng | 13.2 | 4.5 | 34.2 | -2.6 | -2.6 | 22.4 |
| Indonesia | Jakarta Comp | 44.6 | 16.2 | 55.3 | -2.5 | -2.5 | 40.8 |
| Malaysia | Kuala Lumpur Comp | 14.3 | -0.8 | 21.8 | 6.2 | 6.2 | 26.6 |
| Singapore | SES All-Singapore | 17.1 | 13.6 | 27.2 | 3.1 | 3.1 | 24.1 |
| Thailand | Bangkok SET | -13.5 | 6.8 | -4.7 | -0.1 | -0.1 | -9.8 |
| Taiwan | Taiwan Weighted PR | 4.2 | 6.7 | 19.5 | -2.0 | -2.0 | 15.5 |
| **Eastern Europe** | | | | | | | |
| Russia | Russian RTS Index | 8.3 | 83.3 | 70.7 | -6.6 | -6.6 | 22.4 |
| Poland | Warsaw WIG | 27.9 | 33.7 | 41.6 | 3.0 | 3.0 | 31.2 |
| Romania | Romania BET | 101.0 | 50.9 | 22.2 | 5.8 | 5.8 | 8.4 |
| Bulgaria | Sofix | 37.6 | 32.0 | 48.3 | 6.7 | 6.7 | 48.3 |
| Hungary | BUX | 57.2 | 41.0 | 19.5 | -7.1 | -7.1 | -1.7 |
| Croatia | CROBEX | 32.1 | 26.4 | 62.2 | 21.1 | 21.1 | 81.7 |

Source: Thomson Datastream.

1. Data through 2 March. The quarterly change (%Q) corresponds to the period between 2 March and the last day of the previous calendar quarter.

The VIX market volatility indicator[2] also increased considerably to 18% at the beginning of March, after remaining at an average of 11% since the start of 2007.

Apart from rises in share prices, profits can also be made by dividend payments. Hence it is worth highlighting that the dividend yields of the major stock market indexes did not change greatly at the start of 2007. They continued to be significant, at more than 3%, in most of the major European indexes, except for the German Dax 30. In the U.S. S&P 500 and the Japanese Topix dividend yields continued to be more than a percentage point below the European average (see table 8).

**Dividend yield of the main stock market indexes** TABLE 8

| % | 2004 | 2005 | 2006 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Mar 07 [1] |
|---|---|---|---|---|---|---|---|---|
| S&P 500 | 1.84 | 1.94 | 1.91 | 1.96 | 2.10 | 1.98 | 1.91 | 2.02 |
| Topix | 1.11 | 0.95 | 1.11 | 0.94 | 1.16 | 1.17 | 1.11 | 1.06 |
| Euro Stoxx 50 | 3.17 | 3.28 | 3.52 | 3.52 | 3.91 | 3.60 | 3.52 | 3.55 |
| Euronext 100 | 3.22 | 3.23 | 3.32 | 3.48 | 3.86 | 3.52 | 3.32 | 3.36 |
| FTSE 100 | 3.61 | 3.59 | 3.77 | 3.57 | 3.91 | 3.94 | 3.77 | 3.70 |
| Dax 30 | 1.96 | 2.17 | 2.29 | 2.32 | 2.70 | 2.47 | 2.29 | 2.17 |
| Cac 40 | 3.32 | 3.43 | 3.79 | 3.94 | 4.26 | 3.91 | 3.79 | 3.89 |
| Mib 30 | 3.17 | 3.53 | 3.67 | 3.37 | 4.12 | 4.00 | 3.67 | 3.58 |
| Ibex 35 | 2.77 | 3.08 | 3.02 | 2.99 | 3.33 | 2.94 | 3.02 | 3.01 |

Source: Thomson Datastream.

1. Data as of 2 March.

In addition, the price-earnings ratio (PER) picked up in all the European market indexes and in the American S&P 500 at the start of 2007, although as can be seen in Figure 7 the rate was still under the average since 1999. The Topix index once more had the highest PER (see table 9).

With regard to trading on the major international markets, the lack of available data for the first quarter of 2007 means it is not possible to determine whether the significant rate of trading in 2006 has been continued into this year. In 2006 there was an average increase in trading of 34% (see table 10).

2 A measure of the implied volatility of options on the S&P 500 calculated by the Chicago Board Options Exchange CBOE. It reflects market expectations on the volatility of stock markets in the next 30 days, and is considered the benchmark for stock market volatility.

## PER of the major market indexes

TABLE 9

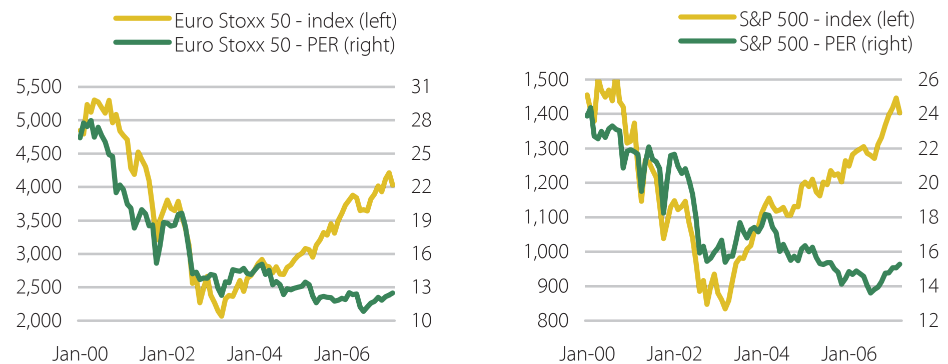
| % | 2004 | 2005 | 2006 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Mar 07 [1] |
|---|---|---|---|---|---|---|---|---|
| S&P 500 | 16.36 | 14.85 | 15.07 | 14.74 | 13.60 | 14.25 | 15.07 | 15.28 |
| Topix | 15.68 | 19.52 | 17.80 | 19.36 | 17.27 | 16.70 | 17.80 | 18.50 |
| Euro Stoxx 50 | 13.00 | 12.03 | 12.15 | 12.35 | 10.82 | 11.73 | 12.15 | 12.48 |
| Euronext 100 | 13.06 | 12.46 | 12.93 | 13.14 | 11.53 | 12.47 | 12.93 | 13.37 |
| FTSE 100 | 16.63 | 12.45 | 12.41 | 12.79 | 11.52 | 11.75 | 12.41 | 12.87 |
| Dax 30 | 12.96 | 12.62 | 12.78 | 13.21 | 11.19 | 12.08 | 12.78 | 13.26 |
| Cac 40 | 12.93 | 12.14 | 12.68 | 12.70 | 11.41 | 12.19 | 12.68 | 13.08 |
| Mib 30 | 15.57 | 13.38 | 13.07 | 13.48 | 11.63 | 12.36 | 13.07 | 13.33 |
| Ibex 35 | 13.78 | 12.88 | 14.29 | 13.68 | 12.30 | 13.35 | 14.29 | 14.79 |

Source: Thomson Datastream.

1. Data as of 2 March.

## Stock market indexes and the PER: Euro Stoxx 50 and S&P 500

FIGURE 7




Source: Thomson Datastream.

## Trading on the major international stock markets

TABLE 10

Billion euros

| Exchange | 2004 | 2005 | 2006 | Q4 05 | Q1 06 | Q2 06 | Q3 06 | Q4 06 |
|---|---|---|---|---|---|---|---|---|
| U.S.[1] | 16,813 | 20,042 | 27,044 | 5,487 | 7,179 | 7,128 | 6,091 | 6,646 |
| New York | 9,317 | 11,410 | 17,222 | 3,150 | 4,429 | 4,603 | 3,958 | 4,232 |
| Tokyo | 2,591 | 3,603 | 4,617 | 1,365 | 1,358 | 1,224 | 986 | 1,049 |
| London | 4,149 | 4,583 | 5,991 | 1,267 | 1,581 | 1,443 | 1,340 | 1,626 |
| Euronext | 1,986 | 2,345 | 3,006 | 618 | 762 | 891 | 617 | 736 |
| Deutsche Börse | 1,238 | 1,546 | 2,165 | 414 | 555 | 608 | 457 | 545 |
| Borsa Italiana | 778 | 1,051 | 1,258 | 275 | 293 | 377 | 231 | 357 |
| BME [2] | 646 | 859 | 1.154 | 215 | 272 | 263 | 265 | 354 |

Source: International Federation of Stock Exchanges and CNMV.

1. The sum of the New York Stock Exchange (NYSE), Nasdaq and the American Stock Exchange.
2. Bolsas y Mercados Españoles (holding company for most Spanish exchanges). Does not include Latibex.

Table 11 shows the size of the major international stock markets by relating their capitalization with the GDP of the corresponding country or region. The latest available data are for 2006. They show that London was again the biggest market at 151.7% of GDP, followed by New York, Tokyo and Euronext, all with a capitalization of over 100% of GDP. The Spanish stock market holding company Bolsas y Mercados Españoles increased its size in 2006 to 83.4% of GDP from 72.6% in 2005 (see table 11).

**Capitalization of the major international stock markets** TABLE 11

% GDP

| Exchange | 2004 | 2005 | 2006 | Q4 05 | Q1 06 | Q2 06 | Q3 06 | Q4 06 [1] |
|---|---|---|---|---|---|---|---|---|
| U.S. [2] | 139.4 | 136.5 | 145.1 | 136.5 | 142.0 | 136.8 | 140.1 | 145.1 |
| New York | 108.5 | 106.9 | 114.3 | 106.9 | 111.1 | 108.2 | 110.0 | 114.3 |
| Tokyo | 73.1 | 107.6 | 107.3 | 107.6 | 111.9 | 102.5 | 103.2 | 107.3 |
| London | 124.7 | 145.4 | 151.7 | 145.4 | 151.5 | 144.5 | 144.9 | 151.7 |
| Euronext [3] | 69.6 | 86.3 | 102.0 | 86.3 | 95.9 | 91.4 | 96.6 | 102.0 |
| Deutsche Börse | 40.0 | 46.3 | 53.9 | 46.3 | 51.4 | 47.4 | 49.3 | 53.9 |
| Borsa Italiana | 41.9 | 47.7 | 53.2 | 47.7 | 51.8 | 48.5 | 50.8 | 53.2 |
| BME [4] | 66.7 | 72.6 | 83.4 | 72.6 | 79.0 | 76.0 | 81.5 | 83.4 |

Source: International Federation of Stock Exchanges, Thomson Datastream and CNMV.

1. The GDP data for Euronext countries and Italy are estimated by taking an average of the rate of year-on-year change of the first three quarters of 2006.
2. The numerator is the combined sum of the New York Stock Exchange (NYSE), Nasdaq and the American Stock Exchange.
3. The denominator is the combined GDP of France, the Netherlands, Belgium and Portugal.
4. Bolsas y Mercados Españoles (holding company for most Spanish exchanges). Does not include Latibex.

# 3 Spanish Fixed-income Markets

Short-term interest rates continued to rise in January and February 2007 (see table 12). The expectations that the European Central Bank would raise official interest rates ensured that rates continued the upward trend that had been a feature of the money markets since the middle of 2005.

Available data to January show a recovery of 5-10 basis points in rates for commercial paper and inter-bank deposits. Worth highlighting is that the 12-month rate exceeded 4% for the first time since August 2001. The accumulated increase since June 2005 in money market rates is significant, at between 1.5% for three months and 1.9% for twelve months.

**Short-term interest rates [1]** TABLE 12

| % | Dec 04 | Dec 05 | Dec 06 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Jan 07 |
|---|---|---|---|---|---|---|---|---|
| **Commercial paper [2]** | | | | | | | | |
| 3 month | 2.14 | 2.40 | 3.54 | 2.63 | 2.83 | 3.15 | 3.54 | 3.59 |
| 6 month | 2.23 | 2.64 | 3.81 | 2.88 | 3.15 | 3.53 | 3.81 | 3.85 |
| 12 month | 2.29 | 2.84 | 3.96 | 3.07 | 3.33 | 3.76 | 3.96 | 4.08 |
| **Interbank deposits** | | | | | | | | |
| 3 month | 2.17 | 2.47 | 3.69 | 2.72 | 2.98 | 3.33 | 3.69 | 3.75 |
| 6 month | 2.21 | 2.61 | 3.80 | 2.84 | 3.15 | 3.54 | 3.80 | 3.87 |
| 12 month | 2.30 | 2.78 | 3.92 | 3.12 | 3.43 | 3.70 | 3.92 | 4.05 |
| **Repos / Treasury bills** | | | | | | | | |
| 3 month | 1.90 | 1.87 | 3.19 | 2.45 | 2.65 | 3.09 | 3.19 | 3.61 |
| 6 month | 2.07 | 2.42 | 3.58 | 2.74 | 2.97 | 3.33 | 3.58 | 3.51 |

Source: Bank of Spain.

1. Average daily data.
2. Trading in the AIAF private fixed-income market.

The positive economic growth figures in Germany raised expectations of increased inflation in the euro zone in December 2006, and provoked an upturn in the yields of medium and long-term public debt. The yields increased further in January 2007 (see figure 8), with significant rises amounting to 30 basis points for three and ten-year debt and 40 basis points for five-year. The increase in medium and long-term interest rates since they began their upward trend in the middle of 2005 until January 2007 has been 2% for three-year, 1.6% for five-year and 0.9% for ten-year rates.

The upward trend in yields halted in February in Spain, as it did internationally, by bond buying closing equity positions reacting to the fall in stock markets at the end of February and the start of March.

## Yield of medium and long-term public debt and fixed-income private [1]

TABLE13

| % | Dec 04 | Dec 05 | Dec 06 | Mar 06 | Jun 06 | Sep 06 | Dec 06 | Jan 07 |
|---|---|---|---|---|---|---|---|---|
| **Fixed-income private [2]** | | | | | | | | |
| 3 year | 2.81 | 3.15 | 4.04 | 3.59 | 3.86 | 3.91 | 4.04 | 4.23 |
| 5 year | 3.38 | 3.48 | 4.14 | 3.82 | 4.12 | 4.02 | 4.14 | 4.35 |
| 10 year | 4.15 | 3.89 | 4.26 | 4.13 | 4.48 | 4.24 | 4.26 | 4.50 |
| **Public debt [3]** | | | | | | | | |
| 3 year | 2.62 | 2.99 | 3.83 | 3.31 | 3.60 | 3.64 | 3.83 | 4.13 |
| 5 year | 3.01 | 3.05 | 3.81 | 3.59 | 3.84 | 3.68 | 3.81 | 4.19 |
| 10 year | 3.73 | 3.37 | 3.82 | 3.63 | 3.96 | 3.76 | 3.82 | 4.11 |
| **Spread [4]** | | | | | | | | |
| 3 year | 19 | 16 | 21 | 28 | 26 | 27 | 21 | 10 |
| 5 year | 37 | 43 | 33 | 23 | 28 | 34 | 33 | 16 |
| 10 year | 42 | 52 | 44 | 50 | 52 | 48 | 44 | 39 |

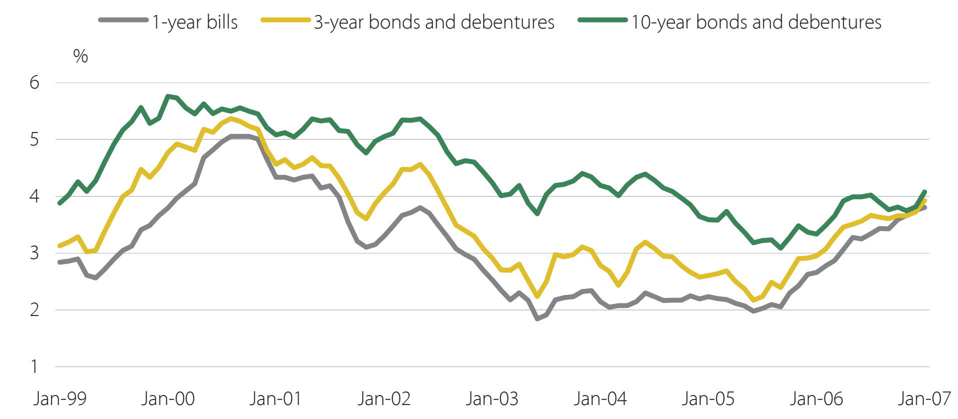
Source: Bank of Spain and AIAF.

1. Average daily data.
2. Bonds and debentures in outright trade in the AIAF market.
3. Unstripped government bonds and debentures in spot trading.
4. Basis points.

The escalation in the shortest-term Spanish public debt yields in January 2007 meant that the interest rate curve levelled off significantly, as can be seen in figure 8. The spread between ten-year and three-month rates was 35 basis points at the end of January 2007, compared with 105-110 basis points in June 2005.

## Spanish public debt yields

FIGURE 8




Source: Bank of Spain.

In addition, the reduction in yield spreads between private fixed-income and public debt continued (see table 13). This was particularly notable in January 2007 with three and five-year terms, which stood at 10 and 15 basis points respectively. In the ten-year term, the reduction in the spread was less marked, at 5 basis points to 40 basis points.

The positive ratings of the credit risk of issues listed on the AIAF would explain why the risk premium for private fixed-income did not increase in January to the same extent as public debt yield. As an illustration, table 14 shows the ratings of credit risk for December 2006. Most of the simple bond and debenture issues registered with the CNMV and listed in the AIAF are rated as "A" or above.

## Credit risk ratings of issues registered with the CNMV and listed on the AIAF [1]

TABLE 14

% of total unless otherwise indicated

| | Simple bonds | Mortgage backed securities | Asset-backed securities | Matador bonds |
|---|---|---|---|---|
| **With credit rating** | | | | |
| Amount (millions of euros) | 77,490.5 | 24,156.7 | 196,328.4 | 1,839.2 |
| Percentage | 89.8 | 99.7 | 98.8 | 100.0 |
| *Investment grade* | | | | |
| AAA | 5.9 | 94.0 | 93.8 | 71.4 |
| AA | 46.0 | 1.2 | 0.9 | 17.1 |
| A | 37.9 | 3.5 | 2.4 | 9.8 |
| BBB | 0.0 | 0.7 | 1.3 | 0.0 |
| *Speculative grade* | | | | |
| <BBB | 0.0 | 0.3 | 0.4 | 1.7 |
| **Without credit rating** | | | | |
| Amount (millions of euros) | 8,813.6 | 67.2 | 2,313.8 | 0.0 |
| Percentage | 10.2 | 0.3 | 1.2 | 0.0 |

| | Mortgage bonds | Territorial bonds | Simple debentures | Preference shares | Total |
|---|---|---|---|---|---|
| **With credit rating** | | | | | |
| Amount (millions of euros) | 129,270.0 | 8,400.0 | 36,188.3 | 20,974.0 | **494,647.1** |
| Percentage | 99.7 | 88.2 | 80.8 | 90.7 | **95.5** |
| *Investment grade* | | | | | |
| AAA | 94.7 | 85.0 | 3.8 | 0.0 | **67.2** |
| AA | 5.0 | 0.0 | 17.2 | 0.8 | **10.9** |
| A | 0.0 | 3.2 | 53.3 | 48.7 | **14.3** |
| BBB | 0.0 | 0.0 | 6.5 | 40.8 | **2.9** |
| *Speculative grade* | | | | | |
| <BBB | 0.0 | 0.0 | 0.0 | 0.4 | **0.2** |
| **Without credit rating** | | | | | |
| Amount (millions of euros) | 440.0 | 1,125.0 | 8,585.5 | 2,141.6 | **23,486.6** |
| Percentage | 0.3 | 11.8 | 19.2 | 9.3 | **4.5** |

Source: CNMV.

1. Outstanding balance on 31 December 2006.

# 4 Spanish Equity Markets

## 4.1 Prices

Share prices continued to increase in January and part of February 2007, maintaining the strong growth that had begun in the middle of last year. At the end of February the selling mood which had taken over the other international stock markets extended to the Spanish market as well, although to a lesser extent than in other European markets.

As a result, the January-February period was slightly negative in the main indexes of the Spanish markets. The Ibex 35 lost 1.3%, and the IGBM (the Madrid Stock Exchange General Index) 0.3%. The average result of the European markets was worse, as they registered losses of 1.8%. However, it is worth pointing out that the Ibex Medium Cap and Ibex Small Cap indexes gained nearly 8% in the January-February period. The main reason was that the profits of companies in these indexes continued to rise strongly, confounding market expectations.

The market correction at the end of February reduced the annual rises, though they continued to be substantial, at between 17.7% for the index of the Barcelona exchange and 44.1% for the Ibex Small Cap.

In the case of the Ibex 35 the role of dividends in adding to the profitability of this index should be taken into account. The available data until January show that this contribution was of more than four percentage points. This level is similar to the average registered in 2006, and is indicative that Spanish listed companies continued to put a premium on their policy of rewarding shareholders thanks to increased earnings and strong balance sheets. The dividend yield of the Ibex 35 in the first two months of 2007 remained at the same levels as in 2006, at around 3% (see Table 8).

The indexes of the Latibex exchange of Latin American securities traded in euros (FTSE Latibex) registered losses in the first two months of 2007 similar to those of the main national indexes. This corrected their strong rise since the second quarter of 2005, which had partly been the result of the strength of the currencies of origin of Latibex-listed companies against the euro.

The marked decline in the final sessions of February 2007 significantly increased volatility levels (see Figure 9). Implicit at the money (ATM) volatility at the nearest expiry on the Ibex 35, which until the end of February had remained at record average lows of 13.7% (similar to the average for 2006), increased to over 20% at the beginning of March.

## Yields on the Spanish stock market by index

TABLE 15

annual % unless otherwise indicated

| | 2004 | 2005 | 2006 | 2007 - Mar [1] Index | % Q | % change on Dec 06 | annual % |
|---|---|---|---|---|---|---|---|
| Ibex 35 | 17.4 | 18.2 | 31.8 | 13,962 | -1.3 | -1.3 | 18.2 |
| IGBM [2] | 18.7 | 20.6 | 34.5 | 1,550 | -0.3 | -0.3 | 21.4 |
| Barcelona | 17.6 | 12.7 | 29.3 | 1,120 | -1.3 | -1.3 | 17.7 |
| Bilbao | 18,2 | 17,7 | 34,1 | 2,548 | -1,1 | -1,1 | 19,9 |
| Valencia | 21.0 | 21.4 | 35.3 | 1,259 | -0.7 | -0.7 | 22.0 |
| Ibex with dividends | 21.1 | 22.0 | 36.0 | n/a | n/a | n/a | n/a |
| Ibex-NM [3] | 32.6 | 12.7 | 34.0 | 3,617 | 3.0 | 3.0 | 21.9 |
| Ibex Medium Cap [4] | 25.1 | 37.1 | 42.1 | 21,146 | 7.6 | 7.6 | 34.5 |
| Ibex Small Cap [5] | 22.4 | 42.5 | 54.4 | 16,775 | 8.6 | 8.6 | 44.1 |
| BCN-Mid 50 [6] | 29.9 | 47.5 | 51.0 | 40,402 | 9.4 | 9.4 | 41.0 |
| FTSE Latibex All-share [7] | 31.0 | 83.9 | 23.8 | 2,261 | -2.5 | -2.5 | 2.0 |
| FTSE Latibex Top [8] | -- | 76.3 * | 18.2 | 3,751 | -0.7 | -0.7 | 0.2 |
| FTSE Latibex Brazil [9] | -- | -- | 24.3 ** | 8,474 | -1.5 | -1.5 | -- |

Source: Thomson Datastream, Reuters, Madrid Stock Exchange and Sociedad de Bolsas.

1. Data through 2 March. The quarterly change (%Q) corresponds to the period between 2 March and the last day of the previous calendar quarter.
2. Madrid Stock Exchange General Index.
3. Ibex Nuevo Mercado, made up of TMT (technology, media and telecommunications) companies.
4. Index of mid-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 Stock Exchange.
7. Index of all the shares quoted in euros on the Latin American market (Latibex).
8. Index of the main shares on the Latibex market.
9. Index of the main Brazilian shares on the Latibex market.

* Since the index started on 3 January 2005.

** Since the index started on 26 September 2006.

n/a: data not available at the time of preparing this report.

## Ibex 35 performance and implied volatility

FIGURE 9

Source: Thomson Datastream and MEFF.

* Implied ATM volatility on nearest expiry.

The breakdown of price changes by sector and main shares in the first months of 2007 shows that the fall in prices was not across the board. Of the six sectors analysed by the Madrid Stock Exchange two registered losses: *technology and telecommunications* (because of a 2.2% drop in Telefónica prices) and f*inancial and real estate services*. The latter included a fall of 3.5% in Santander Central Hispano and a 7.9% fall in the sub-sector of *real estate and others* (above all because of Metrovacesa), ending the steady increase in prices over recent years. Another major negative impact on the IGBM was the drop in the price of Repsol YPF of 10.5%, although this loss was untypical, as the sector as a whole (*oil and energy*) had moderate gains thanks to the big rise in Endesa (see tables 16 and 18).

**Yield by sector and main shares [1] on the Madrid Stock Exchange** TABLE 16

annual % unless otherwise indicated

| | | | | | 2007 - Mar [3] | | |
|---|---|---|---|---|---|---|---|
| | Weighting[2] | 2004 | 2005 | 2006 | % Q | % change on Dec 06 | annual % |
| **Financial and real estate services** | 41.84 | 8.9 | 22.7 | 34.9 | -1.1 | -1.1 | 18.1 |
| Real estate and others | 2.41 | 23.7 | 72.9 | 111.2 | -7.9 | -7.9 | 49.5 |
| BBVA | 13.84 | 19.2 | 32.0 | 21.0 | -1.9 | -1.9 | 5.5 |
| SCH | 15.55 | -2.8 | 22.1 | 26.8 | -3.5 | -3.5 | 11.7 |
| **Oil and energy** | 21.19 | 20.1 | 28.0 | 33.3 | 0.3 | 0.3 | 21.2 |
| Endesa | 6.33 | 13.4 | 28.5 | 61.2 | 7.5 | 7.5 | 40.5 |
| Repsol YPF | 4.34 | 23.9 | 28.8 | 6.2 | -10.5 | -10.5 | -1.5 |
| Iberdrola | 5.73 | 19.3 | 23.5 | 43.4 | -1.1 | -1.1 | 23.6 |
| **Commodities, industry and construction** | 10.14 | 28.7 | 43.4 | 61.9 | 1.3 | 1.3 | 39.2 |
| Construction | 5.89 | 31.2 | 54.0 | 61.0 | -0.8 | -0.8 | 38.1 |
| **Technology and telecommunications** | 16.41 | 18.4 | -6.6 | 28.4 | -1.9 | -1.9 | 21.7 |
| Telefónica | 15.45 | 19.1 | -4.6 | 26.8 | -2.2 | -2.2 | 20.1 |
| **Consumer goods** | 5.58 | 34.7 | 24.2 | 31.9 | 4.0 | 4.0 | 29.5 |
| **Consumer services** | 4.84 | 34.3 | 21.2 | 8.6 | 1.4 | 1.4 | 4.1 |

Source: Thomson Datastream and Bolsa de Madrid.

1. Shares whose capitalization is more than 4% of the IGBM.
2. Relative weight (%) in the IGBM as of 2 January 2007.
3. Data through 2 March. The quarterly change (%Q) corresponds to the period between 2 March and the last day of the previous calendar quarter.

Only 20.8% of the companies in the IGBM had losses (see table 17). This is a similar proportion to the fourth quarter of 2006, but this year the percentage of companies with bigger gains (25% or over) fell and the percentage of companies with moderate gains (up to 10%) rose.

## Range of yield in IGBM companies

TABLE 17

% of IGBM companies

| | Q1 06 | Q2 06 | Q3 06 | Q4 06 | Q1 07 [1] |
|---|---|---|---|---|---|
| ≥ 25% | 31.3 | 1.7 | 17.2 | 14.8 | 7.2 |
| 10% to 25% | 33.0 | 2.6 | 34.4 | 27.9 | 27.2 |
| 0% to 10% | 26.1 | 29.6 | 36.1 | 36.1 | 44.8 |
| ≤ 0% | 9.6 | 66.1 | 12.3 | 21.3 | 20.8 |
| **Pro-memoria: total no. of companies** | | | | | |
| | 115 | 115 | 122 | 122 | 125 |

Source: Thomson Datastream.

1. Data through 28 February.

## Shares with greatest impact on IGBM change [1]

TABLE 18

| | | 2007 - Mar [2] | | |
|---|---|---|---|---|
| **Share** | **Sector** | **Q1 07** | **Jan-Mar 07** | **Last year** |
| **Positive impact** | | | | |
| Endesa | Oil and energy | 0.46 | 0.46 | 2.33 |
| Banco Popular Español | Financial and real estate services | 0.31 | 0.31 | 1.21 |
| Telefónica | Technology and telecommunications | 0.17 | 0.17 | 4.01 |
| **Negative impact** | | | | |
| Repsol YPF | Oil and energy | -0.36 | -0.36 | 0.11 |
| Metrovacesa | Financial and real estate services | -0.27 | -0.27 | 0.45 |

Source: Thomson Datastream and Bolsa de Madrid.

1. Included are shares which had the greatest impact (equal to or more than 0.15 points) on the change in the IGBM .
2. Data through 28 February.

## IGBM shares with biggest quarterly change

TABLE 19

| | | 2007 - Mar [1] | | |
|---|---|---|---|---|
| **Share** | **Sector** | **% Q** | **% change on Dec 06** | **annual %** |
| **Rise** | | | | |
| Inbesos | Financial and real estate services | 122.11 | 122.11 | 136.93 |
| Montebalito | Financial and real estate services | 69.72 | 69.72 | 102.23 |
| Const. y auxiliar FF.CC. | Commodities, industry and construct. | 52.94 | 52.94 | 111.70 |
| Astroc Mediterráneo | Financial and real estate services | 40.18 | 40.18 | -- |
| Nicolás Correa | Commodities, industry and construct. | 34.90 | 34.90 | 22.09 |
| **Fall** | | | | |
| Metrovacesa | Financial and real estate services | -28.46 | -28.46 | 47.09 |
| Acerinox 'R' | Commodities, industry and construct. | -12.67 | -12.67 | 56.41 |
| Sacyr Vallehermoso | Commodities, industry and construct. | -8.67 | -8.67 | 80.58 |
| Aguas de Barcelona | Oil and energy | -8.36 | -8.36 | 10.66 |
| Ebro Puleva | Consumer goods | -8.33 | -8.33 | 15.18 |

Source: Thomson Datastream and Bolsa de Madrid.

1. Data through 28 February. The quarterly change is between 28 February 2007 and 29 December 2006.

## IGBM shares with biggest annual change

TABLE 20

| Share | Sector | 2007 - Mar [1] annual % | % Q |
|---|---|---|---|
| **Rise** | | | |
| Grupo Inmocaral | Financial and real estate services | 327.20 | 3.29 |
| Cleop | Commodities, industry and construct. | 259.89 | 20.79 |
| Avanzit | Technology and telecommunications | 209.58 | 8.15 |
| Duro Felguera | Commodities, industry and construct. | 138.30 | 9.69 |
| Inbesos | Financial and real estate services | 136.93 | 122.11 |
| **Fall** | | | |
| Antena 3 | Consumer services | -22.41 | -5.10 |
| EADS | Commodities, industry and construct. | -16.28 | -0.88 |
| Dogi International Fabrics | Consumer goods | -16.03 | 8.55 |
| Sogecable | Consumer services | -15.80 | 5.19 |
| Lingotes Especiales | Commodities, industry and construct. | -14.56 | 2.53 |

Source: Thomson Datastream and the Madrid Stock Exchange.

1. Data through 28 February. The quarterly change (%Q) corresponds to the period between 28 February and the last day of the previous calendar quarter.

In the first two months of 2007 the capitalization of the Spanish stock market consolidated the level of over 1,000 billion euros it had reached in the third quarter of 2006 thanks to an increase in prices. The capitalization of the electronic market increased to 840 billion euros, 3% more than in December 2006. Of this figure, 61% was for companies listed on the Ibex 35 (see table 21).

## Spanish stock market capitalization [1]

TABLE 21

million euros

| | 2004 | 2005 | 2006 | Q1 06 | Q2 06 | Q3 06 | Q4 06 | Q1 07 [2] |
|---|---|---|---|---|---|---|---|---|
| **All exchanges** | 685,026 | 879,516 | 1,144,157 | 980,715 | 943,485 | 1,014,846 | 1,144,158 | 1,163,101 |
| Electronic market | 525,695 | 616,685 | 813,765 | 686,439 | 673,851 | 735,681 | 813,765 | 840,195 |
| Open outcry | 34,284 | 40,140 | 17,420 | 41,413 | 39,323 | 37,651 | 17,420 | 13,282 |
| Of which, SICAV | 28,973 | 33,998 | 9,515 | 34,811 | 32,545 | 30,467 | 9,515 | 4,477 |
| MAB [3] | -- | -- | 40,398 | -- | 1,029 | 6,706 | 40,938 | 36,693 |
| Second market | 293 | 307 | 393 | 416 | 447 | 829 | 393 | 605 |
| Latibex | 124,755 | 222,384 | 271,642 | 252,447 | 228,835 | 233,979 | 271,642 | 272,327 |
| **Pro-memoria: Ibex 35** | | | | | | | | |
| | 344,240 | 407,797 | 502,828 | 450,329 | 438,871 | 464,171 | 502,828 | 515,456 |

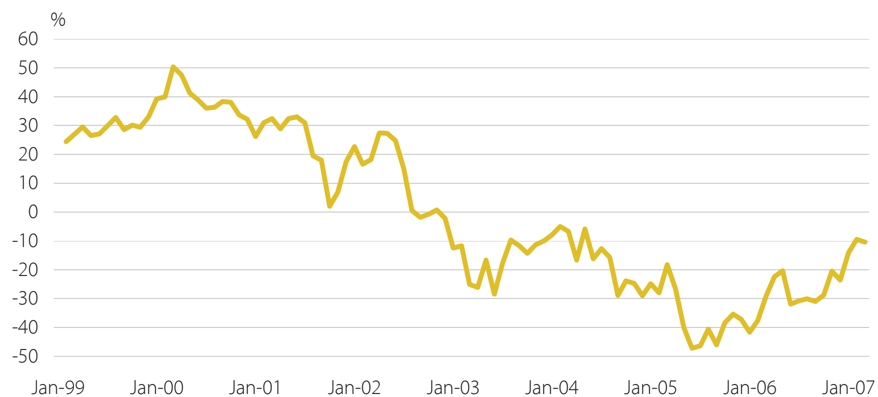
Source: CNMV and Sociedad de Bolsas.

1. Data at the end of the period.
2. Data for February.
3. MAB (Alternative stock market).

After the market corrections at the end of February and the beginning of March 2007, the Ibex 35 was pushed below 14,000 points. This level does not appear to be a correct adjustment to the real situation of the Spanish economic cycle, long-term interest rate levels and the growth of profits of listed companies (see section 4.3). The price-earnings ratio (PER) increased slightly at the start of 2007 (see table 9), but remained at historically low levels. The PER of the Ibex 35 was 14.8 on 2 March 2007, and the average since January 1999 has been 16.3.

In addition, with long-term interest rates at around 4% and a level of equilibrium for the earning yield gap between equity yields and interest rates of 2.13% (the average since 1999), the Ibex 35 is more than 10%[3] below its equilibrium level (see figure 10).

**Overvaluation (+) / Undervaluation (-) of the Ibex 35 [1]** FIGURE 10




Source: Thomson Datastream and CNMV.

1. Differential with the level of equilibrium of the Ibex 35 using an objective earning yield gap of 2.13%, with data up to 1 March 2007.

## 4.2 Activity: trading and liquidity

Market trading in Spain continued to be intense at the start of 2007. The data for January and February show a significant increase in average trading per session on the SIBE to over 6 billion euros, when in 2006 it was 4.5 billion euros.

The liquidity of the Spanish stock market remained at high levels at the start of 2007. The turnover velocity or ratio between trading and capitalization consolidated the significant rise it had registered in 2006. Up to February, turnover velocity on the electronic market was 166, slightly up on 2006 and notably more than the figure of 113 in 2005 (see figure 11).

3 If we take a longer historical perspective back to 1999 for estimating the equilibrium level of the earning yield gap, the room for a rise in the Ibex 35 increases to 14.7%.

## Trading on the Spanish stock market

TABLE 21

million euros

| | 2004 | 2005 | 2006 | Q1 06 | Q2 06 | Q3 06 | Q4 06 | Q1 07 [1] |
|---|---|---|---|---|---|---|---|---|
| **All exchanges** | **642,109** | **854,145** | **1,154,294** | **272,076** | **262,779** | **265,181** | **354,260** | **256,794** |
| Electronic market | 636,527 | 847,664 | 1,146,390 | 270,084 | 261,344 | 263,943 | 351,020 | 255,098 |
| Open outcry | 5,194 | 5,899 | 5,318 | 1,779 | 1,207 | 974 | 1,358 | 408 |
| Of which, SICAV | 4,541 | 4,864 | 3,980 | 1,478 | 1,146 | 867 | 1,091 | 222 |
| MAB [2] | -- | -- | 1,814 | -- | 17 | 93 | 1,705 | 1,108 |
| Second market | 21 | 26 | 49 | 8 | 11 | 11 | 20 | 48 |
| Latibex | 366 | 557 | 723 | 205 | 200 | 160 | 158 | 133 |
| **Pro memoria: trading of non-resident entities (% all exchanges)** | | | | | | | | |
| | 57.6 | 57.1 | 57.8 [3] | 55.4 | 59.7 | 58.3 | n/a | n/a |

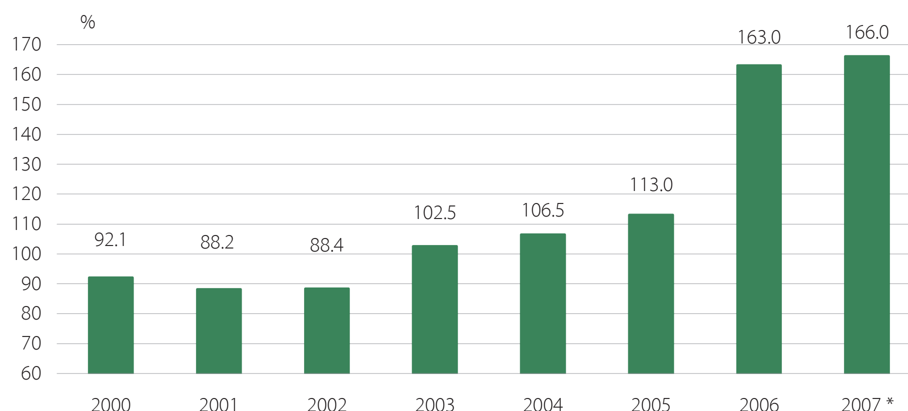
Source: CNMV and the General Directorate for Trade and Investment.

1. Accumulated data for January and February.
2. MAB (Alternative stock market). Data from the start of its activity on 29 May 2006.
3. Data between January and September.

n/a: data not available at the time of preparing this report.

## Turnover velocity[1] of the Spanish stock market

FIGURE 11




Source: CNMV and Sociedad de Bolsas.

1. Ratio of the total trading volume in the electronic market over the last twelve months divided by the average monthly capitalization during this period.

* Data for February.

### 4.3 Results of listed companies

Strong balance sheets, reflected not only in increased profits but also favourable perspectives for 2007, have been a fundamental reason for the rising share prices of Spanish listed companies in recent years.

The latest available data show an increase in company profits above market expectations at the start of 2006. The EBITDA of companies in the electronic market increased at an annual 25.8% in the first quarter, the highest figure since 2000 (see table 23). The increase has been general across all sectors and companies (only six had losses out of a total of 124). Particularly positive were the results of the biggest companies in the Spanish market in terms of trading and

capitalization. The *technology and telecommunications* sector stands out with notable increases in Telefónica's EBITDA. Next comes the *financial and real estate services* sector, which was boosted by the results of the two big Spanish banks, BBVA and SCH. There was a more modest increase in the *consumer goods* sector, where companies which saw their results worsen had a greater impact (13 of the 29 companies in the sector).

**EBITDA [1] of companies listed on the electronic market** TABLE 23

annual %

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|---|---|
| **Financial and real estate services** | **13.8** | **27.2** | **24.5** | **-2.5** | **0.4** | **17.0** | **28.3** | **27.7** |
| BBVA | 10.6 | 27.0 | 26.1 | -2.1 | -12.9 | 11.7 | 20.4 | 39.2 |
| SCH | 18.6 | 32.6 | 24.0 | -6.9 | 0.4 | 15.7 | 37.4 | 27.3 |
| **Oil and energy** | **36.2** | **45.0** | **-2.6** | **-11.5** | **4.2** | **4.9** | **23.1** | **21.5** |
| Endesa | 37.6 | 22.8 | -3.6 | 1.8 | -6.6 | -6.1 | 33.2 | 33.2 |
| Repsol YPF | 63.5 | 110.7 | -12.4 | -28.0 | 4.8 | 12.7 | 20.6 | 17.4 |
| Iberdrola | 5.5 | 4.6 | 19.7 | 0.2 | 9.0 | 9.3 | 12.5 | 19.7 |
| **Commodities, industry and construction** | **26.0** | **37.3** | **8.1** | **13.5** | **16.2** | **14.7** | **13.9** | **24.6** |
| **Technology and telecommunications** | **13.4** | **9.1** | **33.9** | **-6.6** | **8.9** | **-4.5** | **24.9** | **33.1** |
| Telefónica | 15.1 | 11.2 | 9.4 | -10.5 | 5.3 | -6.1 | 25.0 | 42.2 |
| **Consumer goods** | **14.1** | **63.1** | **20.4** | **10.8** | **1.8** | **13.2** | **15.4** | **5.3** |
| **Consumer services** | **11.2** | **24.5** | **13.5** | **19.3** | **18.5** | **17.5** | **11.7** | **24.6** |
| **Total electronic market** | **21.0** | **30.0** | **14.9** | **-4.0** | **5.9** | **7.3** | **23.1** | **25.8** |
| **Pro memoria: Total EBITDA of the electronic market** (millions of euros) | | | | | | | | |
| | 42,972 | 55,842 | 64,141 | 61,544 | 65,183 | 69,954 | 86,134 | 50,588 |

Source: Madrid Stock Exchange.

1. Earnings Before Interests, Tax, Depreciation and Amortization. Gross operating results.
2. Data for the first quarter.

The figures on net business and results take in until the third quarter of 2006 and offer the same positive vision of the balance sheets of listed Spanish companies. According to data from the Madrid Stock Exchange, companies listed on the electronic market saw their net volume of business increase an annual 20.8% and their net profits after tax and minority interests an annual 31.6%.

The increase in corporate profits in 2006 will continue to be bolstered by the following factors in 2007:

(i) continued growth of well over 3% in the Spanish economy;

(ii) a reactivated European economy;

(iii) more dynamic and more stable Latin American economies;

(iv) healthy balance sheets, with a reasonable rate of debt.

# Performance and Characteristics of the Broker-dealer, Broker and Portfolio Management Company Sector

**Paloma Hernández Cienfuegos (*)**

(*) Paloma Hernández Cienfuegos is on the staff of Authorization and Registration Directorate of the CNMV.

# 1 Start of the Broker-dealer and Broker Sector

The 1988 Securities Markets Law (Law 28/1988, 28 July), referred to as the LMV, was the starting point for a new phase of securities trading in Spain. The provision of services in this market was no longer considered a purely business or commercial activity and a new framework of competition rules and economic efficiency was introduced to give the public greater confidence in the sector. A new system of broker-dealers and brokers replaced the old concept of the stockbroker operating in the market as an exclusive privileged agent, rather like a public lawyer in the courts. This new system consisted of authorised companies that met the requirements of economic solvency, professional competence and human, material and organisational resources appropriate to an activity so essential to the financial system.

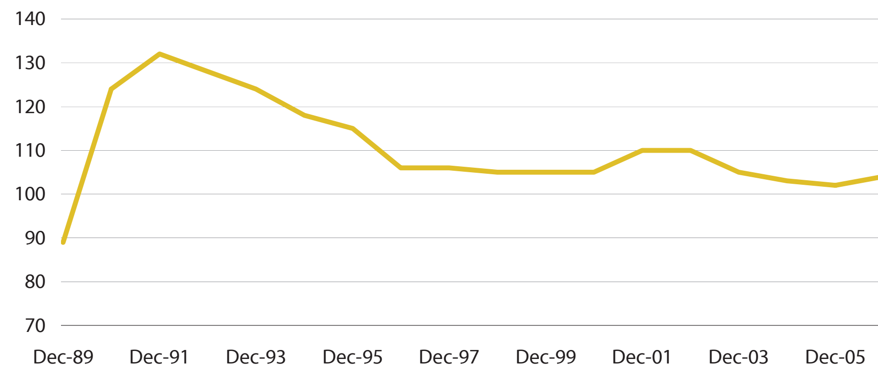
The LMV delayed the full implementation of the measures until 1992 so that the changes were not too disturbing and because of uncertainties as to how the markets would react to the new framework. During this transition period part of the capital of the broker-dealers and brokers/stock market members had to be held by stockbrokers and brokerage fees remained fixed as they were before the publication of the LMV.

During this period, the capital of brokers/stock market members could only be registered in the name of individual persons. This was intended to make it difficult for large national and international financial groups to enter the market.

These market operators had the exclusive right to become stock market members up to the year 2000 and could offer all the usual market services. Under the new law broker-dealers were required to have a minimum equity capital of 750 million pesetas (equivalent to approximately 4.5 million euros). They could operate independently in the markets and underwrite new issues and public offerings. Brokers were required to have a minimum equity capital of 150 million pesetas (equivalent to 0.9 million euros) and were more limited in their activities, especially in the area of independent risk operations.

This new framework was probably responsible for encouraging '*old and new*' market operators to set up a large number of companies which later proved to be excessive. At the end of 1989 there were already 89 firms operating in the market, of which 57 were stock exchange members.

**No. of broker-dealers and brokers from 1989-2006** FIGURE 1




Source: CNMV.

In spite of the transitional stakes held by former stockbrokers in the broker-dealers and brokers / stock exchange members national financial groups had from the outset large holdings in the firms. In this way they were able to channel clients' orders through their extensive commercial networks. Another significant factor in this context was the rule prohibiting a partner from having a holding in more than one firm. This rule encouraged potential shareholders to set up firms only when they could have a majority holding.

Mainly commercial and savings banks acquired these stakes although they were accompanied by insurance companies either acting alone or with others in the capital of one broker-dealer. Their aim was to use their extensive insurance agents' marketing networks for stockbroking and as became apparent later the marketing of investment funds.

The outstanding example of this trend was the investment made by a large number of savings banks, including Confederación Espanola de Cajas de Ahorro. Together they built a stake in a group specialising in the whole range of securities' markets operations. There were also other special cases where, for instance, medium-sized banks formed strategic alliances to set up broker-dealers and brokers.

Major international investment banks had a significant presence in the market right from the beginning. The main foreign stockbroking firms, including the big Japanese financial groups which dominated stockbroking in those years, gambled on building up subsidiaries in Spain. This investment played an important role in giving the new market credibility. Not only did the leading international players bring prestige but they also attracted a significant flow of foreign investment into the country.

The following table classifies the first broker-dealers and brokers registered on 31.12.89. It sorts them into three groups according to their shareholding structure: those with stakes owned by national financial firms, by foreign financial firms and those independent of other financial groups.

**Shareholding structure of the broker-dealers and brokers** TABLE 1

Situation at 31/12/1989

| | National financial firms | International financial firms | Rest | Total |
|---|---|---|---|---|
| **Broker-dealers** | **18** | **11** | **21** | **50** |
| Market members | 15 | 4 | 16 | 35 |
| Non-market members | 3 | 7 | 5 | 15 |
| **Brokers** | **2** | **2** | **35** | **39** |
| Market members | 0 | 0 | 22 | 22 |
| Non-market members | 2 | 2 | 13 | 17 |
| **Total** | **20** | **13** | **56** | **89** |

Source: CNMV.

The important group, independent firms occupies the final place. Their number is greater than the others because of the rule preventing shareholdings in broker-dealers and brokers by legal bodies. They are mainly firms which were operating in the securities markets prior to the implementation of the LMV and were subsequently protected by the new framework. Their main business was asset management and the underwriting of fixed income securities. They also included a large number of what are known as '*money market brokers*' which specialise in monetary asset dealing between financial intermediaries.

# 2 Performance of Broker-dealers and Brokers

The broker-dealers and brokers' sector has been characterised since its beginning by the need for both a high level of fixed capital and also for highly specialised, difficult-to- replace human resources. In fact, though, results have depended largely on market performance, given the importance of price changes and trading volumes, against a background of intense competition. This competition is not just between broker-dealers and brokers but also with commercial banking networks as well.

The competition in the sector in the early years focussed mainly on the retail business. Nearly all the registered firms concentrated on the small investor in an era that some have termed the 'popularisation of the stock market'. This was a phase that lasted several years until investment funds, for reasons to be examined later, became the star vehicle of retail investment. It was also a transitional period when commissions for stock market dealing were still fixed.

Conversely, the institutional brokerage business was not profitable at this time perhaps because it was being taken over by large credit institutions and foreign brokers. From the beginning the fragmentation of the companies made the sector very dynamic and had many effects. Some firms merged or underwent major changes. Some closed because they were uncompetitive or did not achieve sufficient levels of business or were poorly managed. Many new companies were set up, often by individuals displaced by earlier changes.

To sum up, it was a sector in permanent development, very much affected by upheavals within firms, and especially by changes in rules and the regulatory framework. For this latter reason it has been decided to analyse the sector's performance during two different time periods both associated with significant rule changes. Firstly, the decade of the 90's, from the publication of the LMV until its first reform in 1998. Here the emphasis will be on the different Directives, particularly Directive 93/22/CEE relating to investment services (DSI). Secondly, the period from the 1998 reform until nearer the present and the reform of the LMV following the changes in the Spanish regulatory framework resulting from Directive on Markets and Financial Instruments 39/2004 (MiFID).

## 2.1 From Law 24/1988 to Law 37/1998

The low point for the sector occurred in 1992. This was the year in which the system of fixed stockbroking commissions ended and freedom of access to market membership was allowed. Firms no longer needed to have former stockbrokers amongst their shareholders. The deregulation of commissions coincided with a slump in stock trading volumes and led to steep falls in commissions which were then the main source of stockbroking income.

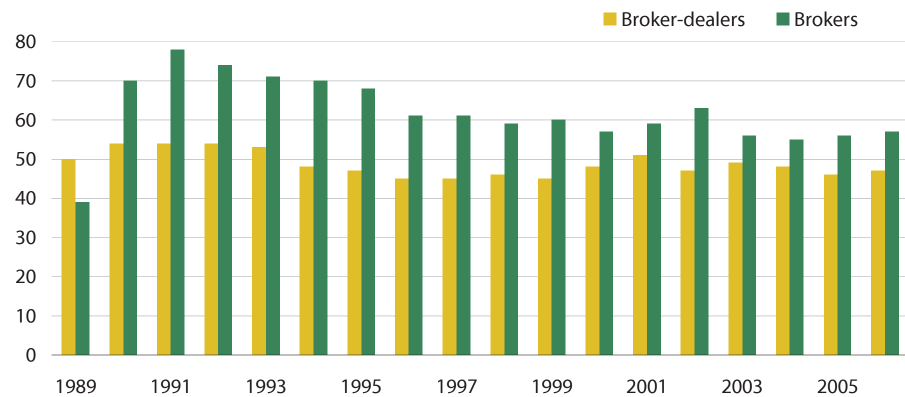
In addition, falls in equity prices and fixed incomes resulting from dramatic interest rate rises led to broker-dealers suffering losses on their own portfolios. Although this was not a significant part of the business it still aggravated the overall losses incurred.

As a result of this significant decline in income the majority of broker-dealers and brokers had to rethink their business plans and make an effort to adapt to the new environment. To become more efficient they simplified the top-heavy management structures associated with retail stockbroking in order to diversify their operations or alternatively specialise in offering just one specific service.

In spite of the hostile economic climate that made it especially hard for their businesses the overall solvency of the sector was not affected, perhaps because it was already a highly capitalised sector. This meant that the sector was able to undergo a process of rapid restructuring that cannot be put down solely to pressure from market conditions.

The greater freedom already mentioned that members had to raise capital was another positive factor. In fact, though, 1992 witnessed the greatest number of closures that the sector had gone through until then. The number of registered firms fell for the first time: from 132 in December 1991 to 128 in December 1992. This was the beginning of a downward trend that lasted until 2001.

**No. of broker-dealers and brokers** FIGURE 2




Source: CNMV.

This especially difficult year for the sector also witnessed the inspection of the Sociedad de Valores Ibercorp Bolsa SVB, SA. Problems originating in the parent banking group spread to the stockbroking subsidiary. They were similar to the previous year's case involving Eurocapital SVB, SA. Both inspections raised doubts for the first time about the newly created stockbroking sector which until then had performed very well. They also showed the problem of the negative effects of combining the results of different companies in the same group where there was inadequate supervision of individual operations.

These events in Spain coincided with similar developments in other countries highlighting how problems in one division of a company can infect the whole group. Financial groups were becoming increasingly complex and in some cases

comprised divisions of a widely different nature under the supervision of separate public bodies.

These developments made overall regulation more and more difficult and led to the passing of Law 13/92. The Law itself, originating from an unapproved Directive, addressed the issue of own resources and the problem of supervising the results across the financial group. It laid down new systems for calculating own resources requirements not only credit institutions but also for broker-dealers and brokers engaged in the same operation. In addition, the Law also sought to bring greater transparency to the operations of financial groups and thus make effective supervision easier.

Regarding the business structure of firms, the profits from stockbroking were declining in this period for a number of reasons, principally the fall in stock prices and trading volumes and the decrease in fees resulting from the deregulation of commissions. This led to the search for new business areas.

However, many firms were highly specialised in retail broking and were unable to adapt to the new conditions. They were forced out of the sector. Thus the number of closures continued at a high level over the following years given that the needed changes in business structure would take a considerable time to achieve.

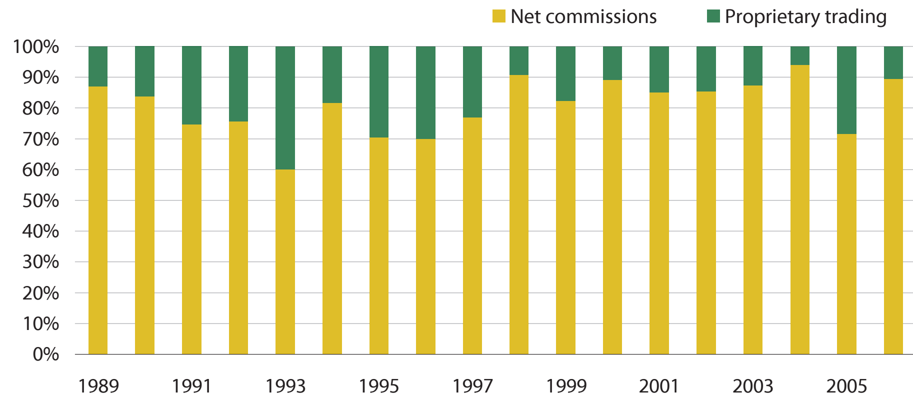
The first alternative business area that attracted broker-dealers arose naturally out of their equity operations. They required no additional investment in either human or material resources. In addition they also enabled them to exploit more fully their available surplus capital which was high because minimum capital requirements were high also.

These factors help to explain why equity operations assumed the importance they did immediately after the crisis of 92. In fact they peaked in the following year, 93, as can be seen in figure 3 when equity operations results accounted for 39.9% of the ordinary margin.

The figure 3 also shows that equity operations have never played a significant part in the sector's results. Their relative importance has always depended less on their own performance and more on fluctuations in the income produced by other business areas. In the larger financial intermediaries equity operations are usually concentrated in the parent company or other divisions of the group and the broker-dealer subsidiaries rarely undertake this type of operation.

The situation of the independent companies is a little different, perhaps because of their history. These types of operations have assumed a greater importance but more in connection with fixed income securities than with equities.

**Breakdown of the broker-dealers´ordinary margin** FIGURE 3




Source: CNMV.

An important trend occurred in the mid-90's which greatly affected the business structure of the companies and the entire make-up of the sector over the following years.

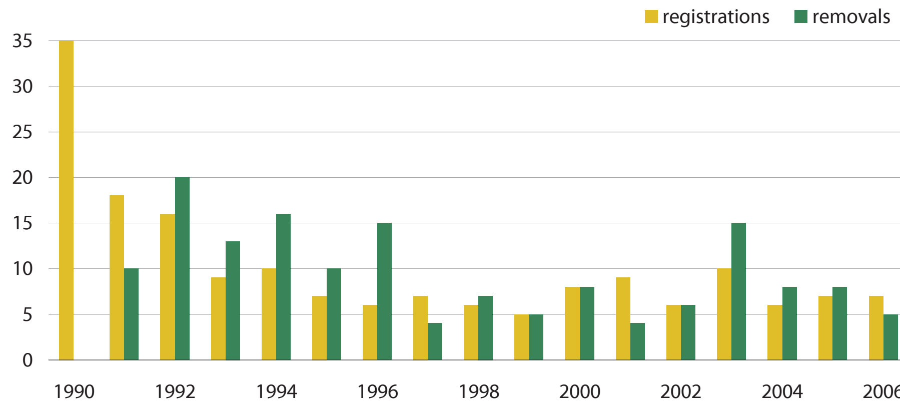
This was the development of collective investments which grew to levels above those of other countries like Germany and Italy. Investment funds became another form of 'popular' investment, at the expense of bank deposits, particularly term deposits. These funds were promoted mainly by savings and commercial banks to give customers a greater choice of investments and at the same time compensate themselves for the loss of income coming from bank deposits.

The marketing of funds became a very stable source of income for the sector. It was more profitable than stockbroking because it generated income throughout the year and the tax advantages encouraged investors to hold the investments for the long term. The business was aimed mainly at the retail market, therefore a good distribution network.

Hence the most successful firms were again those belonging to financial groups or those which had a network of representatives, particularly insurance companies whose agents could perform this function.

For reasons already noted the sector underwent a complete restructuring during these years. It affected independent firms more than those belonging to national and international groups. The former stockbrokers had been given advantages to help them maintain a dominant position in the market. However, they were unable, with few exceptions, to survive the first crisis. As a result they were replaced as dominant players by large national and international financial intermediaries.

**Registrations and removals of broker-dealers and brokers** FIGURE 4




Source: CNMV.

On 1 January 1996 the Directives on Capital Requirements (DAC) and Investment Services (DSI) came into force. They were intended as steps towards the building of a single European market in transferable securities and investment services.

These Directives required major reforms in national laws and were implemented at different speeds in different countries. Some of the new provisions like those relating to own resources requirements were already part of the Spanish regulation. Others like those concerning the rules of secondary market membership, free access to markets, deregulation of services and the setting up of investment guarantee funds required changes in the Securities Markets Law (LMV).

The reform was framed so that securities markets could respond to a greater variety of factors, for instance, the good results of listed companies or the public offerings stemming from the privatisation of public enterprises. These latter in particular became an important part of stock market trading and stimulated the interest of the general public in stock market investment.

Simultaneously, broker-dealers and brokers had to prepare themselves for two great challenges: the freedom of access to the market by European financial intermediaries and the introduction of the euro on 1 Jan 1999. From 1996 until the new LMV came into force firms enjoyed a very favourable environment in which they could develop their operations. The main driving force was the performance of the equity market. The steep rise in trading volumes resulted in a very significant increase in income from stockbrokering.

Business opportunities also expanded in other areas. There was a notable growth in the marketing of investment funds, the placing and underwriting of new issues and public offerings, as well as in corporate advice and consultation.

As a consequence of all these factors sector results grew strongly and the number of firms in the sector stabilised after falling consistently for a number of years. During the second half of the 90's firms from other European countries began to enter the Spanish intermediaries' market, taking advantage of the community passport.

In 1997 there were 293 communications of interest of which 92% came from the United Kingdom. They all concerned the idea of offering services without setting up a permanent or physical presence in Spain. It was not until 1999 that the first foreign branches were actually registered.

## 2.2 From Law 37/1998 to the present

Law 37/1998, the reform of Law 24/1988, introduced the provisions of the Directive on Investment Services DSI) into the Spanish regulation of the broker-dealers and brokers' sector. The resulting changes were critical in determining the new structure of securities intermediaries in Spain. Some of the features of the new law were as follows:

— It introduced the concept of the investment services company (ESI). These are financial entities which offer investment services of a professional nature to clients and includes broker-dealers and brokers. For the first time the new law also included in this sector for portfolio management companies which until then had been regulated under the collective investment framework.

— It recognised the use of the community passport not just for countries of other European Union countries wishing to set up in Spain but also for Spanish companies wishing to set up in other European Union countries.

— It gave investment service companies (ESI) of other European Union countries greater access to secondary markets as market members. Similar access was granted to credit institutions but only from 1 January 2000.

— It regulated the Investment Guarantee Fund set up by the Directive 97/9/CE. This was intended to act in the same way as the Deposits Guarantee Fund of the credit institutions. Its purpose is to compensate investors, up to maximum of 20,000 euros, for losses of securities and funds when a company becomes insolvent. However, the fund did not come into operation until the publication of the Royal Decree in 2001 which finalised the legislative requirements.

These liberalising measures signified a notable change in the philosophy underlying the provisions of the first LMV. Thus the development of the new Law was a complex process and required the creation of completely new rules rather than simply changing the old ones. One example of this was the RD 867/2001 of 20 July dealing with the legal framework for investment services companies.

From the year in which the reform of the LMV came into force until 2001 the year in which the RD 867/01 was published, there was little change in the number of Spanish firms registered in the sector. In fact, the number of firms entering and leaving the sector was broadly in balance.

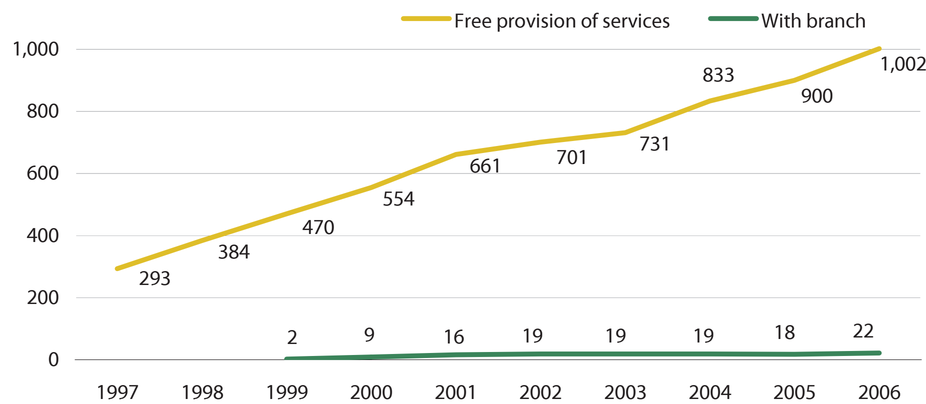
However, this does not mean there were no changes at all. Several firms were affected by an expansion of operations by their parent banking group, one example of which was the merger between Banco Santander and Banco Central Hispanoamericano.

This was also the era of major acquisitions of independent firms by foreign groups. Many of these groups, for example those of Japanese origin, continued to operate through their own investment services companies (ESI) which they transformed into branches of the foreign group. This was a process popularly known as '*sucursalizacion*'.

Although under the new rules firms did not to have to operate in the market through their own Spanish subsidiaries many foreign groups decided to buy up the independent companies which had survived the crisis of the early 90's and grown significantly in the following years. The attraction of these firms was that they already had in place a wide client base and quite solid marketing networks.

The number of European Union investment firms taking advantage of the community passport rose higher and higher. With the result that Spanish firms had to operate in an increasingly competitive market with a large number of players. Although there is some evidence of Spanish firms moving into Europe, on balance Spain became an importer of investment firms and this was a trend that became more pronounced during the following years.

**Foreign Investment Firms** FIGURE 5




Source: CNMV.

Coinciding with this breaking down of frontiers there was also a process of institutional globalisation in the markets themselves. With open access they began to compete against each other, a trend that was accentuated by developments in new technologies. At the same time, the investment services became more sophisticated with more complex, structured products requiring efficient risk management.

In this context, by the financial year 2000 the Internet had become a very important factor in market operations and increased competition amongst intermediaries. In fact, at the end of 2000 80% of all investment firms (ESI) were listed on the Internet.

The introduction of the Internet as a sales system and the resultant speeding up of transactions led to a further fall in commissions. Competition sharpened dramatically amongst firms to capture what was thought to be a new product

although with hindsight experience has shown that it was just the same one as before.

Nevertheless, the fall in commissions had a very negative effect on the sector as a whole. Nearly all firms had to revise their scale of commissions downwards irrespective of the means used to realise the transaction. As a result the new trading environment was worse than it had been before.

Another important landmark in this period for intermediaries was the advent of the euro. The immediate effect of the introduction of the single currency was to limit the scope of certain business areas, for example everything connected with foreign exchange in transnational investment. Additionally, the euro was an incentive for the large financial groups to begin restructuring their capital bases particularly those firms which had been present in Spain for many years but only in a nominal form.

At the same time, the period leading up to the year 2000 was a golden age for private banking compared to previous years. This was the result of the growing popularity of a new instrument for managing assets: open-ended investment companies (SICAV). From this date (especially the period 1999-2002) there was a spectacular increase in the number of SICAV's , creating a new business track for those investment firms which were able to set them up.

However, the relative weight of income generated by the new business was still low compared to the sector's main source of income which remained commissions from stockbrokering.

In spite of the new developments the main business of the larger firms continued, as before, to be brokering. What is certain, though, is that the new business attracted new players to the market although many finally opted to move into other areas covered, for example, by collective investment management companies (SGIIC) which were incompatible with the new instrument. The SICAV's were more closely related to private banking and matched the traditional operations of investment firms (ESI).

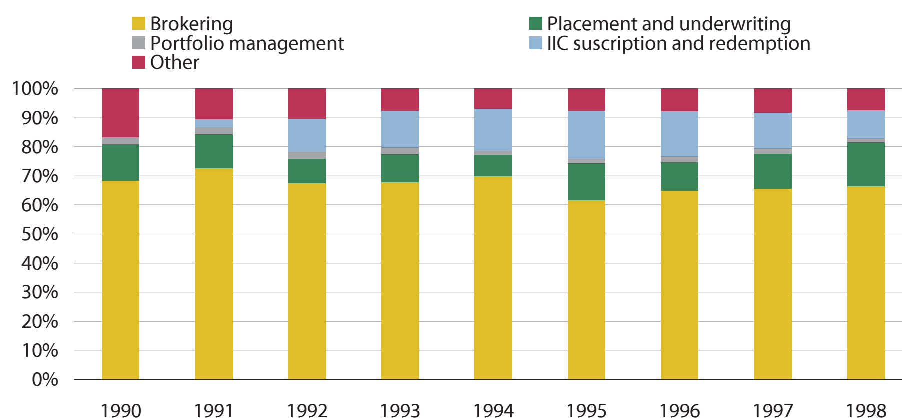
The Royal Decree 867/2001 of 20 July on the legal framework for ESI's can be considered the starting point at which full competition between firms began. Henceforward ESI's and credit institutions could offer investment services under completely equal conditions.

The new legal framework significantly reduced the minimum levels of equity capital required by broker-dealers and brokers. Until then they had been well above the minimum levels envisaged under the Directive on Capital Requirements (DAC) and those demanded of similar companies in other European Union countries.

From that point the capital requirement of a broker-dealer went down from 4.5 million euros to 2 million euros and of a broker from 0.9 to 0.3 million euros. However, this minimum figure rose to 0.5 million euros if the broker wanted to become a secondary market member, make deposits or accept funds from the public of an instrumental or temporary nature.

## Commission revenues 1990-1998

FIGURE 6




Source: CNMV.

Conversely, the Royal Decree raised the minimum equity capital required of portfolio management companies (SGC) from 66,000 euros to 100,000 euros.

The financial year 2001, in which the Royal Decree was published, was characterised by a market slump which again affected investment firms' results. However, this did not prevent them from strengthening their presence in the sector through setting up new firms or acquiring existing ones. The leading players behind these developments were mainly non-resident financial companies.

The ownership structure of the sector in December 2001 was the following: out of a total of 145 firms (110 broker-dealers and brokers and 35 portfolio management companies).

## Shareholding structure of the investment services companies

TABLE 2

Situation at 31/12/2001

| | | No. of companies | % |
|---|---|---|---|
| **Independents** | | **66** | **45.5** |
| | National | 65 | 44.8 |
| | Foreign | 1 | 0.7 |
| **National financial companies** | | **50** | **34.5** |
| | Banks | 23 | 15.9 |
| | Saving banks | 19 | 13.1 |
| | Insurance companies | 8 | 5.5 |
| **Foreign financial companies** | | **29** | **20.0** |
| | EU | 22 | 15.2 |
| | Non-EU | 7 | 4.8 |
| **Total** | | **145** | **100.0** |

Source: CNMV.

The sector of investment firms registered in Spain was almost equally divided between independent firms and those belonging to financial groups, with a clear majority of national companies (79%) over international ones (20.1%).

Also, in 2001 the Investment Guarantee Fund came into existence following the publication of the RD 948/2001 which specified its operating requirements. The structure of the guarantee system is the responsibility of a management company whose shareholders are the subscribing firms. The fund is financed by contributions from these firms according to the size of the assets and clients' deposits that they manage. The system is mutual and depends on all the firms operating in the market contributing to the fund to cover insolvencies.

One of the main characteristics of the fund is that it is a completely private concern. The only public presence stems from its Board of Directors on which sit representatives of the CNMV and those Autonomous Communities which compete in securities' markets. These directors have a say in proceedings but are not allowed to vote.

In its early days the Investment Guarantee Fund had only broker-dealers and brokers as subscribing members. Portfolio management companies could participate only through third-party insurance contracts. However, it proved impossible to implement these contracts and the portfolio management companies were brought into the system by the Law 53/2002 on fiscal and administrative measures and social order.

In 2003 the Law on Collective Investment Institutions widened the scope of the operations of collective investment management companies (SGIIC). It gave them access to the private banking market and allowed them to manage clients' investment portfolios.

This change had extremely important consequences for the future performance of the stockbrokering sector. New factors had to be taken into account when setting up new companies or reorganising existing ones. For example, the SGIIC had the opportunity to develop new operations, especially the marketing of collective investments, and this led to some of the new groups formed from investment firms and management companies forcing others out of the sector. In this respect the different minimum capital requirements for investment firms and management companies also had important implications.

Finally, the new stockbrokering structure virtually excluded the portfolio management companies from effective participation in the sector.

This new environment together with the longer term effects of the Directive on Investment Services (DSI) and the deregulation of entry into the sector had a significant impact on the large national and international financial groups. They began a process of reorganising the channels through which they offered investment services in Spain. The aim was to achieve a greater rationalisation of fixed assets and a significant reduction in operating costs.

However, the reorganisations were carried out in different ways according to the different types of company. Several financial groups based in other European Union countries, some of whom had bought holdings in Spanish investment firms at the end of the 90's, chose to transfer their operations to their banking arm in Spain. This is the phenomenon of so-called '*sucursalizacion*' and reached a peak in the first few months of 2000 when national and foreign credit institutions with an actual physical presence in Spain could become stock exchange members.

Some of the main Spanish financial groups that have been present in the broker-dealers and brokers sector since its outset, or have expanded through buying up existing firms, have chosen to integrate their subsidiaries into the parent banking group. The result has been not just a rationalisation of the operating structures of the firms involved but it has also made effective supervision of the sector much easier.

In addition, several financial groups took advantage of the Internet boom to create firms that specialised in offering services over the Internet. This environment has also encouraged mergers and takeovers leading to the concentration of these services in single firms.

Finally, it is clear that some firms did not manage to realise their business plans and so decided to suspend operations. In this sense, it is interesting to assess the survival rates of companies since the last market '*boom*' (the so-called dot.com boom).

Looking at firms which have ceased to be registered with the CNMV only 3 management portfolio companies and three broker-dealers and brokers were not registered for a period longer than two years.

Securities markets in Spain in 2006 performed exceptionally well, both in terms of trading volumes and profitability, coming on top of three years of continuous gains. Thus the setting up new broker-dealers and brokers remains an attractive business proposition. For this reason, although some of the larger financial groups may have begun to leave the sector they have been replaced by new companies coming in and imparting a new sense of dynamism.

A possible typology of firms registering in the last few years could be the following:

— Firms linked to financial groups from non-European Union countries. In general they are controlled by Swiss banks and usually target clients with a high level of wealth. They offer a traditional asset management service combined with more sophisticated forms of investment.

— Firms set up by individuals displaced by the upheavals mentioned earlier. These persons have wide financial knowledge with reliable client asset portfolios. In general they are small companies which offer specialised services, mainly the marketing of collective investment schemes (IIC), management of asset portfolios and especially of open-ended investment companies (SICAV). For these firms stockbroking, which has been the main operation of the sector for many years, is now only a complementary service to the main business.

— Broker-dealers and brokers promoted by insurance companies. Their main business is the marketing of collective investment schemes managed by the group's SGIIC, as well as advisory services and asset management. While it is difficult to foresee this type of firm growing in numbers they have considerable operating capacity and the growth prospects enjoyed by SGIIC's certainly favour their continued development.

— Firms that target the business usually referred to as 'family office'. They have their origins in the world of investment advisory services and the new operational capacities enable them to offer a complete investment service to clients who usually have a high level of assets and considerable investment potential. This is a new phenomenon characterised by vertical integration of the services provided in which the independence of the provider is greatly valued.

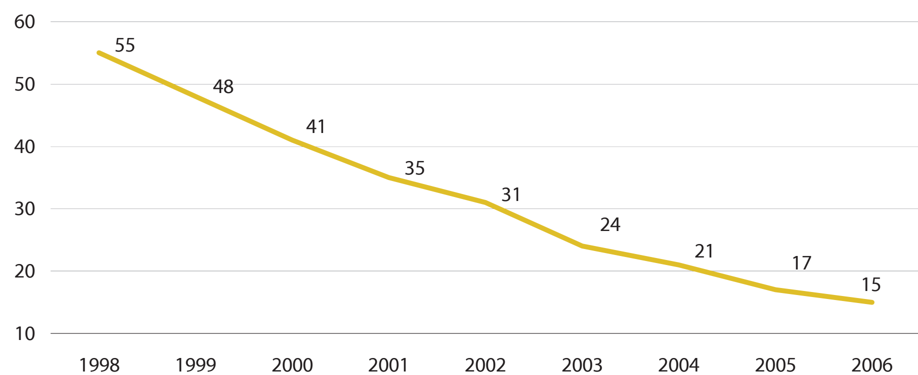
## 2.3 Portfolio Management Companies

Since the publication of the LMV of 1988, as has already been mentioned, this sector has been through a profound reorganisation, characterised by a steady decline in the number of portfolio management companies. This decline has actually increased in recent financial years due to the crisis the smaller-sized companies have gone through mainly with their asset management services (for example, the cases of: AVA Asesores de Valores, A.V., S.A., Gescartera Dinero, A.V., S.A., Broker Balear, A.V., S.A., Bolsa 8, A.V., S.A. and XM Patrimonios, A.V., S.A. etc). Other companies in the sector have in turn also been affected.

Another significant factor has been the Law 35/2003 giving new operational possibilities to the SGIIC's. The portfolio management companies have traditionally been small-sized. About 80% of them have less than 10 employees. The fifteen companies registered with the CNMV at the end of 2006 achieved profits of about 4 million euros although it should be noted that just one of them accounts for 46% of this figure (and belongs to a national banking group).

Thus it is to be expected that the contraction in the number of companies in the sector will continue in the future as a result of the growing competition facing those that remain.

**No. of portfolio management companies** FIGURE 7




Source: CNMV.

# 3 Present Characteristics of the Sector

Having outlined the history of the broker-dealers and brokers' sector since its beginning and that of portfolio management companies since their recognition as investment services companies the next section will deal with the present characteristics of the sector.

## 3.1 Shareholding Structure

The following table shows in diagrammatic form the breakdown of the investment services companies according to their shareholders. It compares the situation at the time of the publication of the RD 867/2001 with that of December 2006.

**Shareholding structure of investment services companies: 2001 vs. 2006** TABLE 3

| | | 31/12/2001 | | 31/12/2006 | |
|---|---|---|---|---|---|
| | | No. companies | % | No. companies | % |
| **Independents** | | **66** | **45.5** | **59** | **51.3** |
| | National | 65 | 44.8 | 56 | 48.7 |
| | Foreign | 1 | 0.7 | 3 | 2.6 |
| **National financial companies** | | **50** | **34.5** | **41** | **35.7** |
| | Banks | 23 | 15.9 | 14 | 12.2 |
| | Saving banks | 19 | 13.1 | 16 | 13.9 |
| | Insurance companies | 8 | 5.5 | 11 | 9.6 |
| **Foreign financial companies** | | **29** | **20.0** | **15** | **13.0** |
| | EU | 22 | 15.2 | 7 | 6.0 |
| | Non-EU | 7 | 4.8 | 8 | 7.0 |
| **Total** | | **145** | **100.0** | **115** | **100.0** |

Source: CNMV.

It should be noted that of the total of companies registered on 31 December 2006 four have been deducted. Their closures were registered in January 2007. They were authorised to operate in the sector but in fact had already ceased trading by the end of the year.

The most noteworthy feature is the reduction in the number of companies, falling by as many as 30 in five years. This gives some indication of the upheavals which characterised the sector during this period.

Another significant factor is the increase in the relative weighting of the independent companies or those not connected to other financial groups. This is the result mainly of the entry into the sector of 'directors companies' and those of the '*family office*'.

Although the increase in the weighting of the independent companies was small it should be remembered that there was a high turnover of firms entering and leaving the sector during this period.

Regarding the companies owned by national financial groups there was a marked reduction in those belonging to banks. This was caused by the increased integration of the investment services companies into the parent banking structures and also by consolidation in the banking sector itself. The percentage of companies owned by savings banks remained stable while the percentage owned by insurance companies rose significantly because they cannot operate directly in securities markets.

Finally, the figures confirm the reduction in the number of foreign financial companies belonging to other European Union countries. In general, they decided to transfer operations to their banking branches in Spain, the process known as '*sucursalizaion*'. There was also a slight increase in the number of firms belonging to non-European Union countries, most notably Switzerland, which were unable to take advantage of the community passport.

In conclusion, it is possible to point to three main factors responsible for the reductions in numbers which has characterised the sector. The exit of companies linked to national banking groups, the effects of the Directive of Investment Services on foreign companies and the marked revival of independent firms. These trends look likely to continue into the future.

Few companies linked to big financial groups will enter the sector mainly because there are not many left who can do so. In any case, it is more efficient to build a presence in the sector though their branch networks. For all these reasons it seems unlikely that the sector will grow significantly in the future. Rather the opposite, a decline in numbers, is more probable, compensated by the entry of new independent firms, small in terms of personnel and resources but highly specialised in their operations.

### 3.2 Commercial Networks

Regarding the branch networks of investment services companies, the majority are located in the main financial centres. Only very few are not situated in provincial capitals.

Many companies have expanded through creating a network of representatives which has the attraction of not increasing fixed costs significantly. However, the cost of supervising the representatives has been high and the unreliability of or fraud committed by them has been an historically important contributing factor to crises in the sector. It should be noted that the policy of using representatives has been practised most by firms not belonging to financial companies.

Regarding the representatives themselves, as of 31 December 2006, there were 45 companies which had registered a total of 7,210 contracted agents. Although this figure is high it should be noted that just one insurance company accounts for 77% of this total.

The policy of using agents is common among firms belonging to insurance companies as is demonstrated by the fact that four out of the five investment services companies with the highest number of contracted agents belong to this type of company.

### 3.3 Structure of the Business

The main characteristic of the investment services sector in Spain, as has been emphasised throughout this work, is its dynamism and high level of competition. It is a sector in permanent change and has still not reached an optimum balance point.

The companies that survive are those that can adapt quickly to market conditions and find new business niches or specialise in areas that give them a competitive advantage. Therefore it is difficult to classify these companies because the criteria used quickly become out-of-date.

However, it is still possible to identify the following types of company in the sector:

— A small number of large-sized companies the majority of which are part of large national or international financial groups. They offer the full range of investment services although their main business is stockbrokering. In general, they are very profitable companies. Where they are part of a financial group they are able to benefit from membership of the group and exploit its commercial network and assets.

— Smaller-sized companies which specialise in the marketing of financial products, usually the collective investment schemes managed by the group. Again they benefit from being members of a group and are usually very profitable because they are not high cost operations.

— Independent companies which specialise in value-added services, for instance management, investment advice etc. They are usually small-sized and their profits fluctuate, being dependent on their clientele. In general clients come from the private banking sector, are few in number but with a high level of wealth. They are never retail clients. These firms are not usually exposed to balance sheet risks because they do not accept clients' money or place their assets.

Since 1989, as has already been mentioned, commissions and fees from stockbrokering have been the main source of firms' incomes and continues to be their key or main operation.

However, in the last few years other operations have become more important, for example the marketing of collective investment schemes. These are now the second source of overall income for the sector, growing in importance each year, while stockbrokering is assuming less importance.

Many broker-dealers and brokers who in the past had a major presence in the market are leaving the sector and transferring their operations to their parent banks who are becoming market members.

As a result the relative weighting of stockbrokering is declining at an ever faster rate (almost 15 percentage points in one year) and this trend is likely to continue with more and more of these specialist firms leaving the sector.

In addition, the increase in the number of market players has led to a fall in commissions which on average are below the levels of fifteen years ago. Consequently, income from stockbrokering is becoming less significant as a share of the total commissions and fees received.

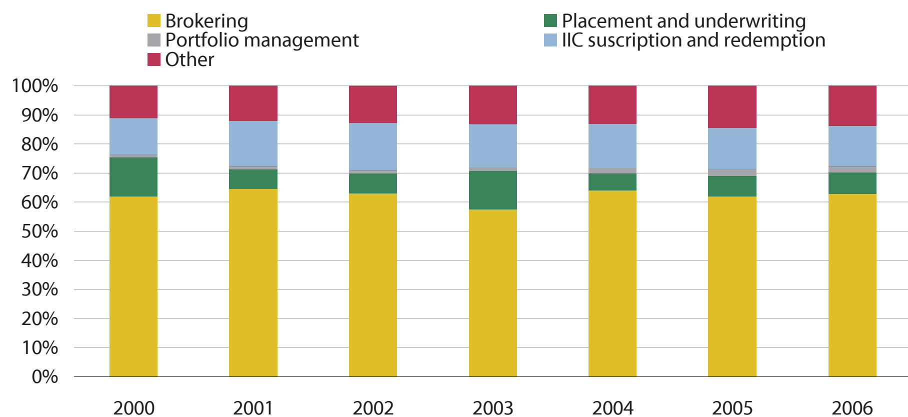
Turning to equity operations, they have always been of minor importance compared to the income from offering services. All the broker-dealers except five declare them in their programme of operations. However, even in financial years like 2006, when the stock market recorded large gains, equity operations have not made a very significant contribution to firms' overall income.

Hence stockbrokering has ceased to be the most profitable operation or even the basic business of the sector. Instead it is now regarded as complementary to other operations and almost without profit.

In the same way, the marketing of collective investment schemes which has been the star profit-maker of the last few years, is being replaced in importance by other operations. These are specialised, high value-added services, not widely marketed, like asset management or investment advice, obviously aimed at wealthy clients.

To sum up: it is increasingly apparent that the sector is abandoning the retail business, which is based on marketing and risk-taking (equities, securities investment, etc) and leaving it to credit institutions which have large marketing networks at their disposal. In its place the sector is targeting clients from private banking and institutional business and offering them value-added services. These do not require large-scale financial and material resources, rather highly-trained and specialised personnel.

**Commission revenues 2000-2006** FIGURE 8




Source: CNMV.

### 3.4 Profitability and solvency

Broker-dealers and dealers made total profits of 490 million euros in 2006. Only 11of the 96 firms registered with the CNMV incurred losses during this period – of about 450 thousand euros. Only one of them was a broker-dealer which together with two brokers accounted for roughly 53% of the losses.

Profits amounted to 496.5 million euros. 8 out of the 89 firms were responsible for 50% of that total. These 8 firms are all broker-dealers and all except one belong to financial groups.

The sector at present is a solvent one. This is not just in terms of results achieved but also in terms of own resources. As can be seen in the following table only one broker-dealer has declared own resources below the minimum level of equity capital required. While more than half of them have declared own resources five times above this level.

**Solvency of broker-dealers and brokers** TABLE 4

Situation at 31/12/2006
Amounts in thousands of euros

| Broker-dealers | | Brokers | |
|---|---|---|---|
| **Computable Equity [1]** | **No. of companies** | **Computable Equity [1]** | **No. of companies** |
| 2,000 - 10,000 | 21 | < de 300 | 1 |
| 10,001 – 25,000 | 15 | 300 – 1,000 | 16 |
| 25,001 – 50,000 | 3 | 1,001 – 2,000 | 16 |
| 50,001 – 100,000 | 3 | 2,001 – 4,000 | 12 |
| > 100,000 | 3 | > 4,000 | 10 |

Source: CNMV.

1. Required equity is 2 million euros.
2. Required equity is 0.3 million euros.

# 4 Short-term Outlook

The future structure of the sector will be greatly affected by regulatory changes and of those upcoming the most important is undoubtedly the Directive on Markets and Financial Instruments, better known by its English acronym (MiFID).

The real effects of this important regulatory change are difficult to predict exactly. Partly this is because the process of drawing up the new framework is still not finished. MiFID has not yet been incorporated into the Spanish regulations nor into those of any comparable country. Also, the Directives published so far have left large areas of uncertainty about how to interpret the new rules. These uncertainties will have to be resolved so that the new regulations can be applied fully and fairly across the board. MiFID will affect not only investment firms but all companies offering related services, including credit institutions and collective investment companies. Finally, the Directive will significantly change the structure of the markets and this will have unpredictable effects on the companies operating in the sector.

Whatever the future holds, however, it is unlikely that there will be any dramatic changes in the short term, especially affecting the number of companies entering and leaving the sector. That is, the trends of the last few years will almost certainly continue, particularly with reference to the reorganisation of both national and international financial groups. They will continue to transfer their investment services to their own specialised in-company divisions and in the case of the international groups they may even leave Spain altogether.

With the result that the sector will probably carry on losing those large firms which offer the whole range of services with stockbrokering as their core business.

The boom in the setting up of independent companies is likely to continue, sometimes as a consequence of changes elsewhere in the sector. They are small-sized firms and offer highly specialised services, mainly the marketing of collective investment schemes, asset management and investment advice. This latter service encompasses personalised management of private portfolios, management of open-ended investment companies and includes the new business track opening up with the development of hedge funds made possible by recent rule changes affecting collective investments.

It is unlikely there will be a large number of new companies linked to either national or international groups which are not already operating in the sector. In the case of national groups this is because nearly all of them are already present. One possibility is that an insurance company may try to enter the market. Regarding foreign groups, one effect of MiFID has been to stimulate cross-border operations making it less attractive for foreign groups to set up firms actually in Spain, unless they take over already existing ones.

Finally, it likely that there will be a gradual decline in the number of portfolio management companies. They may transfer their operations to collective investment management companies or restructure their businesses to achieve greater operating capacity.

One significant impact of MiFID is the increase in the importance of investment advice as a service. By this is meant the offering of customised recommendations to a client either at the client's request or on the initiative of the firm itself. Under the new regulations advice concerning operations linked to financial instruments will be considered a complementary service. It is likely to grow in importance when the new regulatory framework comes fully into force. Therefore a high level of new registrations is foreseen. Further, the new framework aims to harmonise the sector's rules of conduct. Most importantly, clients will be classified into new categories and will be entitled to greater information about services. Companies will also have to give clients tests of suitability to evaluate if the service being offered is suitable to their needs and requirements.

All these factors will increase costs both in terms of the new technology needed and in terms of the training costs of the staff who will take charge of these operations with inevitably an adverse effect on companies' results.

In spite of these extra costs MiFID introduces rules which will significantly improve clients' protection. Therefore the Directive provides an opportunity for those companies that adapt to it best and fastest to improve their market position.

Looking at the broader picture, Spanish regulation has always been generally strict. It has encompassed internal systems of control, the highlighting and evaluation of risk, compliance with transparency rules and the treatment of clients.

Hence the new regulatory framework contained in MiFID will probably have less impact in Spain than in other member states. Spanish companies may be able to benefit and increase their presence in foreign markets, compensating for what has been up to now perhaps the weakest point in the broker-dealers and brokers' sector.

# Developments in Listed Company Corporate Governance in 2005

**Galo Juan Sastre Corchado (*)**

(*) Galo Juan Sastre Corchado is Deputy Director of Financial Statements of the CNMV.

# 1 Introduction

In December 2006, the CNMV published its second Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets, corresponding to the year 2005. This report looks at the latest advances in corporate governance both nationally and internationally, accompanied by an analysis of the good governance practices of 176 listed companies, 19 issuers of fixed-income securities and 42 savings banks.

The report takes as its starting point the Annual Corporate Governance Reports (hereafter ACGRs) that these organisations are obliged to file with the CNMV pursuant to article 116 of the Spanish Securities Market Law. The ACGR is intended to provide complete and reasoned information on the corporate governance structures and practices of the issuers of securities listed on secondary markets, so investors can make a founded judgement on their quality.

This article offers an overview of listed companies' governance practices in the year 2005. The references for these practices are the recommendations set out in the Olivencia Code of 1998 and the Aldama Report of 2003.

The Board of the Comisión Nacional del Mercado de Valores, at its meeting of 22 May 2006, approved a new Unified Good Governance Code, which replaces the Olivencia and Aldama texts and updates their recommendations in line with the latest international advances in the field. Firms should begin benchmarking their practices to its standards in their ACGRs for 2007, to be filed in the first six months of 2008.

# 2 Comply or Explain. Developments in Corporate Governance Practices

Spain works to a hybrid model of corporate governance, in which certain standards, primarily those to do with disclosure practices and directors' duties, have been written into legal texts like the Securities Market Law or the Law of Public Limited Companies. In matters of organisation and operation, however, it has been left to listed companies to decide whether to follow corporate government recommendations, subject to the "comply or explain" principle. This means they are obliged to state which recommendations they adhere to and offer a reasoned explanation for any departures from the same.

The quality of the explanations that firms offer the market will allow the investor public to reach a founded judgement on their corporate governance practices. For the "comply and explain" principle to work effectively, companies must adhere scrupulously to the concepts and definitions employed in good governance codes.

In this respect, the ACGRs corresponding to 2005 stand out for the greater quality and clarity of issuer explanations regarding deviations from good governance recommendations.

That said, around 50 firms offered explanations of an entirely general nature. The CNMV's review concludes that clarifications are most in order with regard to the appointment of directors, especially independents, without the corresponding proposal from the Nomination Committee; the mismatch between proprietary and independent director numbers; remuneration disclosure; and, finally, the checks in place to the powers of executive chairmen.

We can say generally that corporate governance structures have varied little with respect to the previous year. This will foreseeably change when the new Unified Code begins to take effect. Already, some firms have tabled the necessary amendments in the agendas of their General Meetings or have drafted changes to their internal regulations. There follows an outline of the main developments reported in 2005.

— Average board size is slightly smaller: 9.6 members across all the companies analysed (9.7 in 2004) and 14.5 for the Ibex 35 group (15 in 2004). Only 18 companies (19 in 2004) failed to meet the recommendation that external directors should be in a majority.

— 71.6% of listed companies (70.9% in 2004) reported a proportional relationship between the number of proprietary and independent directors and the percentages of capital with and without board representation. In some of this group, the balance was inclined clearly in favour of independents.

- The distribution of board membership by type of director is broadly as in 2004. The relative weight of proprietary directors (45.2%) is slightly higher than in 2004 (43.5%), while the percentage of independents (31.1%) is a little lower (31.7%). 52.3% of listed companies (50.5% in 2004) reported that independent members occupied less than 1/3 of board places.

- In general, Audit Committees have a large majority of external directors among their members. However, in 47 companies (58 in 2004) this Committee included no independent directors. A further 18 firms (7 Ibex 35) reported Audit Committees comprising exclusively independent members, compared to 14 in 2004.

- A total of 71 companies (74 in 2004) have not set up a Nomination and Remuneration Committee. Existing committees tend to have an ample majority of external directors, although 34 firms (6 Ibex 35) fall short of the recommendation that all members be external directors (29 in 2004).

- All the independent directors joining the boards of Ibex 35 companies were appointed at the proposal of the Nomination Committee. In remaining companies, the proportion was a lowlier 60%.

- The average remuneration of board members was 203,000 euros, 4.1% more than the previous year, while senior officers earned an average 346,200 euros against 262,900 euros in 2004. This last increase traced to the higher payments received by managers at firms with market capitalisation exceeding 1,000 million euros.

- 54.5% of companies analysed reported related-party transactions with their significant shareholders involving a total sum of 61,614 million euros (33,839 million euros in 2004). Most transactions corresponded to normal business flows and were financial in nature (loans, sureties, hedge derivatives, etc.).

- On average, 71.3% of share capital participated in General Shareholders' Meetings (71.7% in 2004). In the Ibex group, participation was a lower 63.2% (65.2% in 2004).

- The bylaws of 23 companies continue to impose restrictions on voting rights.

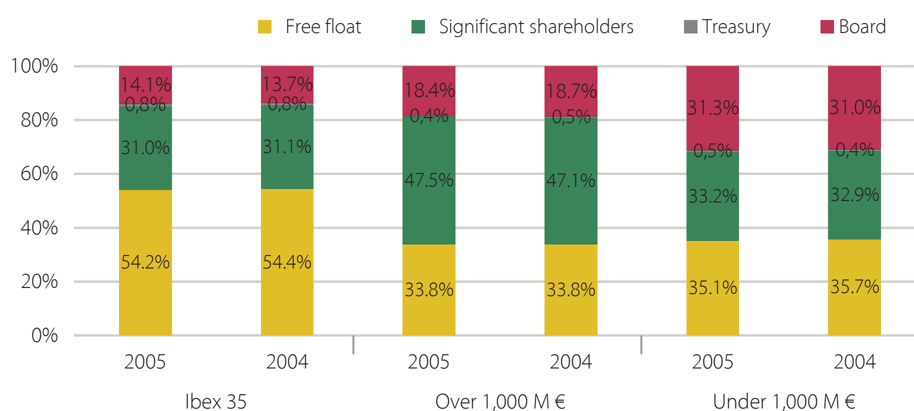
# 3 Ownership Structure

## 3.1 Share capital

Although, logically, good governance recommendations do not touch on ownership structure, this is not to deny its considerable influence on a company's corporate governance practices. Spain, in particular, differs from other countries in the large concentration of capital in the hands of board members and significant shareholders.

We can see from the table below that, in aggregate terms, capital distribution has undergone no major changes since 2004[1].

**Percentage distribution of capital (average)** FIGURE 1




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

The average Board of Directors shareholding in the companies analysed was 26.0% (26.2% in 2004), though in the case of Ibex 35 companies this drops to 14.1% (13.7% in 2004). By type of director, the above holding breaks down 14% for proprietary directors, 11.6% for executive directors and the remainder for independents and other external directors. Most independent directors – 87.3% of the total – hold capital stakes of less than 0.1%.

The average percentage of capital owned by non director significant shareholders moved up from 34.3% in 2004 to 34.8% in 2005. Ibex 35 firms, meantime, reported a repeat score of 30%. The above average presents the following

1 Data representing the arithmetical average of the capital distribution of listed companies, based on the percentages reported by each company. Percentages for non director significant shareholders are arrived at by deducting the shareholdings of board members.

breakdown by type of investor: 4.6% corresponding to resident natural persons (4.2% in 2004), 22.2% to resident legal persons (23.1% in 2004) and the remaining 8.1% to non resident investors (6.9% in 2004).

Another distinctive feature of our market is the extent of cross shareholdings between listed companies. A total of 45 firms (48 in 2004) are significant shareholders in a further 63 (55 in 2004). Financial entities have a strong ownership presence in all sectors of the national economy. The banks are significant shareholders in 22 listed companies (23 in 2004), while 31 savings banks reported relevant interests in the capital of 45 (46 en 2004).

Average free float in the year was 38.7% (39.0% in 2004), with the average for Ibex 35 companies standing at 54.2% against the 34.4% of the remainder. In 26 companies, free float increased in the year by an average 11.1% of capital while another 42 reported a decrease of 12%. 68.8% of listed companies (66.5% in 2004) had free float of over 25%. However 18 companies – 10.2% of the total – reported a free float of less than 5%.

### 3.2 Shareholder agreements and concerted actions

Shareholder agreements are defined as those affecting the exercise of voting rights at General Meetings, or which restrict or constrain the free transfer of shares and convertible or exchangeable bonds. A total of 22 agreements were reported involving 19 listed companies and extending, on average, to 46.5% of their capital. Most corresponded to vote pooling, agreements on the composition of the Board of Directors or other governing bodies, and agreements to stabilise dividend policy or ensure the continuity of a stable shareholder core.

Concerted actions are agreements where the parties attempt to influence the course of a company's management through the strategic exercise of their combined voting rights. Four companies acknowledged 5 concerted actions affecting an average 41.6% of capital.

# 4 Boards of Directors Structure and Operation

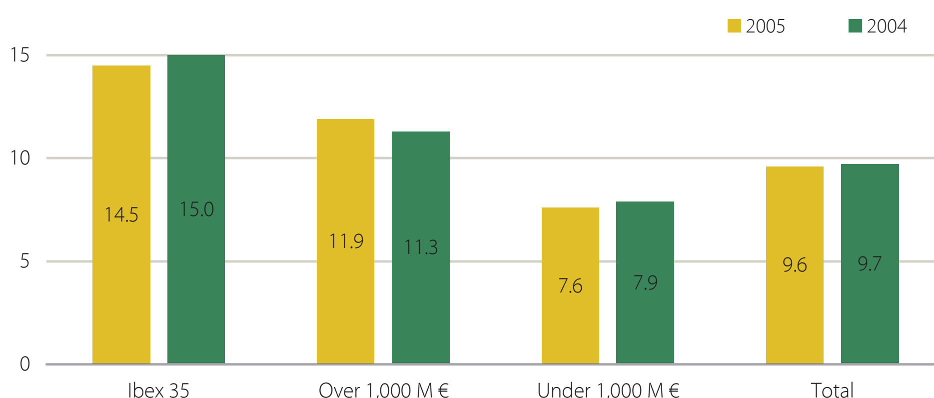
## 4.1 Functions and size of the board

The Board of Directors should assume the general supervisory function as its core mission, encompassing the definition of the company's general strategy, the control of its day-to-day management and communication with its shareholders. All directors, of whatever provenance, should perform their duties with unity of purpose striving at all times to defend "the corporate interest", understood as the common interest of all shareholders. What this means in practice is pursuing a policy designed to maximise the company's economic value over time.

Good governance recommendations stress that boards should adjust their size to maximise efficiency and participation, with 5 to 15 members as the optimal level.

As our next figure shows, the average size of listed company Boards of Directors underwent no significant changes with respect to the previous year.

**Average size of Board of Directors** FIGURE 2




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

Listed companies have a total of 1,694 directors, of whom 508 correspond to Ibex35 members. Their average board size is 9.6 members (9.7 in 2004) against 14.5 members (15 in 2004) for the Ibex 35 group. That said, 20% of the survey, including 15 Ibex 35 members, still fall outside the recommended interval of 5 to 15 members.

The presence of women on the boards of listed companies barely varied in 2005. More specifically, the average number of female board members dropped from 5.9% in 2004 to 5.6% in 2005, with Ibex 35 companies reporting 3.4% and 3.3% respectively.

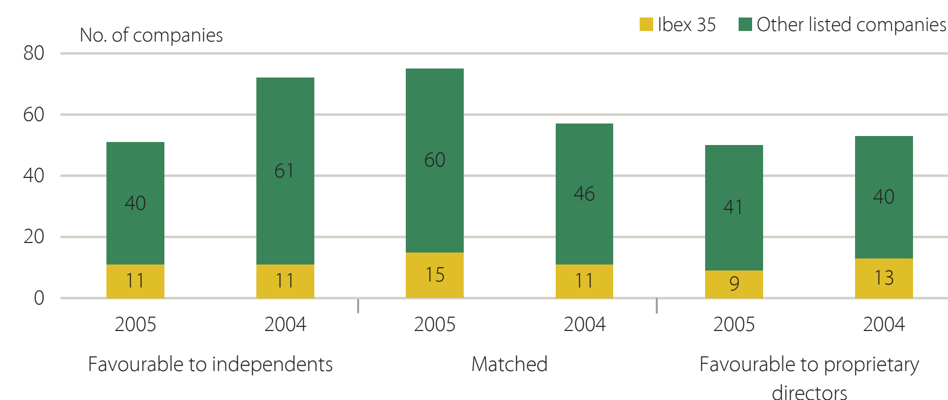
## 4.2 Types of director

The Board of Directors can best perform its functions if it comprises a majority of external directors, with executive members kept to a minimum. Only in 18 companies, all with market cap below 1,000 million euros, were external directors not in the majority.

The ratio of proprietary directors to independents should reflect the relationship in the company's capital between the shareholdings they represent and the remaining ownership. Indeed it is logical that if independent directors are there to represent minority interests, their board weight should stand in proportion to free-floating equity.

As we can see from our next figure, 72% of companies present a balanced mix or else one favourable to independents.

**Ratio of independent to proprietary directors** FIGURE 3




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

## 4.3 Presence of independent directors

A core good governance recommendation touches on the presence of independent directors, defined as those in a position to perform their duties without being influenced by ties with the company, its significant shareholders or its management team. On average, independent directors represent 31.1% (31.7% in 2004) of company boards, rising to 40.7% (39.2% in 2004) in the case of Ibex 35 companies. Independent directors were in a majority on the boards of 17.6% of the companies analysed (16.5% in 2004). In 52.3% (50.5% in 2004) of listed companies – 31.4% for Ibex 35 members – independents accounted for less than 1/3 of board members.

Such is their importance that companies must ensure they meet all the qualifying conditions for independence set out in good governance codes. The CNMV's review detected several situations in which the classing of a director as independent (under the criteria of the Aldama and Olivencia codes and Recommendation 2005/163/EC on the role of non executive or supervisory directors) was, at the very least, open to question. These involved:

– Having been a past employee or executive director with the company without 3 or 5 years having lapsed, respectively, from the end of the relation.

– Having had business dealings in the year with a company where the group has a significant influence.

– Not being appointed on the proposal of the Nomination Committee.

– Being executive director of a company belonging to the group of a significant shareholder.

– Being chairman of a company that has material business dealings with the company where they serve as an independent.

– Being reclassified from proprietary to independent director without any material change in the circumstances leading to the original classification as proprietary.

### 4.4 The Board Chairman

The Chairman has the job of directing board meetings and encouraging all members to participate fully. He or she is therefore a key piece in the functioning of the board. A central debate in corporate governance is whether a board chairman should also take on the labours of chief executive. Good governance recommendations refrain from pronouncing on this issue, which is frequently the result of national tradition. It is recommended, however, that safeguards be adopted to prevent too much power accumulating in the hands of executive chairmen.

The chairmen of 84 listed companies – 47.7% of the total – are also chief executives (60.0% in the Ibex 35 group). The percentage of companies without separation of functions is in line with that reported in 2004 (47.2%). 17 companies reported special eligibility requirements for appointment as Board Chairman (18 the previous year). The most usual requirements are having previously been a board member and being below a certain age limit.

According to ACGRs, the main safeguards companies have adopted to prevent too much power accumulating in the hands of executive chairmen are: existence of a board committee performing executive functions; the daily management of the company being delegated elsewhere; and delegation of certain functions to board committees with a significant presence of independent directors.

Some companies have appointed Vice Chairmen qualifying as independents, though their exact functions vary from one to the next.

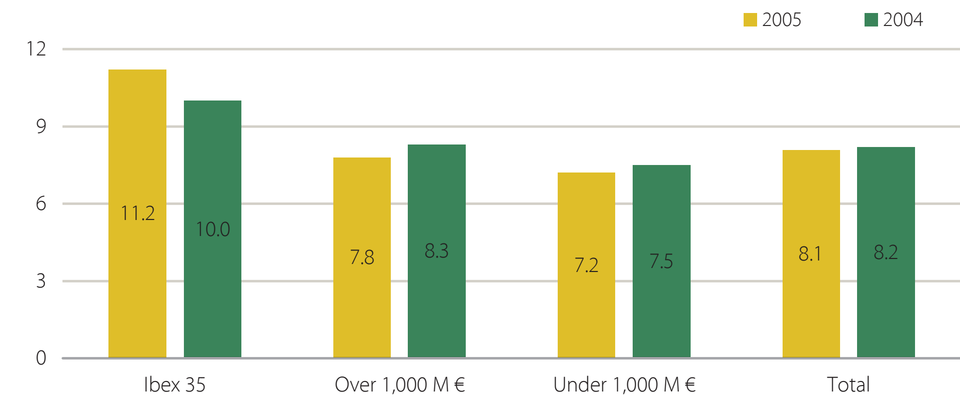
### 4.5 Board meetings and resolutions

Boards of Directors should meet with the necessary frequency to properly perform their functions. The Unified Code urges that director absences should be kept to a minimum and quantified in ACGRs.

Our next graph shows the annual average number of meetings held by the boards of listed companies, grouped by market capitalisation.

## Annual Board meetings

FIGURE 4




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

# 5 The Audit Committee. Risk Management and Financial Reports

## 5.1 Terms of reference and composition

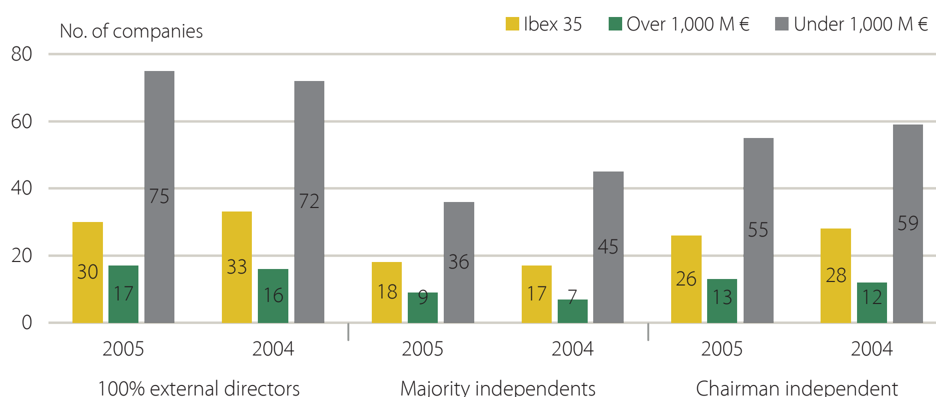
The existence of an Audit Committee is a key good governance recommendation, as well as a widely accepted practice. However in some countries, among them Australia, Canada, Italy, USA and Spain, it is also a statutory requirement.

In Spain's case, Financial Law 44/2002 of 22 November introduces an 18th additional provision to the Securities Market Law transforming the Olivencia Code recommendation on the Audit Committee into a legal standard, and laying down ground rules for its make-up and operation. In 2003, the Aldama Report set forth a series of recommendations to improve its operation, urging that is should be made up exclusively of external directors and chaired by an independent.

Finally, the Unified Code goes into some detail on Audit Committee terms of reference. Its mandate, it specifies, should be to guarantee the quality and integrity of the information companies provide to investors and to supervise internal and external audit functions and risk management systems.

These supervisory functions call for Audit Committee members to have appropriate experience and knowledge. The Good Governance Code goes a little further than the Securities Market Law in recommending that the committee be made up of at least three members, all external directors, under the chairmanship of an independent.

**Audit Committee composition** FIGURE 5




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

The Audit Committees of listed companies are formed by an average of 3.3 members, generally with external directors in a large majority. In 63 companies (18 from the Ibex 35) representing 35.7% of the survey (37.9% in 2004), independents made up over 50% of membership.

In this last group, 18 companies (7 Ibex 35) have an Audit Committee formed entirely by independent directors. However, 47 companies (26.7% of the total against 25.8% in 2004) report not one independent among their Audit Committee members. The same holds true for 2 companies in the Ibex 35 contingent.

In 94 companies or 53.4% of the total (54.4% in 2004) the Audit Committee is chaired by an independent. Of this number, 26 are Ibex 35 members (28 in 2004).

### 5.2 The Audit Committee and risk management

It is the work of a company's senior officers to quantify and manage risk under the supervision of the Board of Directors. The Unified Code assigns the Audit Committee a key role in risk management policy, centring on their correct identification, the determination of the risk levels seen as acceptable and deployment of measures to mitigate the impact of realised risk events.

Larger companies with a higher market cap tended to be more forthcoming about their risk exposure. The drawing-up of risk maps is a standard practice, with objectives as follows: (i) identify the main risks to which the company is exposed; (ii) specify risk indicators and limits; (iii) define measurement and control procedures; and (iv) detail mitigation measures for the event of these risks materialising.

Companies generally group their main risks into four large categories: financial risks (credit, market, liquidity, etc.), operational risks, regulatory risks and environmental risks. ACGRs often specify that some risk has materialised in the year with regard to business operations, but that the incident was picked up by internal control systems and contained within reasonable limits. However, very few make express mention of what these risks entailed.

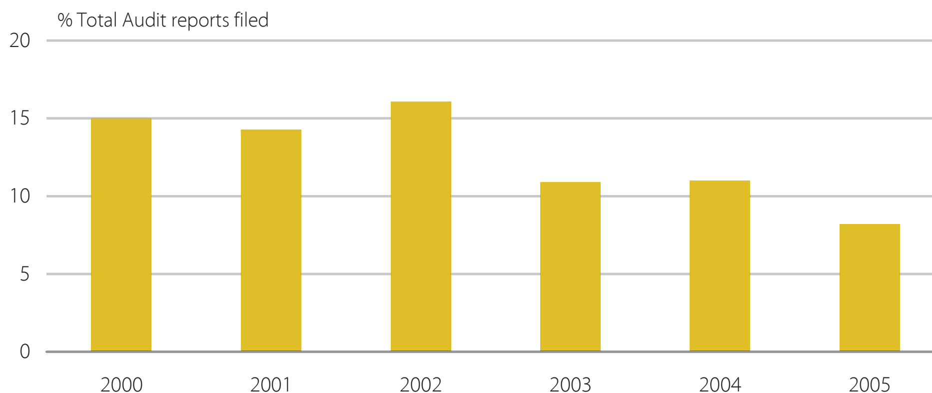
### 5.3 The Audit Committee, financial reports and account auditing

Regarding the quality of financial reporting, corporate governance recommendations say that the Board of Directors should seek to present the annual accounts to the General Shareholders' Meeting without reservations or qualifications in the audit report. 91.8% of audit reports for 2005 were issued with a favourable opinion. Conversely 62 financial statements – 8 corresponding to Ibex 35 companies – met with a qualified opinion from the auditor, although in 23 cases (5 Ibex 35) the reason stated was that accounting standards were not uniformly applied. This kind of reservation does not indicate failure to comply with the applicable accounting policies, since the same auditors affirm that the financial statements provide a true and fair view of the company's assets, financial position and profit and loss, and contain sufficient information for their correct interpretation.

Of the qualified reports, except those referring to inter-year comparisons, 20 included quantified qualifications, 5 limitations of scope and 25 uncertainties.

Audit Committees have already done a lot to improve the quality of the financial information reaching the markets. This is evidenced by the sizeable decline over recent years in the number of audit reports issued with qualified opinions due to non compliance with accounting policies, uncertainties or limitations of scope.

**Qualified audit reports** FIGURE 6




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

Good governance principles also focus on the relationship between client and auditor, in the awareness that conflicts of interest can undermine the impartiality of the latter's work. In this respect, the Unified Code calls on the Audit Committee to take an active role in the proposal, selection, appointment, renewal or removal of external auditors and in supervising the progress of the audit programme. It should also work to ensure the upkeep of auditor independence and strive for maximum transparency when an auditor is removed or resigns due to discrepancies with the company.

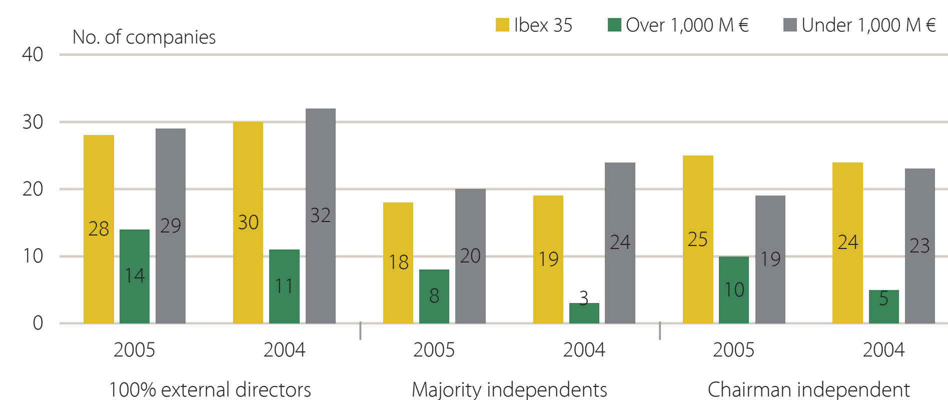
# 6 Nomination Committee. Board and Senior Officer Appointments and Remuneration

## 6.1 Terms of reference and composition

According to the Olivencia Code, the core mission of the Nomination and Remuneration Committee is to oversee the integrity of the selection process for company directors and top executives, ensuring that candidates meet the target profile for each vacancy, and assisting the board with drawing up and supervising remuneration policy.

The Unified Code recommends that this Committee be formed entirely of external directors, the majority independent. It also advocates that the Nomination Committee should invariably propose the candidates for independent directorships, as well as issuing a report on other prospective appointees.

**Composition of Nomination and Remuneration Committee** FIGURE 7




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

A total of 105 companies – 59.6% of the sample – have appointed Nomination and Remuneration Committees, made up of an average of 3.7 directors. All Ibex 35 members operate an equivalent committee, although in one case its functions have been assigned to a board committee dedicated to supervising related-party transactions and in another it confines itself to remuneration matters. In 2005, 3 companies appointed this committee on a first time basis.

In general, external directors are in a large majority versus executive directors, although 34 companies, among them 6 Ibex 35 members, disregard the Olivencia Code recommendation to the effect that all members should be external. 51.4% (48.1% in 2004) of these committees are chaired by an independent director.

## 6.2 Board member appointments

The process of selecting and appointing board members is about ensuring companies are steered by the best qualified individuals with a profile that fits their needs. Director selection, in the case of independents at least, should follow a perfectly defined routine starting with a reasoned proposal from the Nomination Committee.

A total of 222 new directors were appointed in 2005 (in 99 companies) against the 230 removed or leaving (102 companies). 58.6% of all new appointments were at the proposal of the Nomination Committee. Appointments proposed by the Committee had the following breakdown by type of director: 55.7% proprietary, 54.8% executive, 63.3% independents and 60.0% others.

Of the 352 renewals reported in 2005, 58.5% were at the Committee's proposal: 54.1% proprietary, 57.9% executive, 67% independent and 44.4% other external.

These percentages tell us that the Nomination Committee's role in proposing director appointments remains limited at best and companies need to try harder, the more so as the Unified Code stipulates that no director may be classed as independent if he or she was not first proposed by this Committee.

## 6.3 Board and senior officer remuneration

Recommendations on board and senior officer remuneration seek to compatibilise the search for well qualified professionals with criteria of moderation, performance-related compensation and maximum transparency.

The Olivencia Code includes among its strictures that remuneration policy should be guided by market considerations in order to attract people with the right skills. It should also conform to criteria of moderation and be commensurate with the company's performance, seeking to reward directors' dedication without compromising their independence. Remuneration reporting should uphold the principle of maximum disclosure as a way to mitigate the risk of immoderate compensation.

Finally, the Unified Code recommends that the Shareholders' Meeting take a more active role in director remuneration policy by voting on the same, even if only on an advisory basis.

## 6.4 Board remuneration

Remuneration policy tends not to be submitted to the Shareholders' Meeting beyond the general requirements of each company's bylaws, except with regard to shares, options and other share-based incentives (legal obligation).

The practice of stating individual directors' remuneration in the notes to the annual accounts or the ACGR likewise finds few takers. That said, a total of 10 Ibex 35 companies – 28.6% of the index – disclose the individual remuneration of each board member.

Average remuneration per board works out as 1.96 million euros, giving an average per director of 203,000 euros against the 195,000 of the year before (up 4.1%). Again we find a strong divergence between the Ibex 35 contingent and other listed companies.

Remuneration varied considerably depending on director class. Hence executive directors received an average of 654,000 euros (578,000 in 2004), compared to the 88,000 euros of external directors (84,000 in 2004). This gap is largely because executive director remuneration includes the salaries they receive for their management duties on top of director fees and other payments.

Under corporate governance rules, the board's remuneration policy should be tied in with the company's performance. In 2005, board remuneration amounted to an average 3.7% of listed companies' profits against 4.8% the previous year.

In the case of senior management, average payments summed 346,216 euros (262,900 euros in 2004). Among the Ibex 35 group, the average per officer climbs to 530,731 euros (511,700 in 2004), while firms capitalising at under 1,000 million report an average payment of 135,600 euros. Among larger cap companies, senior officer remuneration falls mainly in the 200,000 to 500,000 euros bracket.

A total of 68 companies – 38.6% of the total – declared in their 2005 ACGRs that they had severance clauses operative with 421 senior officers. The biggest concentration was among Ibex 35 members, where 83 companies reported severance packages with 312 senior officers. Only one company had submitted these packages to the vote of the General Shareholders' Meeting, while a further fourteen had at least apprised the Meeting of their existence.

# 7 Related-party Transactions and Conflicts of Interest

## 7.1 Obligations and recommendations

Relations between listed companies and their shareholders, directors and senior officers must be informed by the general duties of care and loyalty and the principle of maximum transparency. The purpose is to prevent individuals from using their advantaged position inside a company to make transactions that benefit their interests but harm those of the company and thereby its shareholders.

Listed companies must state all transactions with their shareholders, directors and senior officers in their ACGRs, along with any intragroup transactions not eliminated in the consolidation process. This reporting requirement is confined to related-party transactions of significant amounts or that may have a material bearing on the contents of periodic reports.

Related-party transactions came to 65,807 million euros, of which 95% corresponded to significant shareholders. Although 81 companies reported transactions with significant shareholders, two Ibex 35 firms accounted for 49% of the total amount. Transactions mainly corresponded to companies' normal business flows and tended to be of a financial nature (loans, sureties, or derivative contracts to hedge against interest or exchange rate risk). Sureties and financial derivatives are stated in ACGRs at the face value of the corresponding contract. This is used for calculating their market value but does not reflect the actual amount at which transactions go through.

Concerning conflicts of interest, article 127 *ter* of the Public Limited Companies Law obliges directors to inform the board of any situation of conflict with the company's interests and to refrain from engaging in the relevant transaction. A total of 25 companies – 20 in 2004 – reported some conflict of interest, which the director in question refrained from pronouncing or voting on at the meeting of the board or board committee. Transactions involving conflicts of interest were primarily: engagement by the company of the professional services of director-related parties; financial transactions between the company and the significant shareholder appointing the director; and share capital increases contributed by a shareholder where the listed company director is also a director.

# 8 The General Shareholders´ Meeting

## 8.1 Obligations and recommendations

There has been a growing movement in recent years towards strengthening the role of the General Shareholders' Meeting as the company's supreme decision-making body. The Olivencia Code, in particular, warns of the danger that the Meeting may deteriorate into a formal, routine occasion, instead of a decision-making and control structure of vital importance for the life of the company and the interests of its shareholders.

Corporate governance recommendations have focused on maximising the participation of all shareholders. Some earlier recommendations have been written into the texts of the Securities Market Law and the Public Limited Companies Law, among them: the existence of Shareholders Meeting Regulations; the possibility of using technological advances to favour shareholder participation; or the duty of directors to avoid conflicts of interests with regard to proxy applications.

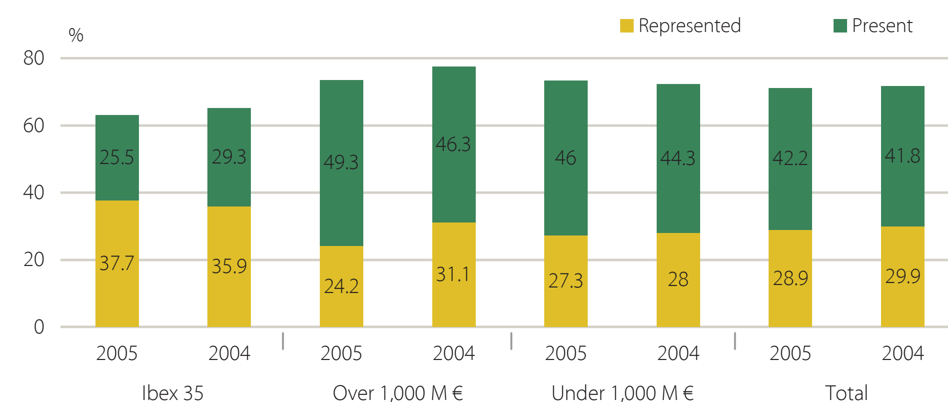
The Unified Code reinforces the role of the Shareholders' Meeting by urging that any matters involving a fundamental corporate change should be submitted for its approval. It also seeks to enhance decision-making transparency by recommending that proposals to be voted at the Meeting are published sufficiently well in advance and that each proposal is voted on separately.

Average participation at General Meetings held in 2005 equated to 71.3% of capital compared to 71.6% in 2004. In the Ibex 35 group, average participation was a lower 63.17% of capital (65.2% in 2004) compared to the 73.4% (73.2% in 2004) of remaining companies. The figure below shows the average participation in General Shareholders' Meetings held in 2005 and 2004, with a breakdown by market capitalisation and percentages of capital present and represented.

Only 82 companies reported AGM attendance exceeding 75% of capital, of whom only 12% had free float above 50%. Of the 70 reporting attendance between 50% and 75%, 38.5% had a free float higher than 50%. These figures demonstrate a clear need to encourage more minority shareholders to get along to meetings.

Good governance recommendations seek to strengthen the decision-making powers of the Shareholders' Meeting by advocating the removal of bylaw restrictions or ownership thresholds dictating attendance rights. They also urge greater use of new information and communication technologies.

**Participation in General Shareholders´ Meetings** FIGURE 8




Source: "Corporate Governance Report of Entities with Securities Admitted to Trading on Official Secondary Markets", Exercise 2005, CNMV.

On the subject of bylaw restrictions, the Unified Code is adamant that an active control market provides an unparalleled spur to the good governance of listed companies. The bylaw restrictions most widely applied are the so-called anti-takeover clauses. Most companies' bylaws, as it turns out, do not include this type of restriction. However, 23 companies in the survey still impose constraints on the exercise of voting rights.

60.2% of listed companies specify a minimum number of shares for attendance at the General Shareholders' Meeting: a) in 9 companies (10 in 2004), including 1 Ibex 35 member, the threshold has been set at one thousandth part of capital; b) in 13 (14 in 2004), including 5 Ibex 35, it lies between 500 and 10,000 shares; c) in 84 (88 in 2004) it stands below 500 shares; and d) the remaining 70 companies, including 6 Ibex 35 members, impose no limit whatsoever.

Remote voting is a good way to encourage shareholders – especially minority and non resident investors – to take part in Shareholders' Meetings (Law 23/2003 of 17 July and Ministerial Order ECO/3722/2003 of 26 December). And companies have begun amending their bylaws and meeting regulations in order to make this a practical option. In 2005, 57.14% of Ibex 35 companies had procedures in place for shareholders to vote electronically, although the actual take-up was no more than marginal.

From the data provided, it seems that shareholders' reluctance to use electronic voting means is due to the technical difficulties involved. This is precisely one of the questions taken up by the European Union in its campaign to favour the exercise of shareholders' rights. A key piece in this campaign is the Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies which have their registered office in a Member State.

Its goal is for non resident shareholders to be able to vote at General Shareholders' Meetings with the same facility as those residing in the country where the company is headquartered.

Measures accordingly focus on removing obstacles in the way of non resident shareholders receiving the content of proposals and casting their votes without being physically present at meetings. The Draft Directive also advocates the use of existing technologies so shareholders can consult such information, and enshrines remote voting among the other rights available to shareholders: that is, the removal of limitations and administrative constraints that have made remote or proxy voting a cumbersome and costly process.

# 9 Closing Remarks

In the course of this article, we have reviewed the main characteristics of listed company corporate government practices in the year 2005, which truth to say were not much different from in 2004. Changing the structure of corporate governance is a complex and lengthy process and we cannot expect to see radical differences from one year to another.

However, upcoming corporate governance reports should prove richer in novelties thanks to the recommendations of the new Unified Code, touching on such crucial matters as the size of boards, the presence of independent directors, the role of board supervisory and control committees, the disclosure of board and senior officer remuneration, the submission of all decisions involving a fundamental corporate change to the vote of the General Shareholders' Meeting and the involvement in the same of minority shareholders.

The General Meeting notices sent out in the first months of 2007 already feature agenda items about aligning company structures and practices with the content of the new recommendations. Companies are also amending their internal rules and regulations along the lines advocated by the Unified Code or, at least, removing those that might preclude or hinder their fulfilment.

At aggregate level, certain 2005 data indicate the main future challenges for corporate governance, though we should not forget that each company's practices must be considered as a whole. Remember also that many of Spain's listed companies have a number of significant shareholders.

The weight of independent directors is lower than the average proportion of free-floating capital and in over half of listed companies (52.3%), their number is below one third. A total of 71 companies have not set up a Nomination and Remuneration Committee, in future an essential prerequisite for any director to qualify as independent. Board committees need to exert more of an influence on such important matters as financial reporting quality, appointment policies, especially regarding independent directors, and the remuneration of board members and senior officers. Although most of their members are external directors, independents weigh in at an average 42% and 46% respectively. Boards, as a rule, are not informing General Meetings about the broad lines of their remuneration policy, and few go as far as to give an itemised account of payments.

More needs doing to increase the participation of minority shareholders at General Meetings. Particularly telling is the fact that only 12% of firms where participation extends to over 75% of capital have a free float of more than 50%. Two initiatives could effect a change here. Annex II of the Unified Code calls on the Government to amend Royal Decree 116/1992 to extend listed companies' entitlement to know their shareholders to the owners of bearer shares, as a means to facilitate the

organisation of General Meetings. And the European Union is about to approve a new Directive on the exercise of voting rights by non resident shareholders.

Finally, good governance codes rest on voluntariness, subject to the comply or explain rule. Listed companies, in other words, can choose whether or not to follow their recommendations, but must provide a reasoned explanation for areas of non compliance. For this comply or explain rule to be effective, they must avoid giving blanket explanations and should in no event depart from the definitions and concepts employed in the code.

# II Studies

# Public-to-private Deals and Private Equity in Spain

**Nuria Baena Tovar (*)**

(*) Nuria Baena Tovar is on the staff of the Studies and Statistics Directorate of the CNMV.
This paper is a summary of CNMV Monograph no. 12, by the same author and with the same title.

# 1 Introduction

Three large liquid companies (Amadeus, Cortefiel and Recoletos) were delisted from the Spanish stock market in 2005. What distinguished these transactions from those in previous years was that they were performed by private equity investors who had acquired control via takeover bids. This type of operation – called public-to-private (PtoP) – had few precedents in Spain and was also uncommon elsewhere in Europe.

Private equity investors are also buying into unlisted companies, enabling families and large companies to sell out. In addition to the proliferation of PtoP deals and the private sale of unlisted companies, there are very few cases of IPOs as an exit strategy for private equity investors. The overall result is a steady decline in the number of listed companies. Moreover, there may be more delistings in the future.

In this context, it is interesting to analyse the boom of PtoP deals, their economic rationale, and the factors that may be driving their growth (such as the valuation of the delisted companies and the costs of being listed). The paper also tries to identify companies that may be susceptible to delisting.

# 2 Public-to-private Deals

By PtoP, we mean the acquisition of a significant stake in a listed company in order to take it private. Most such deals are financed with a large proportion of debt (higher than the average for the industry in which the company operates). For that reason, they are also referred to as leveraged buyouts (LBO). Most LBOs are headed by a management team, either that of the company itself[1] or an external team[2].

The literature identifies eight arguments or reasons that justify PtoP deals. One is tax benefits, since the interest on the high acquisition debt is tax deductible. This argument is rejected on the grounds that, in a competitive market in corporate control, the predictable tax benefit can be incorporated into the acquisition price and, therefore, be appropriated by existing shareholders of the target company.

Agency theory provides three justifications for PtoP deals. Firstly, reuniting ownership and control realigns management and shareholder interests, which may increase the company's value. Secondly, the concentration of capital that arises in an LBO makes it possible to improve the quality of management. Thirdly, the control function exercised by indebtedness on the investment project, since it forces more efficient management of resources.

The literature also mentions, as an advantage of LBOs, the transfer of wealth from bondholders to shareholders due to the increase in the proportion of debt within the company's financial structure. However, empirical studies provide no clear evidence of this.

Three additional arguments in favour of LBOs of listed companies are: (i) elimination of the cost of being listed; (ii) defence against hostile takeovers; and (iii) appropriation of any positive difference between the company's estimated earning capacity and its market value.

1 Management buyout (MBO).

2 Management buy-in (MBI).

# 3 Public-to-private Deals in Spain

PtoP deals have arisen in Spain in a context of a boom in private equity. Venture capitalists were actively involved in the three PtoP deals in 2005 (Amadeus, Cortefiel and Recoletos) and the failed attempt to take over Aldeasa. In previous years, the only such deal was the attempt to delist Parques Reunidas in 2004, but that was much smaller than the 2005 deals (table 3).

There have been few PtoP deals in Europe in the past, although they have tended to increase in number and size since 2004[3].

The reasons why venture capitalists are interested in PtoP deals in Spain include:

(i) The search for alternative investments in Europe in the medium to long term.

(ii) Low interest rates are enabling venture capitalists to structure LBOs with good prospects of returns. The Amadeus and Cortefiel deals fit this pattern.

(iii) The surplus liquidity in the system, which results in private equity firms (particularly international firms) having accumulated funds to invest. This has resulted in an increase in the size of the targets.

(iv) Greater risk-taking by banks specialised in this type of deal, by financing them or acquiring a stake. Spanish banks have traditionally been reluctant to get involved in deals that are riskier than normal. For example, apart from SCH, funding for LBOs has been provided by foreign banks[4].

(v) Pan-European competition among the big private equity firms, whose presence in Spain is growing, puts upward pressure on the prices that they are willing to pay for targets.

3 There was an average of 24 PtoP deals between 2000 and 2004 in the EU-15 (excluding Greece), Norway and Switzerland. The average amount was 503 million euro.

4 The main financiers of LBOs worldwide are Credit Suisse First Boston and Chase Manhattan.

# 4 Characteristics of Spanish companies that have been delisted

The total number of companies listed in the Spanish stock market has declined steadily in recent years. At the end of 2005, there were 125 companies listed in the electronic market (SIBE), i.e. a reduction of 17 in four years (table 1).

The number of delistings in 2005 was not large in comparison with previous years. In terms of strict delistings from the electronic market (i.e. not counting mergers or changes in market), there were 6 (including Cortefiel) in 2005, practically the same number as in 2002, 2003 and 2004. The companies that were delisted were: Aldeasa, Amadeus, Cortefiel, Global Steel Wire, Recoletos and Volkswagen. Three of these deals (Amadeus, Cortefiel and Recoletos) were driven by private equity firms. Terra was another significant delisting from the electronic market, but this was due to merger with Telefónica.

**Number of companies[1] delisted from the Spanish stock market** TABLE 1

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Total | 14 | 23 | 47 | 24 | 14 |
| SIBE | 5 | 7 | 11 | 7 | 7 |
| **Delistings** | **2** | **6** | **6** | **7** | **6[2]** |
| Due to mergers | 3 | 1 | 5 | 0 | 1 |
| Open outcry | 8 | 11 | 35 | 12 | 3 |
| Delistings | 8 | 9 | 26 | 12 | 3 |
| Due to mergers | - | 2 | 9 | - | - |
| Second market | 1 | 5 | 1 | 5 | 4 |
| **Pro-memoria: No. of listed companies** | | | | | |
| Total | 267 | 251 | 219 | 198 | 186[2] |
| SIBE | 142 | 140 | 132 | 128 | 125[2] |
| Open outcry | 96 | 87 | 65 | 53 | 47 |
| Second market | 29 | 24 | 22 | 17 | 14 |

Source: CNMV.

1. At year-end, not counting SICAVs.

2. Includes the delisting of Cortefiel, which commenced in May 2005 but was not actually completed until 21 March 2006.

Table 2 shows that the total capitalisation of the companies delisted from the electronic market was not particularly large: 9.416 billion euro. That was 6.4% more than in 2004 but was less than the 9.854 billion euro registered in 2003. If the delistings due to merger are excluded, the capitalisation of companies delisted in 2005 falls to 7.668 billion euro (8.853 billion euro in 2004).

## Capitalisation[1] of delisted companies

TABLE 2

| Million euro | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Total | 2,595.7 | 6,862.6 | 11,073.8 | 9,368.6 | 9,940.9 |
| SIBE | 2,570.8 | 5,943.0 | 9,854.1 | 8,852.7 | 9,416.0 |
| **Delistings** | **1,511.4** | **5,420.3** | **3,875.1** | **8,852.7** | **7,668.2** [2] |
| Due to mergers | 1,059.4 | 522.7 | 5,979.0 | - | 1,747.8 |
| Open outcry | 22.7 | 864.2 | 1,214.8 | 387.6 | 482.4 |
| Delistings | 22.7 | 512.6 | 846.6 | 387.6 | 482.4 |
| Due to mergers | - | 351.6 | 368.2 | - | - |
| Second market | 2.2 | 55.4 | 4.8 | 128.2 | 42.5 |
| | | | | | |
| Pro-memoria: delistings (%) | | | | | |
| as % of total market | 0.55 | 1.87 | 2.38 | 1.67 | 1.51 |
| from SIBE/ total SIBE | 0.58 | 1.75 | 2.27 | 1.68 | 1.53 |
| strict PtoP from SIBE/total SIBE | 0.34 | 1.60 | 0.89 | 1.68 | 1.24 |
| from open outcry/ total open outcry (%) | 0.09 | 3.17 | 4.03 | 1.13 | 1.20 |
| from second market/ total second market | 0.66 | 14.46 | 1.31 | 43.85 | 13.82 |

Source: CNMV.

1. At year-end, not counting SICAVs. Calculated using the closing price in the last session prior to delisting.

2. Not counting Volkswagen, whose low liquidity in the Spanish market and large capitalisation distorted inter-year comparisons.

The size of the delistings (as a percentage of total capitalisation) did not increase in 2005. The delistings from the electronic market in 2005 (including Cortefiel) amounted to 1.53% of that market's total capitalisation. That was a decrease with respect to 2002, 2003 and 2004. Strict delistings from the electronic market accounted for 1.24% of that market's capitalisation in 2005, compared with 1.68% in 2004.

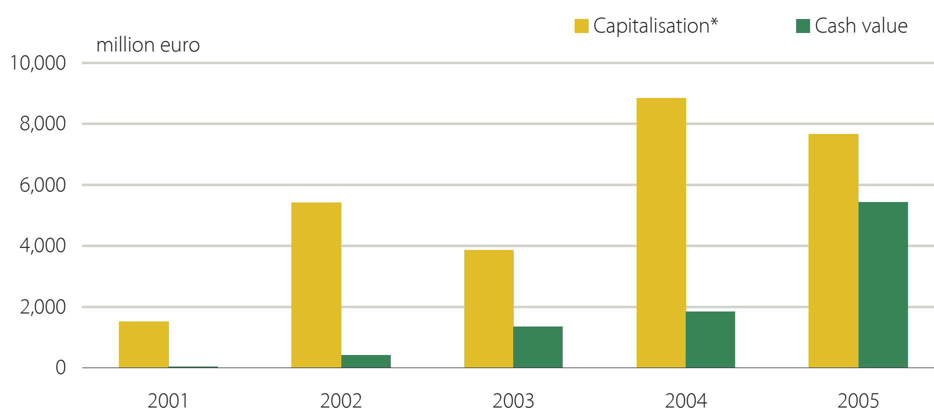
The main distinguishing feature of the PtoP deals in the electronic market in 2005 was that three deals driven by private equity accounted for the bulk of the total. Their market value was 6.752 billion euro, 1.09% of the market's capitalisation at year-end. The biggest delisting was Amadeus. Its market capitalisation before delisting was 4.337 billion euro. It was also one of the market's most liquid stocks: it was included in the Ibex 35 and Ibex Nuevo Mercado indices.

The delisting of Terra in mid-2005, plus that of Amadeus, meant that Spain's Nuevo Mercado lost two of its eleven components (40.5% of the index's total capitalisation)[5]. This jeopardises the viability of this segment of the market, which was created in 2000 during the tech boom[6].

In 2004, there were other large capitalisation delistings, such as CC Carrefour (the largest delisting of the last five years) and Aceralia. However, their stocks were not very liquid. Concentration of ownership due to purchases in the market, by Carrefour France subsidiaries in the former case and by Arcelor in the latter, had reduced their free float to below 5%, with the result that they had been removed from the Ibex 35 index in 2002. Details of these operations are given in table 3.

Another notable feature of the delistings in 2005 was the cash value of their delisting takeover bids – much larger than in previous years (figure 1). They totalled 6.679 billion euro (with Amadeus accounting for over half), compared with 1.847 billion euro in 2004 and 1.351 billion euro in 2003.

**Capitalisation and cash value of delisting takeover bids** FIGURE 1




Source: CNMV.

* Using the closing price in the session prior to delisting.

If we consider the entire period 2001-2005, the cash value of delisting takeover bids by private equity (6.089 billion euros) still amply exceeds that of other deals (4.241 billion euros). The difference is even greater if the average size of the delisting takeover bid is considered. The average size of private equity-driven delistings was 1.522 billion euros, compared with 201.9 million euros for the remainder. For details of the cash value of delisting takeover bids, see table 4.

5 Amadeus was the largest stock in that segment, accounting for 28.9% of its total capitalisation.

6 Spain's Nuevo Mercado is actually one of the last of the markets in tech stocks created in Europe during the tech boom that is still operational, since Easdaq, Nouveau Marché (France), Neuer Markt (Germany) and Nuovo Mercato (Italy) have closed. Markets or specific trading segments for companies with fast growth potential have been created recently, such as the London Stock Exchange's AIM and Euronext's Alternext.

# 5 Why Public-to-private Deals have grown in size

## 5.1 Valuation of delisted companies

One reason for the sale of listed companies to private equity firms is that the latter are willing to pay more than the target's market price and fundamental value. The prices paid in PtoP deals since 2001 bear this out.

Table 4 shows the liquidity premium paid in the PtoP deals (delisting takeover bids and standing purchase orders) with respect to the average market price in the second half of the year prior to the delisting takeover bid. The table also shows the price/earnings ratio (PER). The average premium paid in recent PtoP deals with respect to the market price is 30.4%, higher even than the average premium paid in delistings not performed by private equity firms (28.2%).

The difference is even greater when expressed in terms of PER: 46 for private equity-driven PtoP deals, compared with 33.5 for the remainder (using parent company net profit in both cases). Using consolidated net profit reduces the ratios somewhat: 29.4 vs. 22.6.

Why are companies being overvalued? One possible explanation is that the PtoP deals are the result of careful selection of companies, often family firms, where more efficient management may be able to unlock value and obtain over 20% returns during the projected period of investment[7].

There is also the fact that private equity firms are holding large amounts of cash, and competition between foreign firms for Spanish companies is driving up the bidding.

Moreover, delisting eliminates a range of costs associated with being listed on the stock market: record-keeping, listing and maintenance of listing, and compliance with the transparency requirements imposed for investor protection.

7 The holding period for investments by private equity firms is slightly over 4 years in the case of established companies and over 5 years in the case of companies in the seed and start-up phase.

## Companies delisted from Spain's electronic market (SIBE)

TABLE 3

| | Company | Capitalisation[1] (thousand euro) | Index | Free-float [2] (%) | Significant shareholders [3] Shareholder [4] | % capital | Reason | Proc. [5] |
|---|---|---|---|---|---|---|---|---|
| 2001 | Saint-Gobain Cristalería | 913,755.5 | Ibex 35 [6] | 2.79 | Compagnie de Saint-Gobain | 97.21 | Narrow free float after last takeover bid | (A) |
| | Asturiana de Zinc | 597,630.6 | Ibex 35 [7] | 4.30 | Xstrata Hólding and Xstrata Spain | 92.42 | Narrow free float after last takeover bid | (A) |
| | Puleva | 503,987.7 | Ibex 35 [8] | 50.75 | G&W Financial Eng. Intn. Services | 26.64 | Merged into Azucarera Ebro | (B) |
| | Meliá Inver. Americanas | 299,625.0 | -- | 2.39 | Sol Meliá Investment and Sol Meliá | 97.11 | Merged into Banco de Madrid | (B) |
| | Inmobiliaria Zabálburu | 255,814.6 | -- | 2.51 | Bami | 94.98 | Merged into Bami | (B) |
| 2002 | Hidrocantábrico | 3,077,820.1 | Ibex 35 [9] | 3.65 | Ferroatlántica, Adygensival | 93.85 | Narrow free float after last takeover bid | (A) |
| | Superdiplo | 1,259,700.0 | -- | 0.50 | Koninklijke Ahold | 98.73 | Narrow free float after last takeover bid | (A) |
| | Pórtland Valderrivas | 522,720.0 | -- | 41.11 | FCC, Ibercaja | 55.23 | Merged into FCC | (B) |
| | Heineken España | 438,031.8 | -- | 2.81 | Heinekent NV | 97.19 | Narrow free float after last takeover bid | (C) |
| | Bodegas y Bebidas | 279,185.6 | -- | 6.94 | Grupo Allied Domecq España | 93.06 | Narrow free float after last takeover bid | (C) |
| | Filo series A shares | 195,284.2 | -- | | | | | |
| | Filo series B shares | 68,210.0 | -- | 2.12 | ING Real Estate Inv and Bishop Invest Spain | 97.88 | Narrow free float after last takeover bid | (A) |
| | Omsa Alimentación | 102,064.2 | -- | 10.28 | Campofrío | 57.02 | Merged into majority shareholder | (A) |
| 2003 | Grupo Dragados | 3,058,171.7 | Ibex 35 [10] | 57.73 | ACS and Chase Nominees Ltd | 39.56 | Merged into ACS | (B) |
| | Aurea | 1,914,033.0 | Ibex 35 [11] | 26.45 | Grupo Dragados | 66.15 | Merged into ACESA | (B) |
| | Mapfre Vida | 1,165,902.4 | -- | 0.72 | Mapfre Caja Madrid Holding EA | 99.28 | Narrow free float after last takeover bid | (A) |
| | Banco Zaragozano | 1,143,000.0 | -- | 1.69 | Barclays Bank | 98.31 | Narrow free float after last takeover bid | (C) |
| | Iberpistas | 950,547.3 | -- | 1.61 | Acesa | 98.39 | Narrow free float after last takeover bid | (A) |
| | Uniland Cementera | 425,520.0 | -- | 7.09 | Corporación Uniland | 92.91 | Narrow free float after last takeover bid | (A) |
| | Koipe | 417,306.3 | -- | 1.48 | SOS Cuétara and Caja Ah de Granada | 81.07 | Merged into SOS Cuétara | (B) |
| | Bami | 374,180.6 | -- | 30.35 | Bancaza, CAM, Stenenberg Hólding | 49.44 | Merged into Metrovacesa | (B) |
| | Energía e ind. aragonesas | 215,328.9 | Ibex 35 [12] | 12.12 | Uralita | 84.20 | Merged into Uralita | (B) |
| | Enaco | 164,343.3 | -- | 0.48 | Caprabo | 99.52 | Narrow free float after last takeover bid | (C) |
| | Banco Financia Sofinloc | 25,793.2 | -- | 7.30 | Financia, Sofinloc and Cuarenta | 92.70 | Narrow free float after last takeover bid | (C) |
| 2004 | CC Carrefour | 5,503,234.2 | Ibex 35 [13] | 2.82 | Grupo Carrefour Francia | 97.18 | Narrow free float after last takeover bid | (A) |
| | Aceralia | 2,113,750.0 | Ibex 35 [14] | 4.97 | Arcelor | 95.03 | Merged into majority shareholder | (A) |
| | Banco Atlántico | 1,499,919.9 | -- | 7.17 | Banco de Sabadell | 92.83 | Narrow free float after last takeover bid | (C) |
| | Parques Reunidos | 165,781.3 | -- | 9.45 | Fondos Advent | 90.55 | Narrow free float after last takeover bid | (C) |
| | Nueva Montaña Quijano | 13,669.6 | -- | 24.52 | Coal Trade S.L. | 75.48 | Extraordinary cancellation of assets | (C) |
| | EPPI | 4,925.7 | -- | 42.71 | Smurfit España and Grupo Torras | 57.29 | Liquidation of the company | (D) |
| | Fastibex | 1,434.5 | -- | 70.79 | -- | -- | Liquidation of the company | (D) |
| 2005 | Volkswagen | 11,847,711.5 | -- | 58.02 | F. Porsche AG and Niedersachsen Land | 41.98 | Narrow free float after last takeover bid | (E) |
| | Amadeus | 4,336,500.0 | Ibex 35 [15] and Ibex NM | 1.26 | BC Partners and Cinven, Air France, Iberia and Lufthansa | 94.73 | Narrow free float after last takeover bid | (C) |
| | Terra | 1,747,822.2 | Ibex 35 and Ibex NM | 25.00 | Telefónica | 100.00 | Merged into Azucarera Ebro | (B) |
| | Recoletos | 941,139.0 | -- | 2.00 | Retos Cartera (Providence, Mercapital e Investindustrial) | 98.00 | Merged into Banco de Madrid | (C) |
| | Aldeasa | 767,970.0 | -- | 4.11 | Autogrill España and Altadis | 95.89 | Merged into Bami | (C) |
| | Global Steel Wire | 148,317.8 | -- | 17.38 | Hnos. Rubiralta Vilaseca | 82.59 | Narrow free float after last takeover bid | (A) |
| 2006 | Cortefiel | 1,474,258.5 | Ibex 35 [16] | 9.61 | MEP Retail España (CVC, PAI Partners and Permira) | 87.39 | Narrow free float after last takeover bid | (A) |

Source: CNMV.

1. Market value of the listed securities at the closing price of the previous trading session. 2. Free float estimated on the basis of direct significant holdings disclosed and of own shares: (i) before delisting takeover bid; (ii) after last takeover bid, just before delisting by an intermediate procedure; or (iii) at the time of merger or integration. 3. Direct holdings of over 5% prior to delisting. 4. Companies with larger significant holdings. 5. Delisting procedure: (A) on issuer's request, via delisting takeover bid, (B) Technical, due to merger, (C) on issuer's request, by intermediate procedure, (D) Technical, due to liquidation, and (E) on issuer's request. 6. Between 1 October 1991 and 2 January 1992. 7. Between 1 July 1997 and 4 January 1999. 8. Between 1 October 1997 and 3 January 2000. 9. Between 1 July 1991 and 10 April 2001. 10. Until delisting on 15 December 2003. 11. Between 1 July 1992 and 3 July 2000. 12. Between 1 July 1992 and 4 July 1993. 13. Between 2 October 2000 and 30 December 2002. 14. Between 1 July 1998 and 9 February 2002. 15. Between 3 January 2000 and 28 June 2005. 16. Between 2 January 1995 and 2 July 1995.

## Valuation of purchases prior to delisting of companies from the Spanish electronic market

TABLE 4

| | Company | Capitalisation [1] (thousand euro) | Cash value [2] (thousand euro) | Delisting price [3] | Average price in last six months [4] | Premium [5] (%) | PER [6] Parent co. net profit | PER [6] Consolidated net profit |
|---|---|---|---|---|---|---|---|---|
| 2001 | Saint-Gobain Cristalería | 913,755.5 | 21,184.3 | 60.00 | 45.55 | 31.72 | 18.50 | 20.43 |
| | Asturiana de Zinc | 597,630.6 | 15,450.7 | 15.00 | 12.74 | 17.74 | 60.84 | 5.46 |
| | **Total 2001** | **1,511,386.1** | **36,635.0** | **--** | **--** | **24.73** | **39.67** | **12.95** |
| 2002 | Hidrocantábrico | 3,077,820.1 | 83,364.3 | 27.30 | 25.53 | 6.93 | 52.74 | 41.57 |
| | Superdiplo | 1,259,700.0 | 6,255.1 | 25.99 | 23.62 | 10.03 | -- | 24.68 |
| | Heineken España | 438,031.8 | 54,528.0 | 7.50 | 6.12 | 22.55 | 60.14 | 62.73 |
| | Bodegas y Bebidas | 279,185.6 | 259,810.1 | 15.70 | 10.60 | 48.11 | 35.45 | 7.63 |
| | Filo series A shares | 195,284.2 | 3,385.1 | 2.45 | 2.14 | 14.49 | | |
| | Filo series B shares | 68,210.0 | 787.4 | 2.63 | 2.21 | 19.00 | 13.19 | 7.34 |
| | Omsa Alimentación | 102,064.2 | 8,254.4 | 8.30 | 6.85 | 21.17 | 102.41 | 76.54 |
| | **Total 2002** | **5,420,296.0** | **416,384.5** | **--** | **--** | **20.33** | **30.73** | **36.75** |
| 2003 | Mapfre Vida | 1,165,902.4 | 5,634.7 | 32.95 | 32.72 | 0.70 | 39.52 | 27.14 |
| | Banco Zaragozano | 1,143,000.0 | 1,123,683.3 | 12.70 | 9.33 | 36.12 | 26.40 | 22.51 |
| | Iberpistas | 950,547.3 | 12,942.1 | 13.65 | 12.55 | 8.76 | 49.98 | 44.72 |
| | Uniland Cementera | 425,520.0 | 28,196.6 | 98.10 | 64.50 | 52.09 | 10.06 | 9.64 |
| | Enaco | 164,343.3 | 156,807.9 | 7.67 | 4.26 | 80.05 | -- | -- |
| | Banco Financia Sofinloc | 25,793.2 | 23,910.3 | 1.66 | 1.42 | 16.90 | 0.39 | 0.39 |
| | **Total 2003** | **3,875,106.2** | **1,351,174.8** | **--** | **--** | **32.44** | **17.68** | **14.11** |
| 2004 | CC Carrefour | 5,053,234.2 | 127,296.1 | 15.00 | 14.40 | 4.17 | 16.10 | 15.65 |
| | Aceralia | 2,113,750.0 | 85,104.7 | 17.00 | 14.20 | 19.72 | 44.65 | 19.07 |
| | Banco Atlántico | 1,499,919.9 | 1,479,821.0 | 71.79 | 55.30 | 29.82 | 40.25 | 30.6 |
| | Parques Reunidos | 165,781.3 | 150,114.9 | 6.25 | 3.77 | 65.78 | 66.82 | 29.75 |
| | Nueva Montaña Quijano | 13,669.6 | 4,188.9 | 0.34 | 0.34 | 0.00 | -- | -- |
| | **Total 2004** | **8,846,355.0** | **1,846,525.5** | **--** | **--** | **23.90** | **33.36** | **19.90** |
| 2005 | Amadeus | 4,336,500.0 | 3,833,626.8 | 7.35 | 6.98 | 5.30 | 20.86 | 20.04 |
| | Recoletos | 941,139.0 | 856,248.3 | 7.20 | 5.84 | 23.29 | 56.01 | 44.73 |
| | Aldeasa | 767,970.0 | 719,741.5 | 36.57 | 26.22 | 39.47 | 34.09 | 23.00 |
| | Global Steel Wire | 148,317.8 | 20,222.0 | 4.40 | 2.40 | 83.33 | 15.25 | 16.70 |
| | **Total 2005** | **6,193,926.8** | **5,429,88.6** | **--** | **--** | **37.85** | **31.55** | **26.12** |
| 2006 | Cortefiel | 1,474,258.5 | 1,249,395.4 | 18.40 | 14.46 | 27.25 | 40.37 | 23.12 |
| | Total 2001-2006 sin CR | 20,403,650.0 | 4,240,568.4 | -- | -- | 28.22 | 33.49 | 22.63 |
| | **Total 2004-06 CR** | **6,879,781.0** | **6,089,385.3** | **--** | **--** | **30.40** | **46.02** | **29.41** |

Source: CNMV.

1. Using closing price of last session prior to delisting. 2. Result of multiplying the number of shares that accepted the delisting bid by the bid price. 3. Price set in the delisting takeover bid or the standing purchase order for delisting by means of an intermediate procedure. 4. Average closing price in the six months prior to the regulatory disclosure of the winning bid before delisting. 5. Percentage difference between delisting price and six-month average price. The annual figure is the average of premiums paid in each period. 6. Ratio between delisting price and net profit per share based on the periodic public disclosures available at the time the takeover bid was presented. The annual figure is the average of positive PER ratios in each period.

## 5.2 Cost of flotation

Sales of companies to private equity firms reduce the number of potential divestments via IPOs. Moreover, there have been practically no IPOs in Spain as part of private equity exit strategies.

Cost saving is an advantage attributed to selling unlisted companies to private equity firms as an alternative to a listing. The costs of an IPO are varied. The main expense is management, underwriting and placement fees. Advertising expenses are the second-largest item. These expenses could be minimised through mere compliance with the legal obligation to post announcements in the Official Bulletin of the Mercantile Register (BORME) but, since IPOs are normally aimed at retail investors, companies generally engage in mass media advertising.

Other items (initial listing and trading fees, CNMV fees, etc.) are normally negligible compared with the total expenses. Additionally, listed companies must pay an annual listing fee, which Bolsas y Mercados Españoles (BME) maintained unchanged in 2005 and 2006 at 0.045 per mil of the market capitalisation on the first business day of the year (maximum: 290,000 euro).

Table 5 shows the costs of the main IPOs since 2001[8]. IPOs cost an average of 3.32% of the cash value of the offering. The largest expenditure ratio was 5.65% (Renta Corporación). Inditex carried out the cheapest IPO in relative terms: 1.84%. Adding annual listing fees to the IPO costs raises the average expenditure ratio to 3.33% of the cash amount of the IPO.

A breakdown reveals that management, underwriting and placement fees are the largest single item, averaging 75.6% of the IPO expenses. Mandatory and commercial advertising costs averaged 15.9% of the total costs. CNMV fees accounted for 0.25%.

The conclusion is that the monetary costs of a flotation in the Spanish market cannot be described as excessive. Since the various items are capped, the larger the IPO, the smaller their impact in relative terms. In any case, the costs of a stock market flotation are large enough, in absolute terms, to create a notable difference in the capital gains to be obtained through a flotation and a sale to private equity firms.

Estimated IPO costs in the USA and the UK are somewhat higher than in Spain. The cost in the US is estimated to average between 7.5%-8.5% of the enterprise value (Currie, 2000) and 11% (Lee et al., 1996). For the UK, Menyah and Paudyal (2002) estimated the direct costs of a flotation on the London Stock Exchange (LSE) at 7.98% of the cash value of the IPO, in average terms. That study discovered clear economies of scale. The direct average cost of the first quintile was estimated at 13.84%, compared with 4.18% for the highest quintile. In the case of privatisations, the cost fell sharply to 1.82% of the cash value.

8 The data were gathered from IPO prospectuses filed with the CNMV; consequently, they are provisional and may diverge from the actual final expenditure.

## Monetary costs of an IPO *

TABLE 5

Thousand euro

| | 2006 | 2005 | 2004 | | | 2002 | 2001 | |
|---|---|---|---|---|---|---|---|---|
| **Concept** | **Renta Corporación** | **Corporación Dermoest.** | **Fadesa** | **Tele 5** | **Cintra** | **Enagás** | **Iberia** | **Inditex** |
| Management, underwriting and placement fees and incentives | 12,420 | 5,014.6 | 13,058.5 | 16,238.9 | 23,827.0 | 20,374.3 | 12,420 | 5,014.6 |
| Mandatory and commercial advertising, legal advice and other expenses | 1,075 | 1,000.0 | 5,687.9 | 1,370.0 | 11,560.0 | 7,903.2 | 1,075 | 1,000.0 |
| Mandatory and commercial advertising | na | 970.0 | 4,556.9 | 200.0 | 4,000.0 | 5,135.0 | na | 970.0 |
| Legal advice and other expenses [1] | na | 30.0 | 1,131.0 | 1,170.0 | 7,560.0 | 2,768.2 | na | 30.0 |
| CNMV fees | 27.0 | 17.6 | 63.8 | 64.0 | 60.0 | 61.3 | 27.0 | 17.6 |
| Iberclear, brokerage and other charges, listing and trading fees | 21.6 | 16.0 | 303.6 | 263.0 | 864.0 | 606.8 | 21.6 | 16.0 |
| Iberclear charges and fees | 7.5 | nd | 21.2 | 60.0 | 17.0 | 130.0 | 7.5 | na |
| Brokerage, initial listing and trading fees | 14.1 | nd | 282.5 | 203.0 | 847.0 | 476.8 | 14.1 | na |
| **Total IPO costs** | **13,543.7** | **6,048.2** | **19,113.8** | **17,935.9** | **36,311.0** | **28,945.6** | **13,543.7** | **6,048.2** |
| Borne by company | nd | 1,033.6 | 282.5 | 1,133.0 | 12,484.0 | 8,571.3 | na | 1,033.6 |
| Borne by selling shareholders | nd | 5,014.6 | 18,831.3 | 16,802.9 | 23,827.0 | 20,374.3 | na | 5,014.6 |
| Annual listing fee | 34.5 | 19.2 | 64.9 | 170.6 | 173.5 | 66.1 | 34.5 | 19.2 |
| **Total** | **13,578.1** | **6,067.6** | **19,178.7** | **18,106.5** | **36,484.5** | **29,011.7** | **13,578.1** | **6,067.6** |
| | | | | | | | | |
| **Pro-memoria: Cash amount of IPO** | 240,120.0 | 157,120.5 | 501,280.7 | 865,931.2 | 1,536,560.9 | 917,097.7 | 240,120.0 | 157,120.5 |
| % IPO expenses / total cash amount (%) | 5.64 | 3.85 | 3.81 | 2.07 | 2.36 | 3.16 | 3.80 | 1.84 |
| Borne by company | na | 0.66 | 0.06 | 0.13 | 0.81 | 0.93 | 0.00 | 0.00 |
| Borne by selling shareholders | na | 3.19 | 3.76 | 1.94 | 1.55 | 2.22 | 3.80 | 1.84 |
| Total expenses/total cash amount (%) | 5.65 | 3.86 | 3.83 | 2.09 | 2.37 | 3.16 | 3.81 | 1.86 |
| Borne by company | na | 0.67 | 0.07 | 0.15 | 0.82 | 0.94 | 0.01 | 0.03 |
| Borne by selling shareholders | na | 3.19 | 3.76 | 1.94 | 1.55 | 2.22 | 3.80 | 1.83 |

Source: CNMV.

* Costs set out in IPO prospectuses filed with the CNMV.

1. The "Other expenses" item includes agency fees, printing, taxes, and notary and mercantile register fees.

na: No available data.

# 6 Identifying Potential Future Delistings

There may be further delistings in the future. There is liquidity to invest, domestic players are raising funds and foreign players are increasingly active in the Spanish market. Additionally, private equity is willing to pay attractive prices and banks are willing to finance leveraged deals.

A company that is susceptible to takeover by private equity firms would presumably have the following characteristics:

— *size:* up to medium- or medium-large

— *industry:* we rule out financial services and real estate; in particular, we identify services and technology as potential targets

— *debt-bearing capacity:* medium-high; i.e. with relatively low indebtedness ratios

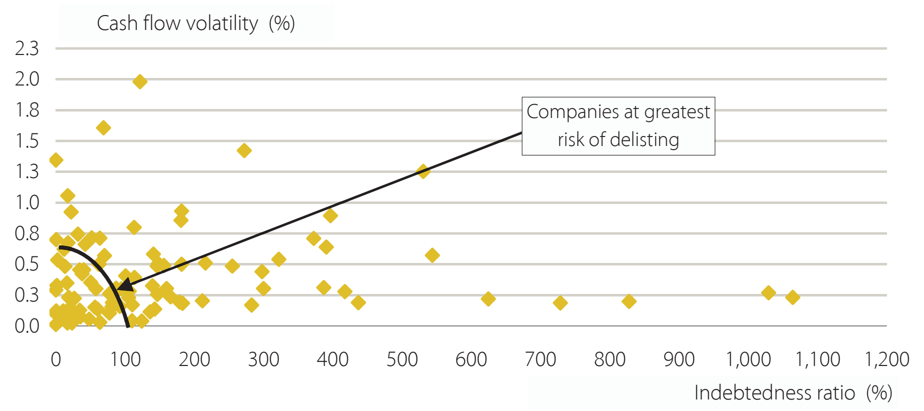
— *cash flow:* sufficient to cover the interest payments on a large percentage of debt; also, cash flow should be stable and predictable

— *capital structure*: owned by a family or one large shareholder.

Using these criteria, we established three initial filters for companies listed in the electronic market (SIBE) at the end of the first quarter of 2006: (i) companies which are not in the banking or real estate sectors, (ii) whose capitalisation is under 5 billion euro, and (iii) whose free float is under 80%.

Of the companies that matched those criteria, we selected those with lower indebtedness ratios and low volatility of cash flow per share between 2000 and 2005 whose average cash flow was not low. We identified 19 companies that are susceptible to a PtoP deal by this yardstick; they are clustered in the bottom left-hand corner of figure 2.

Companies identified in the IGBM: indebtedness and revenue volatility FIGURE 2




Source: Thomson Datastream, Reuters and CNMV.

# 7 Conclusions

Recent PtoP buyouts in Spain have occurred in the context of a boom by private equity, which is expanding rapidly in Spain. The arrival of international players, private equity firms' liquidity, the search for higher returns than can be obtained in the financial markets, and the record low interest rates are some of the factors driving large-scale leveraged buyouts.

PtoP deals in Spain have concentrated on mid-large cap stocks which were not illiquid prior to the deal. The deals have been accepted by shareholders as private equity firms have paid higher premiums than in the case of delistings that did not involve private equity.

These operations by private equity firms have had the effect of reducing the size of the Spanish stock market. In addition to the delisting of larger listed companies, there is a dearth of IPOs as private equity exit strategies. Moreover, a private sale is the alternative to a stock market listing for family firms and strategic industrial holdings.

Therefore, if this trend continues, private equity may come to act more as a competitor of the stock exchange rather than a means of funding new or growing companies or projects. It is now the norm in Europe that private equity firms invest little in seed and start-up and make little use of IPOs as an exit strategy, but they do engage in PtoP deals of medium-sized companies.

The direct costs of an IPO and continued listing do not seem to be the main obstacle to flotations in Spain, at least for companies of a certain size. They may be more of an obstacle for smaller companies because of scale diseconomies, particularly if the costs of the transparency imposed on listed companies are factored in.

In this situation, in which PtoP deals may continue to arise, the financial authorities might reconsider the viability of creating a market with lower and more flexible listing requirements, in the style of Alternext (Euronext) and AIM (LSE). Experience has shown that supply and demand were insufficient to sustain the "new markets". Matching supply (projects) to demand (willingness to invest in projects without a track record) is not easy nor can it be achieved in the short term, and it exceeds the capacities of the financial authorities.

# Private Equity in Spain

**Marián Ruiz Martín (*)**

(*) Marián Ruiz Martín is on the staff of the Studies and Statistics Directorate of the CNMV.
This paper is a summary of CNMV Monograph no. 16, by the same author and with the same title.

# 1 Private Equity in Spain

When speaking of private equity, it is necessary to distinguish between pure venture capital (i.e. investment in start-ups and expansion projects) and buyouts of more mature companies. The industry is growing in Spain via buyouts rather than start-ups.

In this context, private equity firms, most of them foreign[1], are very interested in buying listed companies and unlisted companies with the potential for an IPO. In the former case, the companies are eventually delisted. In the latter case, family firms that are large enough to be floated ultimately choose a private sale. In fact, few private equity capital firms use IPOs as an exit strategy.

This article seeks to respond to the following questions:

— Why are investors investing in private equity firms instead of in the securities markets?

— Why are private equity firms focusing much of their investment on large companies that are listed or have the potential for listing rather than fostering growth by small companies or start-ups?

— And why don't IPOs work as an exit strategy?

The first part of the document describes the development of private equity in Europe and Spain by tracking its main variables: funds raised, investments and divestments. The second part analyses the industry's strategies for fund-raising, selecting investments and divesting, and seeks to respond to the foregoing questions.

1 Generally from the USA and the UK, where the private equity business is much more developed than elsewhere in Europe.

# 2 Private Equity Industry in Europe[2]

In the last five years, European private equity firms have raised 193.786 billion euro. Fund-raising was particularly strong in 2000 and 2001 due to the boom of investment in tech start-ups and M&A, but 2005 holds the record: 71.771 billion euro. Between 2001 and 2005, banks and pension funds provided 40.8% of new funding, followed by insurance companies and funds of funds (23.3% combined).

As for investments, 63.1% of the amount invested in 2001-2005 was in buyouts, followed in importance by expansion projects; together, these two categories account for 86.9% of the total investment. In 2005, buyouts represented 68.2% of newly-raised funds, while the proportion of initial phase investment, particularly start-ups, declined notably. Investment in 2005 amounted to 47.000 billion euro.

Divestments also increased steadily during the period of reference, to 29.796 billion euro in 2005. Private equity investors can take a number of exit strategies, but the most common one is a sale to third parties. Secondary buyouts (SBO), in which one private equity firm sells out to another, are growing in importance.

Meanwhile, the industry is experiencing globalisation. On the one hand, the providers of funds are increasingly investing in private equity firms in different regions of the world and, on the other hand, fund managers are seeking the best investment projects in a broader geographical area.

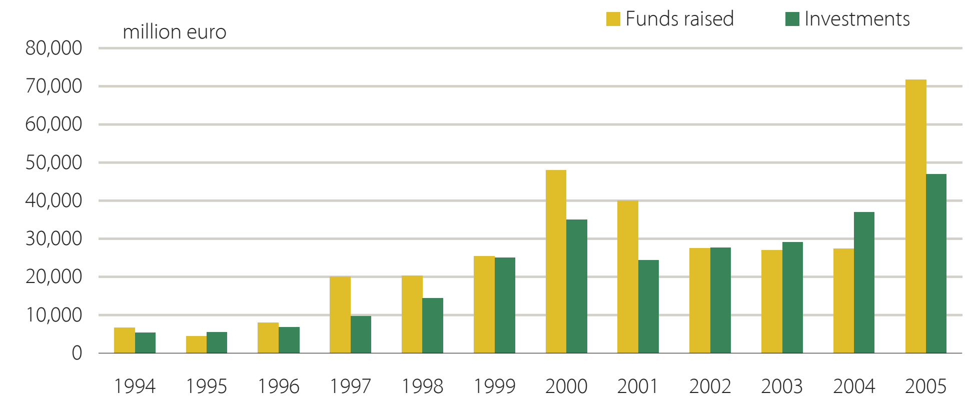
In comparison with North America, according to the *PricewaterhouseCoopers*[3] report for the period 1998-2005, the tech boom was much stronger in the US than in Europe. Also, whereas pension funds provide approximately 50% of private equity funding in the US, their contribution in Europe is 20%. As for investors, pure venture capital is much more developed in the US than in Europe.

2 Source: EVCA (European Private Equity & Venture Capital Association) Yearbook 2006.

3 Global Private Equity Report 2005. PriceWaterhouseCoopers.

## Private equity in Europe: funds raised and invested

FIGURE 1




Source: EVCA Yearbook 2006.

# 3 Private Equity in Spain[4]

The private equity business started in Spain in the 1970s at the government's instigation. After weathering the tech bubble, the industry is now growing. Since 2003, private equity has expanded rapidly, with record investment in 2005.

At the end of 2005, there were 124 private equity firms operating in Spain and, during that year, 15 started up and one firm closed down. Of the 124 private equity firms, only 22 are public.

Spain's new law on private equity firms and their management companies[5] was welcomed by the industry both in Spain and internationally. The law provides:

— An improved administrative regime governing firms, by providing two tiers of private equity firm (standard and simplified).

— Flexibility for investing. Most notable is the possibility of investing in listed companies with a view to delisting them within at most one year (public to private - PtoP).

— The possibility of creating funds of funds.

— A favourable taxation system.

— Improvements in the investment coefficients.

Through September 2006, new and existing private equity funds had registered with the CNMV under the new law, in addition to three funds of funds. Many of the newly-registered firms adopted the simplified system and some pre-existing firms changed to adopt the simplified system.

The trend in private equity in Spain in 2004 and 2005 is shown in the figures and tables below. The ASCRI[6] data base includes private equity firms that operate in Spain, i.e. both those established under the law which are registered with the CNMV and those which are not.

The private equity industry in Spain expanded notably in 2005. In that year, there were some very large buyouts, some of them PtoP deals.

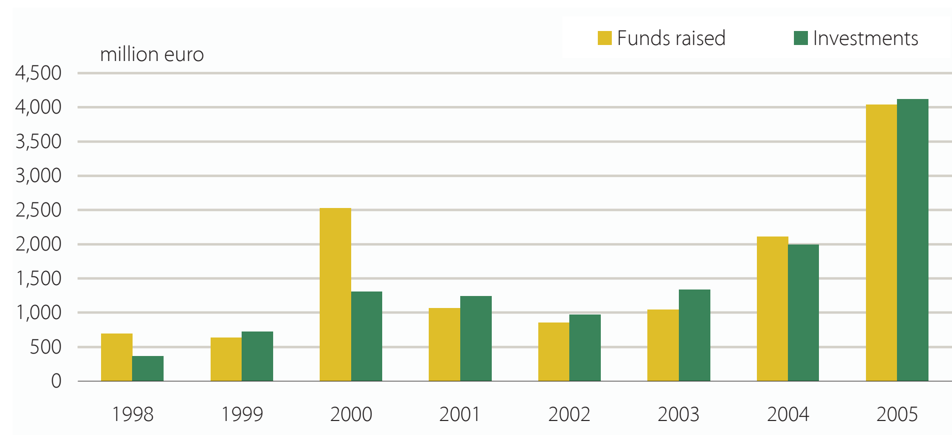
4 Source: "El capital riesgo en España en 2005" http://webcapitalriesgo.com in cooperation with ASCRI. "El capital riesgo en España. Primer semestre de 2006". September, 2006.

5 Law 25/2005, of 24 November, gazetted on 25 November.

6 Asociación Española de Entidades de Capital Riesgo.

**Private equity in Spain: funds raised and invested**
**ASCRI figures**

FIGURE 2




Source: ASCRI.

## 3.1 Fund-raising

Table 1 shows the total amount of funds raised from each funding source. Three-quarters of the funds raised in 2005 corresponded to investment in Spanish companies by pan-European funds.

There is a difference in methodology between ASCRI and EVCA figures. For the purposes of geographical classification, EVCA uses the origin of the private equity firm, while ASCRI uses the country where the investment is made. That is to say, ASCRI's figure for newly-raised funds in Spain includes investments in Spain by pan-European funds. Table 1 contains two columns for 2005: one for the ASCRI figures and another for the EVCA figures.

According to ASCRI, the proportion of funds provided by foreign investors increased from 47.7% in 2004 to 77% in 2005. Funds from other countries are mainly from the US. Specifically, 42.7% of newly-raised funds in 2005 were from the US. The UK provided 21.7% of total funds.

According to EVCA, the main investors were financial institutions, followed in importance by non-financial companies. Pension funds are only a minor source of funds for Spanish private equity firms. In 2004, 1.577 billion euros were raised, according to EVCA.

In the first three quarters of 2006, 1.912 billion euros were raised, according to ASCRI. Note that 53% of these funds corresponded to Spanish private equity firms.

**Private equity in Spain: funds raised in 2004 and 2005** TABLE 1

Million euros

| | 2004 | | 2005 | | | |
|---|---|---|---|---|---|---|
| | Amount (ASCRI) | % | Amount (ASCRI) | % | Amount (EVCA) | % |
| Financial institutions | 940.0 | 44.5 | 993.5 | 24.6 | 392.7 | 38.6 |
| Pension funds | 361.2 | 17.1 | 1,652.2 | 40.9 | 35.8 | 3.5 |
| Insurance companies | 50.1 | 2.4 | 115.0 | 2.8 | 9.0 | 0.9 |
| Funds of funds | 175.6 | 8.3 | 501.4 | 12.4 | 17.8 | 1.7 |
| Non-financial companies | 152.8 | 7.2 | 486.0 | 12.0 | 384.4 | 37.8 |
| Individuals | 131.4 | 6.2 | 100.4 | 2.5 | 41.4 | 4.1 |
| Public investors | 203.4 | 9.6 | 79.8 | 2.0 | 79.8 | 7.8 |
| Academic institutions | 0.0 | 0.0 | 13.9 | 0.3 | 0.0 | 0.0 |
| Securities markets | 91.2 | 4.3 | 85.0 | 2.1 | 44.0 | 4.3 |
| Other | 4.9 | 0.2 | 13.0 | 0.3 | 13.0 | 1.3 |
| Realised capital gains | 0.2 | 0.0 | 1.8 | 0.0 | 1.8 | 0.0 |
| **Total** | **2,110.8** | **100.0** | **4,041.9** | **100.0** | **1,019.8** | **100.0** |
| Domestic | 1,173.4 | 55.6 | 928.2 | 23.0 | 926.8 | 90.9 |
| Rest of Europe | 566.3 | 26.8 | 1,287.4 | 31.9 | 82.7 | 8.1 |
| Rest of world | 371.1 | 17.6 | 1,826.3 | 45.1 | 10.3 | 1.0 |

Source: ASCRI. 2006 Report.

## 3.2 Investments

According to ASCRI, investments increased by over 100% in 2005 with respect to 2004. That increase was due to major deals by pan-European funds. The following seven deals together accounted for the bulk of investment: Auna Tlc, Amadeus, Cortefiel, Recoletos, Mivisa, Panrico and Applus+.

As for the criterion for classifying investments, EVCA uses the country where the investment is made, or the private equity firm's home country if it does not have a branch in the target country. Nevertheless, EVCA does publish statistics of investments based on the target country: Spain is listed with 4.299 billion euros.

Because if the aforementioned seven deals, most of them buyouts[7], the volume invested in buyouts in Spain exceeded investment in expansion for the first time (the latter had traditionally accounted for the bulk of investment). Nevertheless, expansion projects[8] continue to head the list in terms of numbers.

Of the aforementioned deals, three were public-to-private: Recoletos, Amadeus and Cortefiel.

According to ASCRI, *Communications, Consumer products and Other services* accounted for nearly three-quarters of the funds invested in 2005.

Private equity firms invested 1.791 billion euro in Spain in the first nine months of 2006. The investment pattern observed in 2005 in terms of deal type continued,

7 Of the 48 buyouts, the biggest were Auna, Amadeus, Cortefiel, Recoletos, Panrico, Mivisa, Saprogal and Famosa.

8 The biggest were Applus+ and Pepe Jeans.

although there were fewer mega-deals. Leveraged deals accounted for 65% of the total investment, and expansion projects for 24%. The main deals were Grupo Levantina, TALGO, La Sirena, Unión Española de Explosivos, Svenson, Viajes Iberostar, Gamesa Energía Servicios, Telepizza, Gasmedi and STEN (see table 6). Other deals such as Dorna, Applus+ and Calvo are pending. Telefónica is also considering the sale of Endemol to a consortium comprising Apax, Cinven, CVC, Permira, Providence and KKR.

The total volume of investment is expected to reach 3 billion euro in 2006. The year 2005 was exceptional in terms of the volume of investment because of mega-deals such as Auna Tlc and Amadeus.

**Private equity in Spain: investments in 2004 and 2005, breakdown by phase** TABLE 2

Million euros

| | 2004 | | | 2005 | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | ASCRI amount | % | No. of companies | ASCRI amount | % | No. of companies | EVCA amount | % | No. of companies |
| Seed | 6.3 | 0.3 | 16 | 8.8 | 0.2 | 52 | 8.8 | 0.3 | 52 |
| Start-up | 66.0 | 3.3 | 80 | 108.9 | 2.6 | 103 | 108.9 | 4.1 | 103 |
| Expansion | 1,211.4 | 60.7 | 279 | 649.8 | 15.8 | 257 | 651.1 | 24.5 | 258 |
| Replacement | 37.9 | 1.9 | 7 | 31.8 | 0.8 | 4 | 31.8 | 1.2 | 4 |
| Buyout | 671.8 | 33.7 | 16 | 3,317.2 | 80.6 | 48 | 1,861.7 | 69.9 | 47 |
| Other | 2.4 | 0.1 | 4 | 1.3 | 0.0 | 1 | 0 | 0.0 | 0 |
| Total | 1,995.9 | 100.0 | 402 | 4,117.7 | 100.0 | 465 | 2,662.2 | 100.0 | 464 |

Source: ASCRI. 2006 Report.

## 3.3 Divestments[9]

Divestments have increased considerably since 2002. The amount divested in 2005 was nearly triple the 2004 figure. The biggest deals were the sale of Auna Tlc and Amena, Panrico, Probitas Pharma and Saprogal.

The average length of investment was stable at around 5 years in 2002-2004, rising slightly to 5.3 years in 2005. Longer investment periods correspond to less developed companies, while the average period of permanence in established companies is just slightly over 4 years.

Sale to third parties was the most common exit strategy, accounting for 37% of the total. The main development in 2005 was growth in secondary buyouts (SBO), which accounted for 27% of the volume (21 deals). There were four IPOs in 2003, none in 2004 and one (Corporación Dermoestética) in 2005.

Divestments in the first nine months of 2006 totalled 1.067 billion euro, including notably the IPOs of Renta Corporación (by 3i Europe) and Gam (by Nmás1 and Dinamia). Técnicas Reunidas, in which BBVA's venture capital firms hold a stake, is preparing an IPO, as is low-cost airline Vueling. The biggest deal was the sale of

9 Divestment amounts are stated at cost price.

Corporación Eólica CESA to Acciona. There were 11 SBOs, including the management buyout (MBO) of Svenson.

**Private equity in Spain: divestments in 2004 y 2005, by exit strategy**

TABLE 3

Million euro

| | 2004 | | 2005 | |
|---|---|---|---|---|
| | **Amount** | **%** | **Amount** | **%** |
| Shareholder buyback | 113.7 | 22.1 | 309.4 | 20.8 |
| SBO | 53.8 | 10.5 | 402.8 | 27.0 |
| Sale to third parties | 155.3 | 30.2 | 551.7 | 37.0 |
| Sale on the stock market | 0.0 | 0.0 | 8.1 | 0.5 |
| Recognition of loss | 51.5 | 10.0 | 70.7 | 4.7 |
| Loan repayment | 71.4 | 13.9 | 63.7 | 4.3 |
| Other | 69.2 | 13.4 | 84.4 | 5.7 |
| **Total** | **514.9** | **100.0** | **1,490.8** | **100.0** |

Source: ASCRI. 2006 Report.

# 4 Industry Strategies[10]

## 4.1 Fund-raising

The market cycle is the most influential factor in fund-raising. Behind it rank other factors such as the macroeconomic situation, the fund's track record, its investment approach, the investor's strategic interests, and the fund-raising strategy.

The main appeal of private equity to investors is that the large potential yields offset the low liquidity. Investments in buyouts provided higher yields than investments in securities in 2005 (table 4).

During the period considered here, the annualised aggregate IRR of all the funds considered was 10.3%: 6.3% in the case of pure venture capital firm funds and 13.7% in the case of buyout funds. The latter clearly outperformed their benchmark markets (unlike pure venture capital funds). The last column shows the IRR of the best funds (above the median).

**Annualised aggregate yields** TABLE 4

From fund creation to 31 December 2005

| | Number of funds | Aggregated IRR (%) | Morgan Stanley Euro Index [1] | HSBC Small Company Index [2] | JP Morgan Euro Bonds [3] | Number of funds | Top Half aggregated IRR (%) |
|---|---|---|---|---|---|---|---|
| Total pure venture capital | 636 | 6.3 | 6.4 | 9.8 | 10.1 | 317 | 12.3 |
| Buyouts | 349 | 13.7 | 2.7 | 8.7 | 10.7 | 175 | 20.9 |
| Total private equity | 1,069 | 10.3 | 4.3 | 9.7 | 10.5 | 537 | 14.2 |

Source: EVCA/ Thomson Financial.

1. This equity index by Morgan Stanley includes listed shares from several European countries.

2. Index composed of companies listed in European bourses with a market capitalisation of between 30 million euros and 3.5 billion euros.

3. This index tracks the main references used in Europe, both principal and interest of issues available to international investors.

## 4.2 Selecting investments

Private equity investments in Europe focus primarily on buyouts, which offer higher yields than early-stage finance (see table 4).

10 For more information on this area, see "El ciclo de capital riesgo en Europa: su gestión y aportación de valor". Fundación de Estudios Financieros, Papeles de la fundación no. 10, March 2005.

The 1990s saw growing interest in pure venture capital investments but that was truncated in 2000. Results in this segment in recent years have been disappointing, which explains the small number of funds focusing on it.

The yields on venture capital investments must be calculated over long periods of time since the normal cycle from investment to divestment requires at least six years. However, 12-month yields in 2005 were very positive in both pure venture capital and buyouts (table 5). To compare results in Europe and the US, it is better to focus on figures calculated over a longer time period, such as five or ten years. Five-year yields reflect the investments made towards the end of the technology bubble and the beginning of the recovery phase.

**Yields through 31 December 2005 in Europe and the US, by term[11]** TABLE 5

Funds created between 1980 and 2005

| | Pure venture capital | Buyouts | Total private equity | Indices for comparison with total private equity | |
|---|---|---|---|---|---|
| **Europe** | | | | Morgan Stanley Euro | HSBC Small Co. |
| 1 year | 36.5 | 31.7 | 33.8 | 16.6 | 15.8 |
| 3 years | 1.7 | 9.1 | 6.3 | 13.2 | 33.5 |
| 5 years | -3.0 | 6.1 | 2.0 | -3.7 | 13.0 |
| 10 years | 6.4 | 14.3 | 11.4 | 2.9 | 11.1 |
| **U.S.** | | | | NASDAQ | S&P 500 |
| 1 year | 15.6 | 31.3 | 22.6 | 5.2 | 6.3 |
| 3 years | 7.5 | 16.3 | 13.1 | 14.2 | 10.1 |
| 5 years | -6.8 | 5.2 | 1.5 | -2.2 | -1.1 |
| 10 years | 23.7 | 9.2 | 12.3 | 7.7 | 7.3 |

Source: EVCA/ Thomson Financial and NVCA/Thomson Financial.

Up to 2004, pure venture capital yields in Europe were considerably lower than in the US, if we compare 10-year yields. However, in 2005, European 1-year yields more than doubled those in the US in this segment (although the volatility inherent in short-term yields should not be ignored).

Higher yields in pure venture capital in the USA in the past can be attributed to maturity on the part of the industry and its participants, who are more experienced in this type of investment.

Venture capital firms are devoting increasing time to searching for new investment opportunities, such as family firms approaching a generational hand-over or companies where a clear business opportunity is being ignored. However, it is increasingly difficult to gain exclusive access to this type of deal and competition within the industry has increased sharply. The result is a growing number of auctions in which venture capital firms compete for a given company.

In other cases, the target company initiates the process by seeking financial advisors to raise capital or sell a packet of shares in an auction process so as to maximise the price. This trend is rising and is not expected to change in the

11 Terms are counted backward from 31 December 2005; i.e. 1 year means from the end of 2004 to 31 December 2005, 3 years means from the end of 2002 to that date, etc.

future. The alternative approach is an IPO, but it has negative features such as the requirements, costs and obligations of stock market listing.

Growing competition coupled with surplus liquidity in this market is pushing up prices[12] for holdings and, consequently, heightening the risk of default.

## 4.3 Exit strategies

The success of an investment hinges basically on three factors: first, choosing the investment well; second, creating value; and third, realising that value, i.e. divesting in good conditions.

Even where a company has expanded significantly and increased in value since the venture capital investor bought in, the latter may lose if the divestment is made at the wrong time or in poor conditions. Most investors have a clear idea of how long they plan to invest in a company and how they will divest, although this may be more difficult to determine in the case of early-stage investments.

Divestment may be triggered by an influx of new funding into the industry. Divestments are often driven by the need to present real results with a view to raising additional funds.

The holding period for investments by private equity firms is slightly over 4 years in the case of established companies and over 5 years in the case of companies in the seed and start-up phase.

Secondary buyouts (SBOs), i.e. the sale to another private equity firm, are gaining in popularity throughout Europe. This raises the question of why one firm would sell part of its portfolio to another. Opinions vary widely within the industry. Some firms are wary of a rival offering to buy one of their investees. There is a logical conflict of interest between buyer and seller. Nevertheless, as in any market, the deal should be beneficial to both parties and both should fulfil their expectations.

Though a flotation is generally considered to be the ideal exit strategy, it is an infrequent one. There are many reasons why flotations are infrequent as an exit strategy: investors are not interested in buying into companies of this type, and there is also a lack of appropriate structures in the stock market to enable venture capitalists to divest.

The markets emulating NASDAQ that arose in Europe in the second half of the 1990s, such as EASDAQ, *Neuer Markt* and *Nouveau Marché*, experienced a slump in activity after a few years. One of these markets' weaknesses was the lack of market-makers and of analysts specialised in new companies.

EVCA has long called for the creation of a single European market for new and fast-growing companies to offer them an alternative source of finance and provide an attractive exit strategy for private equity investors. Europe suffers from market fragmentation, so it is not surprising that European companies seek a listing on NASDAQ. However, there has been an alarming decline in the number of private equity-driven flotations in the USA in recent years.

12 Prices are normally expressed as a multiple of EBITDA.

In May 2005, *Euronext* created *Alternext*, a market tailored for small and medium-sized enterprises which plans to expand gradually to cover the whole euro area. Other European bourses also have plans for alternative markets, such as *Deutsche Börse* and *OMX*. Spain has *Mercado Alternativo Bursátil* (MAB), where venture capital firms can list.

In January 2006, London's Alternative Investment Market (AIM) announced plans to expand to become a pan-European stock market for SMEs.

# 5 Buyouts

Buyouts generally involve buying a large stake in an established company. There are a variety of sub-types of buyout, all of which are generally leveraged (LBO): management buyout (MBO), management buy-in (MBI), BIMBO (combined MBO and MBI) and public to private deals (PtoP).

Debt is a key component of a buyout. The target is leveraged to enable the new shareholders to maximise their returns because of the positive effect of leverage and the fact that interest is tax deductible. It is assumed that the target company is profitable and that its profitability exceeds its cost of capital (very likely the case given current low interest rates).

Buyouts are a formula by which large business groups can restructure their businesses and shed unprofitable or non-strategic holdings. They are also used as a means of selling family firms, whether due to succession problems or to realise capital gains.

LBOs may also be used to acquire medium-sized or large listed companies with a view to delisting them.. The gains in a public-to-private deal arise basically from the benefits of private management, the discipline imposed by the bank that participates in the LBO, and the fact that the period to divestment (4-5 years) expedites implementation of the business plan. The new takeover regulations that will come into force shortly will make it easier to delist by allowing a shareholder with 90% of a company to force the other shareholders to sell (squeeze-out)[13].

Another source of gains and liquidity in an LBO is the target's real estate, although this is not generally the prime reason for the deal. It is normal for private equity firms to sell off an investee's real estate shortly after acquisition. The purpose is to raise cash and reduce debt; the property is normally sold and leased back.

Buyout structures are generally shaped by the target's debt-bearing capacity in relation to its total liabilities. However, given the ease with which credit can be obtained at present, it is normal to take on as much debt as the lending bank is willing to give. On this basis, once the required rate of return is established, the proportion of equity required to attain it is calculated.

The equity is provided by a number of investors, who may be the management team and one or more private equity firms, as well as the former shareholders and venture capitalists. Once the agreement is reached, the private equity investor negotiates with lenders and analyses the target's ability to generate sufficient predictable cash flow to service the debt.

13 Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.

The deal is structured by creating a special purpose vehicle which owns 100% of the target and whose liabilities consist of common and preference shares, convertible loans, senior debt (50%), and subordinated debt (15%), with equity accounting for at most 30%-35% of total liabilities. The current trend is for the percentage of equity to be lower. Not all buyouts involve subordinated debt, but in those which do (around 70%), it is observed to represent a growing proportion of total liabilities. There are two main types of subordinated debt, which are complementary: mezzanine and second lien.

## 5.1 Buyout deals in Spain

The Spanish buyout market has grown significantly since 2004, including a number of PtoP and MBO deals, with average deal size growing significantly. There were 48 buyouts in 2005, 41 of them involving private equity firms. The main buyouts in 2005 and 2006 are shown in table 6.

## Main buyout deals in Spain in 2005 and the first half of 2006

TABLE 6

| Year | Company | Business | Investor (s) | Significant shareholders | Amount (million euro) | Type [1] |
|---|---|---|---|---|---|---|
| **2005** | Auna Telecomunicación | Telecommunications | ONO, Candover, JP Morgan P, Thomas H. Lee P, Quadrangle Group LLC and Providence | Endesa, SCH and FENOSA | 2,251 | SBO |
| | Amadeus | Tourism | BC Partners and Cinven, Air France, Iberia and Lufthansa | Air France, Iberia and Lufthansa | 3,834 | PtoP |
| | Cortefiel | Garment retail | CVC Capital Partners, PAI Partners and Permira | Hinojosa family | 1,367 | PtoP |
| | Panrico | Food | Apax Partners | Costafreda family, La Caixa and Banco de Sabadell | 900 | Secondary |
| | Recoletos | Media | Providence, Mercapital, Investindustrial, Banesto, individual investors and management | Pearson | 856 | PtoP |
| | Mivisa | Packaging | CVC Capital Partners | PAI Partners and Suala Capital | 525 | Secondary |
| | Saprogal | Animal feed | Mercapital | Carlyle Group | 160 | Secondary |
| | Famosa | Toy manufacture | Vista Capital | AC Desarrollo, Inveralia, Torreal, CAM and management | 150 | Secondary |
| **2006** | Grupo Levantina | Stone | Impala Capital Partners and Charterhouse Capital Partners | Esteve, Martínez Pérez, Botí and Máñez families and a number of other shareholders | 500 | MBO |
| | Unión Española de Explosivos | Explosives | Ibersuizas, Vista Capital | Reef Investissements and BancBoston Capital, Sánchez Junco and others | 350 | MBO |
| | TALGO | Rolling stock | Lehman Brothers and MCH Private Equity | Oriol family | 180 | MBO |
| | La Sirena | Food | 3i | Ramona Solé, Joseph Mª Cernuda and Corporación Agrolimen | 150 | MBO |
| | Svenson | Hair care | Investindustrial | Nazca Capital | 121 | MBO Secondary |

1. MBO: Management Buyout. PtoP: Public to private.

# 6 Conclusions

The private equity business has expanded considerably in Europe in recent years, having peaked in 2000 in terms of funds raised and invested as a result of the tech bubble. The correction in the securities markets in 2001 and 2002 had a major impact on private equity. The sector has recovered since 2002, and it had surmounted the crisis by 2005. Worldwide, the industry is tending towards globalization.

Pension funds and banks are the main sources of funding for private equity in Europe. In Spain, financial institution are the main providers of funding to Spanish private equity firms, as three quarters of funds raised corresponded to pan-European funds investing in Spain (ASCRI data). In the USA, approximately 50% of funds are provided by pension funds.

Buyouts have traditionally predominated in Europe, since they offer the best combination of risk and return, whereas expansion projects predominated in Spain until 2005, when the volume of funds for buyouts exceeded that for expansion projects for the first time. This was due to a number of large leveraged deals in Spain by pan-European funds. In the US, pure venture capital is more highly developed than in Europe and offers better yields. In fact, NVCA does not even include buyouts in many of its statistics.

Because of the surplus liquidity in the industry, there is growing competition to acquire mature companies. This is raising the prices being paid for targets and also the risk of default.

The volume of divestments has also increased in recent years. Sale to third parties is the principal exit strategy in Spain and Europe generally. The main difference is that SBOs have generally been more predominant in other European countries than in Spain. IPOs are infrequent as an exit strategy both in Spain and Europe generally. In the US, whereas IPOs were long the standard exit strategy for pure venture capital firms, their number has declined drastically.

A number of European bourses have tried to encourage the use of IPOs as a venture capital exit strategy and are in the process of creating alternative markets for small- and mid-cap companies.

Finally, a distinction should be made between pure venture capital and buyouts. For the purpose of creating wealth in a country, it is important to foster pure venture capital investment, i.e. in start-ups or companies with strong growth potential. In contrast, leveraged buyouts of mature companies generate wealth for shareholders by using a large amount of bank debt. Banks are increasingly willing to finance buyouts.

# Mutual Fund Fees: Trends and Determinants

**Maribel Cambón Murcia (*)**

(*) Maribel Cambón Murcia is on the staff of the Studies and Statistics Directorate of the CNMV. This paper is a summary of CNMV Monograph no. 21, by the same author and with the same title.

# 1 Introduction

International surveys of trends in the fees borne by mutual funds reveal that they are substantially higher in Europe than in the USA, perhaps because of lower competitive pressure and the fact that Europe's markets are still fragmented; accordingly, there is significant room for further reduction in fees. Mutual fund fees have fallen sharply in recent years, but perhaps not enough in comparative terms.

An analysis of mutual fund fees (i.e. the price that investors must pay to invest in such a vehicle and benefit from professional management of these financial instruments) is important insofar as it may provide some clues about the demand and supply curves and, therefore, the nature of this market. For example, regarding the supply curve, some of the variables may provide information about mutual funds' cost structures and their impact on their final prices. And the supply curve will give a picture of the marginal value that investors attribute to the services provided by the collective investment industry.

The analysis is also relevant from the standpoint of the regulator, who is interested in the conditions for effective competition in this market which, by its very nature, has a number of major sources of frictions such as information asymmetry and the possibility that certain financial institutions may be able to exert a degree of market power.

This paper analyses trends in Spanish mutual fund management and custody fees in 2000, 2004 and 2005 and the factors shaping those fees. A preliminary statistical analysis is performed followed by an econometric estimate of the relationship between mutual fund management and custody fees[1], on the one hand, and: (i) the size of the fund and its manager, (ii) the average investment, (iii) the type of investor (retail or institutional), (iv) the group to which the manager belongs, and (v) the age of the fund. Following a quantitative analysis, the factors driving mutual fund fees in Spain are summarised, with particular emphasis on the factors that may have prevented them from falling further: the configuration of Spain's financial system and possible deficiencies in the dissemination of information, either in the fund marketing company or in the CNMV. Finally, some measures are proposed in the context of the regulatory framework and the framework of supervision and training by the CNMV that might address the inefficiencies in this market and would, ultimately, improve resource allocation and price formation.

1 Together they account for 98% of the total fees charged to mutual funds.

## 2 Data Bases and Processing

The data were obtained from mutual fund prospectuses registered at the CNMV, whose content is incorporated into the CNMV's own data base, managed by the Directorate of Research and Statistics. The main statistical factors to be considered are as follows:

a) Mutual funds registered after the month of September were eliminated from the sample for that year since they did not have data for a full quarter; also eliminated were master funds (so as not to count assets twice) and funds with abnormal returns.

b) Master and feeder funds. Master fund fees were allocated to feeder funds in accordance with the ratio of the feeder fund's assets to those of the master fund. Master funds were then eliminated from the sample. In the case of master and feeder funds that were less than one year old, the master funds' annualised fees or the fees stated in the prospectus were allocated among the feeder funds (depending on the number of full quarters for which data were available).

c) Funds less than one year old. A distinction is made between: (i) funds with data for more than one full quarter but less than two, and (ii) funds with full data for two or more quarters. In the former, the fee stated in the prospectus was used instead of the actual fee, and the returns were corrected by a factor reflecting the funds' investment policy. In the latter case, the fee was annualised and corrected by a factor reflecting the funds' investment policy.

d) To analyse funds on the basis of the size of the average investment, all funds with less than 100 investors at year-end were excluded. Those numbers were normally due to temporary situations (funds starting or closing down) and, therefore, their assets and investor numbers would not be representative and would distort the results.

e) Funds whose fees exceeded the maximum permitted rate at the time. If the deviation were minor (0.03%, or 3,000 euro in absolute terms), no change was made (in line with the approach applied by the CNMV's Directorate of Supervision). If the deviation arose from the combination of fees (% of assets + % of returns), the figure was not modified. If it was due to fund mergers, the fees in the post-merger prospectuses were used. If it was due to errors in the fund manager's regulatory filings, estimates were made or the prospectus fee schedule was used (depending on the type of error).

# 3 Trend in Aggregate Fees in each Fund Category

In recent years, both FIM (securities funds) and FIAMM (money market funds) have steadily reduced their management fees as a percentage of average daily assets. In the years considered in this paper (2000, 2004 and 2005), after correcting the data base as described above, the average securities fund fee is estimated at 1.48% of assets in 2000, falling to 1.24% in 2004 and 1.22% in 2005 (table 1). Money market fund fees (as a percentage of assets) declined from 1.05% in 2000 to 0.87% in 2004 and 0.85% in 2005.

**Management fees as a percentage of average daily assets, broken down by fund investment policy** TABLE 1

%

| Fund category | 2000 | 2004 | 2005 | % chg 04/00 | % chg 05/04 |
|---|---|---|---|---|---|
| Short-term fixed-income (RFCP) | 1.10 | 0.70 | 0.61 | -36.5 | -13.4 |
| Long-term fixed-income (RFLP) | 1.22 | 1.18 | 1.15 | -3.4 | -2.8 |
| Mixed fixed-income (RFM) | 1.44 | 1.37 | 1.25 | -5.1 | -8.4 |
| Mixed equity (RVM) | 1.69 | 1.80 | 1.81 | 6.4 | 0.5 |
| Spanish equity (RVN) | 1.88 | 1.84 | 1.83 | -2.4 | -0.3 |
| Foreign fixed-income (RFI) | 1.46 | 0.97 | 1.06 | -33.8 | 9.8 |
| Foreign mixed fixed-income (RFMI) | 1.54 | 1.47 | 1.52 | -4.3 | 3.0 |
| Foreign mixed equity (RVMI) | 1.83 | 1.46 | 1.60 | -20.0 | 9.5 |
| Euro equity (RVE) | 1.85 | 1.87 | 1.89 | 1.4 | 1.0 |
| Foreign equity (RVI) | 1.94 | 1.79 | 1.96 | -7.5 | 9.2 |
| Guaranteed fixed income (GRF) | 1.13 | 0.85 | 0.78 | -25.2 | -8.1 |
| Guaranteed equity (GRV) | 1.37 | 1.44 | 1.39 | 4.9 | -3.6 |
| Global funds (FGL) | 1.34 | 1.26 | 1.42 | -6.0 | 12.3 |
| Foreign equity Europe (RVIE) | - | 1.85 | 2.01 | - | 8.9 |
| Foreign equity Japan (RVIJ) | - | 1.82 | 2.00 | - | 9.8 |
| Foreign equity USA (RVIU) | - | 1.79 | 1.76 | - | -1.6 |
| Foreign equity emerging countries (RVIM) | - | 1.99 | 2.66* | - | 33.8 |
| Other foreign equity (RVIO) | - | 1.71 | 1.78 | - | 3.9 |
| **Total FIM** | **1.48** | **1.24** | **1.22** | **-16.3** | **-1.6** |
| FIAMM | 1.05 | 0.87 | 0.85 | -16.9 | -3.1 |
| **All funds** | **1.40** | **1.14** | **1.13** | **-18.6** | **-0.7** |

Source: CNMV and author.

* The average fee exceeded the legal limit (2.25%) because this group of funds includes a large proportion of funds with hybrid fees, i.e. part is charged on assets (generally 1.35%) and part on returns (generally 9%).

However, there are important differences in the fee levels and trends depending on a fund's investment policy. In general, fixed-income funds charge lower fees, and equities funds are the most expensive class. As for the trend over time, although fees generally declined as a percentage of assets between 2000 and 2005,

the reduction was much stronger in fixed-income funds (particularly short-term funds), guaranteed funds, international funds and money market funds. Fees charged by funds with a larger equity component (i.e. global funds, euro equities funds and mixed funds) declined by much less.

Custody fees have followed slightly different trends over time. Although the average fee charged by these funds was relatively low as a percentage of the legal maximum between 2000 and 2005, it remained practically stable overall in the case of both securities funds and money market funds. Aggregate average custody fees for securities funds fell from 0.11% of average daily assets in 2000 to 0.10% in 2004 and 2005, while in the case of money market funds, where these fees are somewhat higher, the average custody fee increased slightly, from 0.10% in 2000 to 0.11% of assets in 2004 and 2005. Unlike the case of management fees, no systematic difference was observed between fund categories.

**Custody fees as a percentage of average daily assets, broken down by fund investment policy** TABLE 2

%

| Fund category | 2000 | 2004 | 2005 | % chg 04/00 | % chg 05/04 |
|---|---|---|---|---|---|
| Short-term fixed-income (RFCP) | 0.15 | 0.09 | 0.08 | -39.6 | -4.5 |
| Long-term fixed-income (RFLP) | 0.13 | 0.11 | 0.12 | -11.8 | 1.6 |
| Mixed fixed-income (RFM) | 0.14 | 0.13 | 0.13 | -4.7 | -2.6 |
| Mixed equity (RVM) | 0.10 | 0.12 | 0.13 | 21.9 | 3.5 |
| Spanish equity (RVN) | 0.07 | 0.11 | 0.08 | 47.4 | -29.1 |
| Foreign fixed-income (RFI) | 0.14 | 0.09 | 0.10 | -34.6 | 7.0 |
| Foreign mixed fixed-income (RFMI) | 0.11 | 0.13 | 0.11 | 19.8 | -10.3 |
| Foreign mixed equity (RVMI) | 0.10 | 0.10 | 0.10 | 5.6 | -7.5 |
| Euro equity (RVE) | 0.06 | 0.11 | 0.11 | 79.4 | -0.4 |
| Foreign equity (RVI) | 0.08 | 0.13 | 0.13 | 60.8 | -4.8 |
| Guaranteed fixed income (GRF) | 0.13 | 0.09 | 0.09 | -28.0 | 0.9 |
| Guaranteed equity (GRV) | 0.10 | 0.11 | 0.11 | 5.3 | 2.8 |
| Global funds (FGL) | 0.10 | 0.08 | 0.09 | -15.5 | 10.5 |
| Foreign equity Europe (RVIE) | - | 0.13 | 0.13 | - | -0.9 |
| Foreign equity Japan (RVIJ) | - | 0.14 | 0.14 | - | 1.3 |
| Foreign equity USA (RVIU) | - | 0.16 | 0.16 | - | -1.5 |
| Foreign equity emerging countries (RVIM) | - | 0.14 | 0.14 | - | -2.2 |
| Other foreign equity (RVIO) | - | 0.13 | 0.12 | - | -11.3 |
| **Total FIM** | 0.11 | 0.10 | 0.10 | -7.0 | 0.1 |
| FIAMM | 0.10 | 0.11 | 0.11 | 7.6 | -3.5 |
| **All funds** | 0.11 | 0.11 | 0.10 | -3.7 | -1.1 |

Source: CNMV and author.

## 3.1 Trends in management and custody fees depending on the size of the fund and its manager

### 3.1.1 Fund size

The universe of funds was divided into two large groups: firstly, the funds were sorted in descending order of size. The largest funds that amounted to 50% of total assets were assigned to one group, and the remainder to the other. In most fund

categories, management fees were generally lower in the smaller funds in both 2000 and 2004, with no major differences between fund types (apart from some exceptions). This suggests that the scale economies attained by the larger funds were not passed on as lower fees, apart from some exceptions, in those years. The conclusions for 2005 are different.

An analysis of custody fees reveals different results depending on the year. In 2000, average custody fees were lower at the larger funds (both generally and by fund type). However, this conclusion does not hold for 2004 or 2005.

#### 3.1.2 Manager size

Fund managers were also sorted in descending order of size (i.e. of managed assets). The top group, which together represented 50% of total assets, were assigned to the *large* category; those next in line up to 80% of total assets were assigned to the *mid-sized* category, and the remainder to the *small* category. In general, *small* fund managers charge the lowest fees, followed by *medium-sized* managers; the *large* managers charged the largest fees in 2000 and 2004. No such conclusions can be drawn in 2005. The analysis of custody fees in connection with manager size provides different conclusions depending on the year (negative relationship in 2000, positive relationship in 2004 and 2005).

### 3.2 Trend in management and custody fees depending on size of individual investments

This analysis seeks to determine whether or not larger investors are being rewarded either through lower fees (management and/or custody) or higher yields (if they are being offered better funds because they are "preferred clients"). To this end, the funds in each category were sorted in descending order according to the ratio of assets/investor, and they were divided into four quartile according to the accumulated percentage of assets in each fund category (quartile 1: 0-25%, quartile 2: 25%-50%, quartile 3: 50%-75%, quartile 4: 75%-100%).

In practically all fund categories, quartile 1 fees were systematically lower than the average for the fund category in each of the periods analysed (figure 1). Moreover, the "discount" offered to larger investors increased over time, from 0.4 percentage points in 2000 to 0.7 points in 2005. A preliminary analysis suggests, therefore, that fund managers are rewarding investors of larger amounts over time with a lower fee, but there are upward and downward fluctuations between fund types without any clear trend or distinction (e.g. between equities and fixed-income).

An analysis of custody fees also reveals that in quartile 1 funds they are lower than the category average, but the conclusion is less significant than in the case of management fees for two reasons: (i) there is a larger number of categories in which this conclusion does not hold, and (ii) custody fees are, by definition, much lower than management fees, so that the divergences from the mean are very small in absolute terms.

**Average management fees as a percentage of average daily assets/investor: divergence from the mean in each fund category (%)** FIGURE 1

Source: CNMV and author.

### 3.3 Trend in management and custody fees depending on the management group

In this case, the sample was divided into three classes on the basis of the nature of the group to which the fund manager belongs: bank, savings bank, and other[2]. The goal is to analyse any differences in management and custody fees between the various classes of financial groups[3].

In terms of management fees, the most competitive funds fall under the "Other" group (i.e. not belonging to investor-owned banks or the mutual savings banks) in all years; however, the size of the discount has declined gradually (figure 2). They are normally small independent investment services firms. The savings banks occupy the middle ground. The number of categories of FIM (securities funds) in which their fees are below average increased over time in the study period, as did their size (the situation is somewhat different in the case of money market funds). The investor-owned banks are the least competitive. The only exception is a slight discount that they offer in short-term fixed-income funds and in money market funds because of the size of these categories in absolute terms. In securities funds overall, the banks' fees went from being in line with the average in 2000 to being almost 0.05 percentage points higher.

The savings banks gained market share in securities funds between 2000 and 2005, while the banks lost market share slightly. Independent firms did not improve their share notably. There were practically no changes in market share in money market funds. Although the slight gain by the savings banks could be attributed to more aggressive fee policies, the decline in the banks' market share is very small (they manage about two-thirds of the industry's funds).

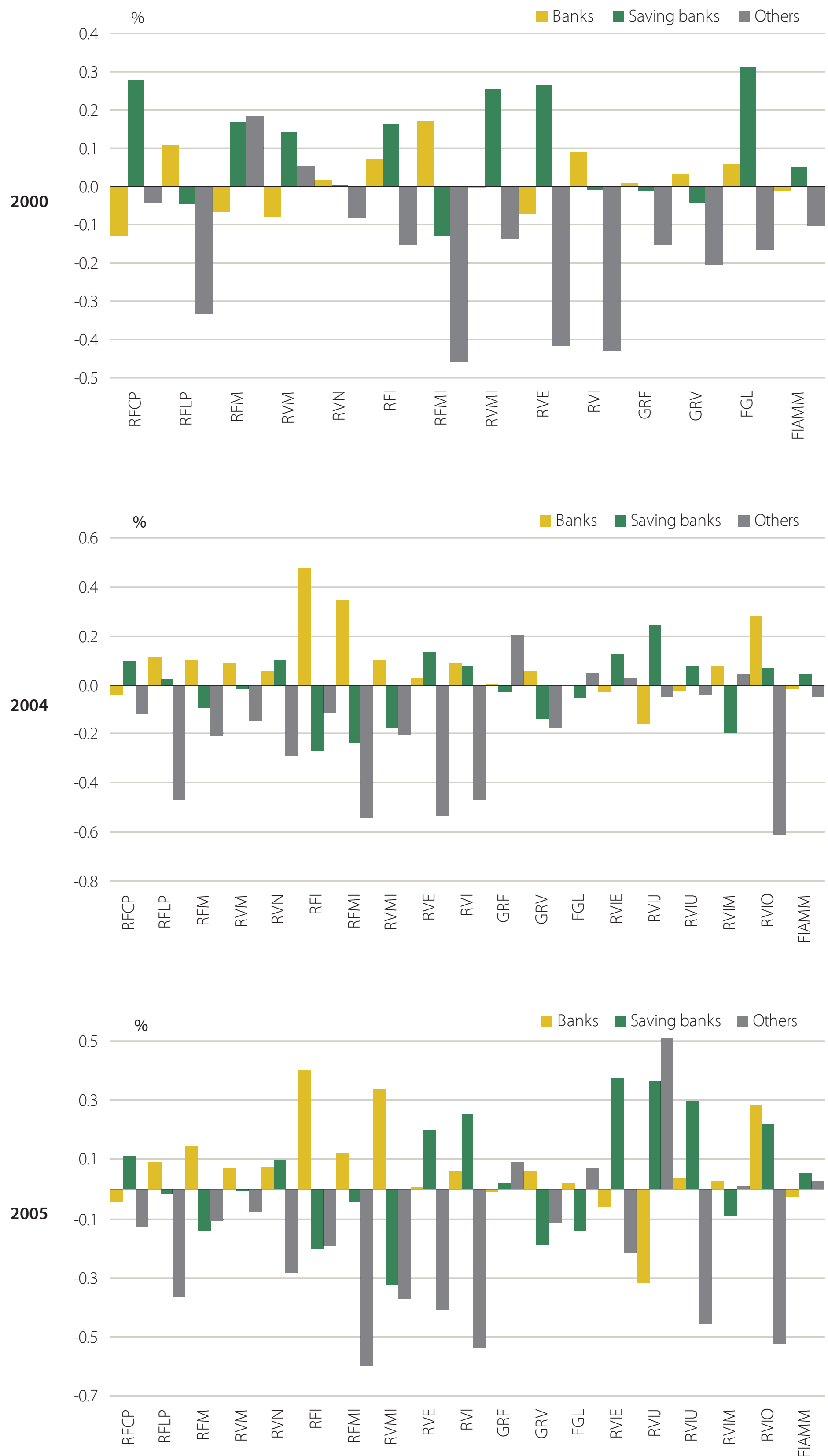
This pattern is also observed in custody fees: although the banks were somewhat competitive in 2000, the situation changed radically in 2004 and 2005, when both independent firms and savings banks charged below-average fees in both securities and money market funds.

2 Broker-dealers, brokers, insurance companies, credit cooperatives, non-financial companies and other entities.

3 The monograph of reference includes individual calculations for each of the top five financial groups (which account for 60% of total assets): the top 2 are banks, the next 3 savings banks.

## Average management fees as a percentage of average daily assets by finance group: divergence from the mean in each fund category (%)

FIGURE 2




Source: CNMV and author.

### 3.4 Trend in management and custody fees depending on investor classification

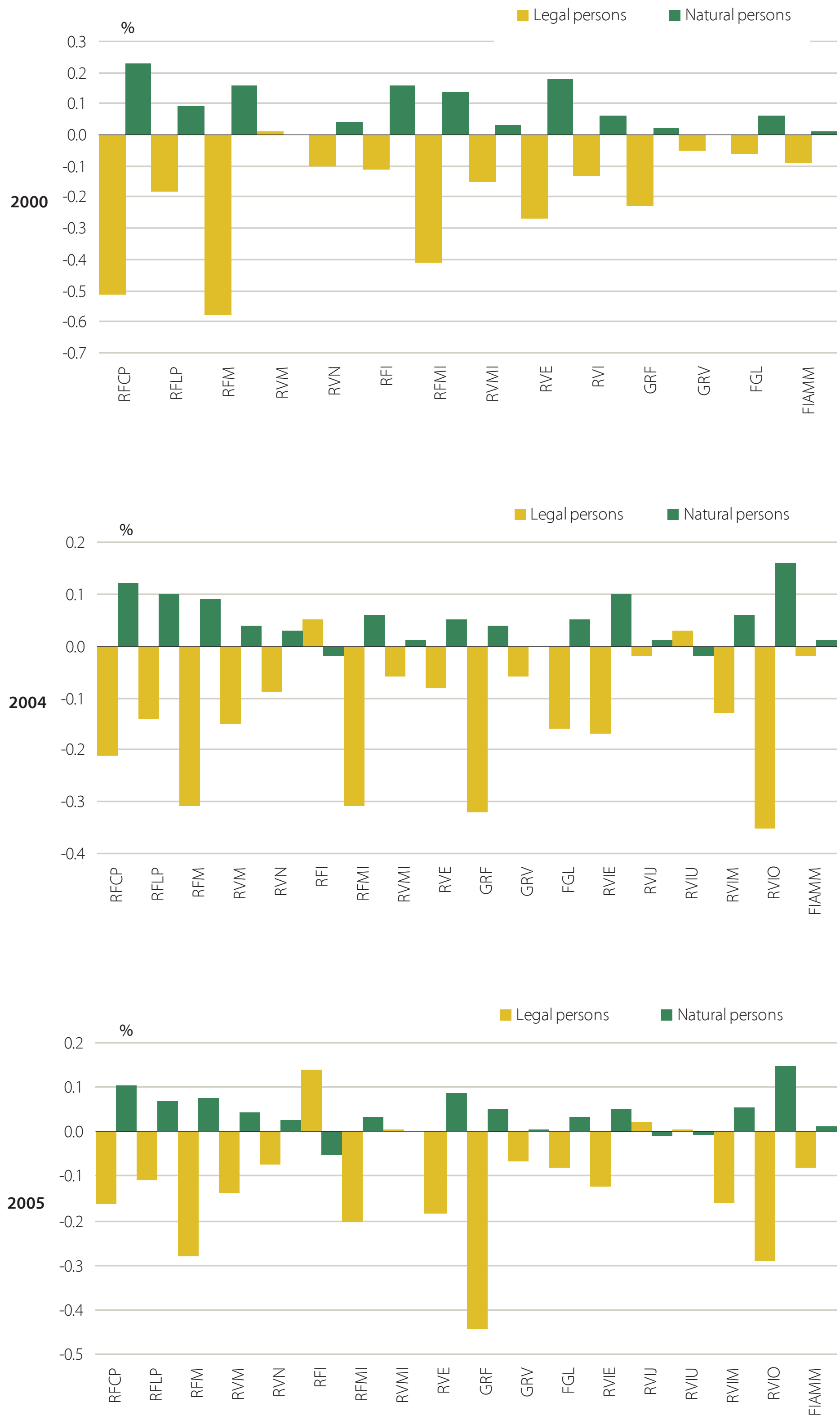
This section investigates whether there are notable differences depending on the type of investor, which might indicate discrimination on the part of fund marketers or greater acumen on the part of a given class of investor. The available statistics offer a very broad range of investor categories; for simplicity, this has been reduced to two categories: natural persons and legal persons. The analysis adopts two different approaches. Firstly, funds were divided into three groups on the basis of their target client: i) institutional clients, ii) retail clients, iii) both. This classification uses an objective indicator based on specialisation coefficients. Secondly, two portfolios were considered: one for natural persons and the other for legal persons. The portfolio consist of all the assets invested in the various funds.

The first approach reveals that funds targeted at legal persons generally charge lower fees than those targeted at natural persons, in all three years of the study. Funds with no specific focus ("both") show no clear pattern. The differences in fees between these groups of funds have been accentuated over time, and they are smaller in the case of money market funds. Custody fees follow a similar pattern but the differences are smaller.

The second approach reaches similar conclusions: the aggregate portfolio of legal persons has lower fees than the aggregate portfolio of natural persons in all three years, both overall and by individual fund category (figure 3). The discount enjoyed by legal persons increased slightly over time during the study period while the surcharge suffered by natural persons was practically unchanged. Whereas aggregate custody fees in securities funds and money market funds are lower for legal persons and higher for natural persons, there are many individual fund categories where this is not the case.

## Average management fees as a percentage of average daily assets: portfolio of natural persons and legal persons: divergence from the mean for each fund category

FIGURE 3




Source: CNMV and author.

## 3.5 Trend in management and custody fees depending on the age of the fund

This section shows the results of segmenting mutual funds on the basis of their age. Subsets were formed in a similar way to the analysis of investment/fund: the sample of funds in each category is ranked by age and divided into quartiles on the basis of asset volume: quartile 1 contains the oldest funds, quartile 4 the most recent.

A positive relationship is observed between fund age and management fees in 2000, 2004 and 2005. This clashes with the "learning curve" idea, according to which accumulated experience (of market and internal operations, analysis, etc.) should enable a fund manager to reduce its fees. That this does not hold may indicate that some investors prefer older funds, even if they are more expensive, or that some investors bought into mutual fund some time ago and are unaware of the newer funds' lower fees (or have difficulties in ascertaining this fact). The largest differences are found in short-term fixed-income, mixed equities and international mixed fixed-income funds, as well as some international equities funds in 2005. The fee differences between the oldest and newest funds exceed 1 percentage point in some cases.

No clear pattern is observed in custody fees in 2000 in the case of securities funds, whereas there is a slight positive correlation between fees and fund age in 2004 and 2005. Money market funds show no clear pattern throughout the study period.

# 4 Econometric Study

To cross-check the main conclusions from the foregoing descriptive analysis, the factors shaping mutual funds' management and custody fees were estimated and modelled using two different econometric techniques.

## 4.1 Tobit model

Since the dependent variable (management fee or custody fee, as the case may be) is subject to upper and lower bounds established by law and, therefore, can be taken as a censured variable, the best approach is to estimate the regression using a heteroskedastic Tobit model. The proposed model is as follows:

$$\begin{cases} y_i = \alpha + \beta' x_i + u_i & \text{if } \underline{y} < y_i < \overline{y} \\ y_i = \overline{y} & \text{if } y_i > \overline{y} \\ y_i = \underline{y} & \text{if } y_i < \underline{y} \end{cases}$$

where:

$y_i$ is the decision on the management or custody fee,

$\overline{y}$ is the maximum legal fee:

| Securities funds | 2000 | 2004 | 2005 |
|---|---|---|---|
| Management fee | 2.5% until June and 2.25% thereafter[4] | 2.25% | 2.25% |
| Custody fee | 0.40% | 0.20% | 0.20% |

$\underline{y}$ is the minimum legal fee (0% of assets or returns),

$\beta'$ is a vector of unknown parameters, with dimension k,

$x_i$ is a vector that contains all the explanatory variables in the decision to set the management or custody fee (see next box) after correcting for the existing multi-colinearity, and

$u_i$ are the model's residuals, which have a normal distribution with mean of zero and standard deviation $\sigma_i$.

The main advantage of this model is that it can handle the decision not to charge a fee or to charge the legal maximum, but its main drawback is that it does not allow observations to be weighted, thus undervaluing the observations with the largest assets.

4 In the Tobit model, the maximum management fee was taken as the higher of the two levels allowed that year, i.e. 2.5%.

## 4.2 Ordinary Least Squares with error weighting

As an alternative, the Ordinary Least Squares method (using the standard representation of $y_i = \alpha + \beta' x_i + u_i$) was used to estimate the linear function while weighting errors by fund assets, where:

$y_i$ is the decision on the management or custody fee,

$\beta'$ is a vector of unknown parameters, with dimension k,

$x_i$ is a vector that contains all the explanatory variables in the decision to set the management or custody fee (see next box) after correcting for the existing multi-colinearity, and

$u_i$ are the model's residuals, which have a normal distribution with mean of zero and standard deviation $\sigma_i$.

This model has some limitations, e.g. that estimates may be inconsistent[5], but it has the advantage of allowing observations to be weighted (by fund assets, in this case).

Description of the explanatory variables:

| | |
|---|---|
| ACTF | Natural logarithm of the fund's average daily assets |
| ACTG | Natural logarithm of the average daily assets of the fund's manager |
| APOPARTF | Natural logarithm of the funds quotient (average daily assets/number of investors) |
| APOPARTG | Natural logarithm of the managers' quotient (average daily assets/number of investors) |
| BANCO | Dummy =1 if the fund is managed by a firm owned by a bank |
| CAJA | Dummy =1 if the fund is managed by a firm owned by a savings bank |
| CUOTA | Ratio between average daily assets and total daily assets in the fund's category |
| EDAD | Natural logarithm of the number of years elapsed since the fund was created |
| INSTIT | Dummy =1 if the fund is oriented principally towards institutional investors |
| MINOR | Dummy =1 if the fund is oriented principally towards retail investors |
| RENT | The fund's net average return in the year |
| CG | Control variable (actual average annual management fee) |
| CD | Control variable (actual average annual custody fee) |
| RFCP | Short-term fixed-income |
| RFLP | Long-term fixed-income |
| RFM | Mixed fixed-income |
| RVM | Mixed equity |
| RVN | Spanish equity |
| RFI | Foreign fixed-income |
| RFMI | Foreign mixed fixed-income |
| RVMI | Foreign mixed equity |
| RVE | Euro equity |
| RVI | International equity |
| GRF | Guaranteed fixed income |
| GRV | Guaranteed equity |

5 As reported by Loucks (1994), Chou & Cebula (1996), Greene (2000) and Maddala y Nelson (1975).

### 4.3 Results

In general terms, the results of the econometric study are quite coherent with the conclusions from the foregoing analysis although, given the range of issues considered, it is not easy for a single-equation test to reflect, with a sufficient level of statistical significance, all the nuances of the descriptive analysis that was conducted by isolating individual factors. Nevertheless, the degree of coherence is reasonable although there are results which vary in degree and some which are contradictory.

Tables 3 and 4 compare the results of the estimates with the two proposed models.

**Econometric analysis of the factors determining securities fund management fees: sign of estimated coefficient p-value** TABLE 3

%

| | Tobit | | | Regression with weighted observations | | |
|---|---|---|---|---|---|---|
| | 2000 | 2004 | 2005 | 2000 | 2004 | 2005 |
| C | (+) 0.00 | (+) 0.00 | (+) 0.00 | (+) 0.00 | (+) 0.58 | (+) 0.09 |
| ACTF | (+) 0.00 | (+) 0.30 | (-) 0.01 | (+) 0.16 | (+) 0.02 | (-) 0.48 |
| ACTG | (+) 0.16 | (-) 0.07 | (+) 0.00 | (-) 0.36 | (-) 0.84 | (+) 0.06 |
| APOPARTF | (-) 0.00 | (+) 0.49 | (-) 0.00 | (-) 0.00 | (-) 0.44 | (-) 0.00 |
| APOPARTG | (+) 0.01 | (-) 0.00 | (-) 0.46 | (-) 0.81 | (-) 0.46 | (+) 0.07 |
| BANCO | (-) 0.64 | (+) 0.06 | (+) 0.93 | (+) 0.03 | (+) 0.53 | (-) 0.18 |
| CAJA | (+) 0.91 | (+) 0.66 | (-) 0.02 | (+) 0.08 | (-) 0.80 | (+) 0.52 |
| CUOTA | (-) 0.14 | (-) 0.30 | (+) 0.73 | (+) 0.32 | (-) 0.18 | (+) 0.05 |
| EDAD | (+) 0.00 | (+) 0.00 | (+) 0.00 | (-) 0.82 | (+) 0.00 | (-) 0.17 |
| INSTIT | (+) 0.97 | (-) 0.24 | (+) 0.87 | (-) 0.56 | (-) 0.91 | (-) 0.16 |
| MINOR | (-) 0.67 | (+) 0.19 | (+) 0.63 | (+) 0.63 | (+) 0.07 | (-) 0.16 |
| RENT | (+) 0.04 | (-) 0.01 | (+) 0.00 | (+) 0.95 | (+) 0.64 | (-) 0.21 |
| CD | (-) 0.03 | (+) 0.00 | (+) 0.00 | (-) 0.03 | (+) 0.76 | (+) 0.00 |
| RFCP | (-) 0.00 | (-) 0.00 | (-) 0.00 | (-) 0.00 | (-) 0.42 | (+) 0.10 |
| RFLP | (-) 0.01 | (-) 0.07 | (+) 0.00 | (-) 0.01 | (+) 0.38 | (+) 0.01 |
| RFM | (-) 0.19 | (+) 0.46 | (+) 0.00 | (-) 0.07 | (-) 0.17 | (+) 0.25 |
| RVM | (+) 0.16 | (+) 0.00 | (+) 0.00 | (+) 0.89 | (+) 0.04 | (+) 0.00 |
| RVN | (+) 0.04 | (+) 0.00 | (+) 0.00 | (+) 0.72 | (+) 0.00 | (+) 0.00 |
| RFI | (+) 0.98 | (+) 0.63 | (+) 0.03 | (+) 0.83 | (-) 0.35 | (-) 0.16 |
| RFMI | (+) 0.93 | (-) 0.90 | (+) 0.02 | (-) 0.04 | (+) 0.03 | (+) 0.09 |
| RVMI | (+) 0.01 | (+) 0.21 | (+) 0.01 | (-) 0.51 | (-) 0.00 | (+) 0.09 |
| RVE | (+) 0.00 | (+) 0.00 | (+) 0.00 | (-) 0.88 | (+) 0.00 | (+) 0.01 |
| RVI | (+) 0.00 | (+) 0.00 | (+) 0.00 | (-) 0.38 | (+) 0.11 | (+) 0.02 |
| GRF | (-) 0.00 | (-) 0.00 | (-) 0.00 | (-) 0.00 | (-) 0.00 | (-) 0.31 |
| GRV | (-) 0.00 | (+) 0.12 | (+) 0.00 | (-) 0.00 | (-) 0.26 | (+) 0.01 |

**Econometric analysis of the factors determining securities fund custody fees: sign of estimated coefficient and p-value** TABLE 4

%

| | Tobit | | | Regression with weighted observations | | |
|---|---|---|---|---|---|---|
| | 2000 | 2004 | 2005 | 2000 | 2004 | 2005 |
| C | (+) 0.00 | (+) 0.00 | (+) 0.00 | (+) 0.00 | (+) 0.00 | (-) 0.13 |
| ACTF | (+) 0.49 | (+) 0.27 | (+) 0.33 | (+) 0.72 | (+) 0.09 | (+) 0.05 |
| ACTG | (+) 0.69 | (+) 0.20 | (+) 0.00 | (-) 0.34 | (+) 0.04 | (+) 0.39 |
| APOPARTF | (-) 0.00 | (-) 0.00 | (+) 0.00 | (-) 0.00 | (-) 0.00 | (+) 0.67 |
| APOPARTG | (-) 0.04 | (-) 0.03 | (+) 0.71 | (-) 0.03 | (-) 0.05 | (-) 0.03 |
| BANCO | (+) 0.78 | (+) 0.75 | (+) 0.05 | (-) 0.75 | (+) 0.86 | (+) 0.02 |
| CAJA | (-) 0.05 | (+) 0.44 | (+) 0.48 | (-) 0.31 | (+) 0.85 | (-) 0.54 |
| CUOTA | (-) 0.00 | (+) 0.65 | (+) 0.93 | (-) 0.00 | (+) 0.10 | (-) 0.00 |
| EDAD | (+) 0.00 | (+) 0.00 | (+) 0.04 | (+) 0.00 | (+) 0.03 | (+) 0.00 |
| INSTIT | (+) 0.33 | (+) 0.60 | (+) 0.00 | (+) 0.87 | (-) 0.02 | (+) 0.35 |
| MINOR | (+) 0.43 | (+) 0.19 | (+) 0.11 | (+) 0.37 | (-) 0.23 | (+) 0.15 |
| RENT | (+) 0.15 | (+) 0.95 | (+) 0.31 | (+) 0.89 | (+) 0.17 | (+) 0.58 |
| CD | (-) 0.23 | (+) 0.00 | (+) 0.00 | (-) 0.03 | (+) 0.75 | (+) 0.00 |
| RFCP | (+) 0.88 | (+) 0.32 | (+) 0.18 | (-) 0.22 | (+) 0.93 | (-) 0.04 |
| RFLP | (+) 0.82 | (+) 0.22 | (+) 0.01 | (-) 0.00 | (-) 0.49 | (-) 0.61 |
| RFM | (+) 0.97 | (+) 0.62 | (+) 0.89 | (-) 0.15 | (+) 0.92 | (+) 0.03 |
| RVM | (+) 0.85 | (+) 0.86 | (+) 0.57 | (-) 0.00 | (+) 0.92 | (+) 0.88 |
| RVN | (-) 0.00 | (-) 0.32 | (+) 0.42 | (-) 0.00 | (-) 0.40 | (-) 0.72 |
| RFI | (+) 0.03 | (+) 0.03 | (+) 0.51 | (+) 0.77 | (+) 0.29 | (+) 0.00 |
| RFMI | (+) 0.08 | (+) 0.67 | (-) 0.21 | (-) 0.66 | (-) 0.16 | (+) 0.90 |
| RVMI | (+) 0.99 | (-) 0.03 | (-) 0.18 | (-) 0.05 | (-) 0.02 | (+) 0.89 |
| RVE | (-) 0.52 | (+) 0.13 | (+) 0.38 | (-) 0.00 | (+) 0.94 | (+) 0.49 |
| RVI | (-) 0.01 | (+) 0.77 | (+) 0.58 | (-) 0.01 | (-) 0.11 | (+) 0.33 |
| GRF | (+) 0.71 | (-) 0.12 | (-) 0.13 | (-) 0.01 | (-) 0.71 | (+) 0.09 |
| GRV | (-) 0.00 | (-) 0.01 | (-) 0.01 | (-) 0.01 | (-) 0.57 | (+) 0.75 |

In the case of the management fees, the Tobit estimate obtains a larger number of significantly non-zero coefficients[6] than the regression estimate, and with the expected sign, but it displays some deficiencies in certain variables where asset weighting is particularly important (e.g. type of client). The relationships which it captures best are those related to average investment by investor and the age of the fund. As for custody fees, the Tobit estimation obtains a smaller number of significantly non-zero coefficients than the regression, and with the opposite to the expected sign. Estimates with the weighted regression are more satisfactory overall.

6 Two references were taken for significance: 5% and 10%.

# 5 Analysis of the Reasons for the Results

The following are some of the factors that may have influenced the trend in Spanish mutual funds' management and custody fees:

- Reduction of the maximum fees permitted by law. The last change in the maximum legal management fees for securities funds (FIM) and money market funds (FIAMM) took place in 2000, and the cap on FIM custody fees was reduced somewhat later (April 2001). The reduction in the maximum rates was one of the main factors affecting the widespread reduction in fees in recent years (particularly management fees), primarily at the beginning of the study period (2000 and 2001).
- Macroeconomic situation of low interest rates. Nominal convergence of the Spanish economy with that of the euro area in the late 1990s included a sharp structural reduction in interest rates. The decline and subsequent stabilisation of interest rates had notable consequences for gross returns on a significant number of fixed-income mutual funds, particularly the shorter-term ones (RFCP and FIAMM), which were forced to cut fees in an attempt to continue appealing to investors. Nevertheless, it should be noted that the net yield (gross yield less fees) on a significant proportion of funds barely exceeded Spain's inflation rate in recent years, and this is a factor that might erode investment in mutual funds in the medium term if a significant number of investors seek alternative financial instruments.
- A degree of competition in the sector. According to the preceding analysis, competition (understood as more aggressive pricing) is being provided only by the independent firms and, more recently, by the savings banks (to an extent). However, this has not yet led to a significant increase in their market share.

Although it could be argued that these are the reasons for the decline in mutual fund fees in recent years, a number of commentators consider the decline to be insufficient and state that fees would be much lower if there were real competition.

International studies of mutual fund fees confirm generally that the fees borne in Spain (TER) are higher than in the main European countries (apart from Italy) and, of course, than in the USA[7]. Other interesting studies highlight the significant difference between US and European fund fees; the latter are significantly higher because of the existence of many fragmented markets as well as a range of different marketing practices, competitive pressures and tax systems[8]. Below are

7 Cf. Ajak Khorana, Henri Servaes & Meter Tufano, 2005, "Mutual Funds Fees Around the World".

8 Lipper, 2005, "A Comparison of Mutual Fund Expenses Across The Atlantic".

discussed some of the factors that may have limited the decline by Spanish mutual fund fees and are leading to inefficiencies in the assignment of financial resources by investors.

### 5.1 Spain’s banking tradition and the reputation factor

The high degree of concentration among fund managers, many of them owned by the country's big banks, has a significant impact on Spanish mutual fund fees. The big banks are deeply rooted in Spain's financial culture and have a base of customers who are not willing to transfer their investments to more competitive firms because they are accustomed to centralising all their financial transactions at a single institution (which provides a broad range of financial services). Investors are also reluctant to change their investment manager because they rely on their institution's reputation, i.e. they prefer to pay more for products on the grounds that they have more assurance due to the backing of broad-based, highly-experienced and skilled institutions. These investors are "voluntary captives".

Financial institutions' policies for marketing investment products are particularly important in this context. The foregoing analysis reveals that pricing varies depending on the type of client that the institutions see in the marketplace. Broadly speaking, whether because they invest more or are institutional clients or invest in international products, more sophisticated clients are rewarded with lower fees. Less sophisticated clients (generally retail or small investors) and those with greater difficulties in obtaining or understanding financial information generally pay higher mutual fund fees.

### 5.2 Deficiencies in information dissemination

Connecting with the comments in the preceding section, deficiencies in information distribution are of great importance since they cause investors to become "involuntary captives" of certain institutions. There are investors who, if they were aware that similar investment products to those in their portfolios are available at other firms at lower fees, they would not hesitate to transfer their funds to the more competitive institutions. In this case, it is vital to identify the root cause of this lack of knowledge. Deficient information distribution in this context may be due to two factors: (i) the institutions themselves, due to incomplete compliance with the codes of conduct regarding fund marketing; and (ii) the CNMV, due to insufficient dissemination and/or inefficient reporting and the absence or proper regulation.

# 6 Conclusions

Competition in the mutual fund industry is an issue of growing importance because of the increase in the volume of assets and the number of investors and also because of the important contribution that mutual funds make to the country's leading financial institutions' earnings, all in a context of growing integration of Europe's financial markets.

This study is a detailed analysis of trends in mutual fund fees in 2000, 2004 and 2005, specifically management and custody fees (the main fee items), in order to gauge competition in the industry. The combined analysis of management fees reveals that they declined generally between 2000 and 2005 in all mutual fund categories, particularly in fixed-income funds. In contrast, custody fees did not vary much during that period.

The reduction in management fees in the period (over 19% overall between 2000 and 2005) is attributable mainly to three factors: (i) the reduction in the legal cap on fees for securities and money market funds; (ii) the macroeconomic situation resulting from nominal convergence by the Spanish economy with the euro area; and (iii) a degree of competition introduced into the industry by independent firms.

Although the decline in fees may be classified as significant, some commentators consider that it is insufficient and that it merely highlights the lack of competition in the fund industry. Our analysis segmented the mutual fund industry in order to detect peculiarities and inefficiencies in price discovery and resource assignment. It was found that: (i) the larger the mutual fund or its manger, the higher the fees (in two of the three years analysed); (ii) the larger the average investment per investor, the lower the fee (rewards for larger investors); (iii) institutional investors also enjoy lower management fees than retail investors; (iv) the banks are the least competitive class of financial institution, but this has not impacted their market share (two-thirds of total assets), and the savings banks have recently become somewhat more competitive; and (v) the older the fund, the higher the fees (no gain from the learning curve). The econometric study confirmed most of these conclusions, although not to the same degree of detail or not in all the years analysed.

Of the factors that may have given rise to the aforementioned inefficiencies and may have prevented management and custody fees in Spain from falling faster, we highlight two: (i) the configuration of Spain's financial system, with a high degree of concentration among financial institutions that enjoy a "voluntarily captive" customer base; and (ii) inadequate dissemination of financial information about these products, leading to the existence of "involuntarily captive" investors.

Measures to address these inefficiencies would be related mainly to the latter factor, i.e. improving information distribution. For small independent firms to

match the reputation of Spain's big banks and win investors' trust requires market participants to improve their financial knowledge and is a medium-term issue.

With regard to measures to enhance and improve information about the mutual fund industry, we highlight three in particular: (i) strengthen supervision of the financial information provided by fund marketers (which often incur in conflicts of interest), including specific measures at those which systematically exhibit deficiencies (e.g. lack of staff training, sale of products that are not appropriate to the investor's profile, etc.); (ii) enhance investor training and information by offering them data bases in which it is easy to compare fund performance and drafting documents that explain all the fees that a mutual fund bears and how to compare them, or through courses and seminars; and (iii) in the field of regulation, it might be possible to implement measures enabling investors to compare fees for similar products or, in line with the European Commission's proposals, to strengthen certain transparency measures such as unbundling fund marketing expenses (currently disguised within management fees).

# III International Reports

# White Paper on Enhancing the Single Market Framework for Investment Funds

**Jorge Vergara Escribano (*)**

(*) Jorge Vergara Escribano is on the staff of the Supervision Directorate of the CNMV.

# 1 Introduction

Investment funds are a saving instrument in wide use among household economies, providing them with affordable access to capital markets and the professional management of their assets. Their importance as a saving vehicle has been magnified by the progressive aging of developed societies which requires citizens to look out for their financial interests well beyond retirement age. The result has been a boom in the fund management business both in Europe and the United States, to the extent that investment funds now account for 12.6% of European households' financial assets and 59% of European GDP. Estimates suggest the European industry will keep up growth rates in the order of 10%, and that by 2010 assets under management could swell to 8 trillion euros against 5 trillion today. This is no less true of Spain and its financial sector, where the boom in collective investment has lifted assets under management to a hefty 30% of GDP.

Europe's legal framework for the investment fund industry is supplied by Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), known more simply as the UCITS Directive. In the nineteen nineties, there was a first, failed attempt to modify the UCITS Directive, known at the time as UCITS II. Not long after, a new reform was put forward. This time the initiative prospered in the form of Directive 2001/107/EC of 21 January 2002, amending Council Directive 85/611/EEC with a view to regulating management companies and simplified prospectuses, and Directive 2001/108/EC of 21 January 2002, amending Council Directive 85/611/EEC with regard to UCITS investments. The first of these texts is commonly called the Management Directive and the second the Product Directive. Together they form the package known as UCITS III with major implications for the legal regime of investment funds; especially the Product Directive which liberalises and enlarges the scope of UCITS investment policies.

All European investment funds complying with the Directive can be freely marketed to the public in other Member States with no other requisite than a prior notification and compliance with the rules of conduct of the host country, especially regarding advertising material. In sum, we are talking of harmonised funds in possession of a European passport.

In this respect, the UCITS Directive was a stimulus to the growth of the European financial industry, to the extent that cross-border fund sales represented around 66% of total net industry inflows in 2005.

UCITS funds, moreover, have attained international brand status, especially in Latin America and Asia, setting the standard for a diversified product that is suitable for retail investors. An important factor here, as mentioned earlier, is the

greater flexibility afforded by UCITS III in general and the Product Directive in particular, which loosened up funds' investment limits while providing them with wider investment opportunities. Hence the UCITS brand now encompasses a rich and varied range of investment strategies and vehicles apt for all kinds of investor appetites.

But the European fund industry is now confronted with a new set of challenges, derived from the growing complexity of financial markets and investors' changing needs. Non-stop financial innovation has put new strains on the UCITS regulatory framework in an increasingly competitive industry landscape. Additionally, the growing niche carved out by non-harmonised products has spurred demand for a standardised treatment that facilitates their pan-European distribution. It also has to be said that the Directive suffers some evident flaws and limitations that push up costs for European operators to the detriment of their international competitiveness.

For this reason, the European Commission published a Green Paper on investment funds in July 2005, announcing a round of consultations on ways to improve and perfect the current regulatory framework. In parallel, three expert groups were set up (on market efficiency, private equity and hedge funds) along with two workshops on the simplified prospectus. The reports and responses gleaned from these initiatives over 2005 and 2006 resulted in a White Paper, published November 2006, on Enhancing the Single Market Framework for Investment Funds. What it does, in essence, is propose a series of amendments to the Directive alongside supplementary measures to modernise the European investment fund framework that simultaneously assure investors ready access to sound, attractive investment solutions.

White Paper measures can be divided into three large groups:

— The first brings together measures to enhance industry efficiency. These proposals can be broken down in turn into those that require amending or adding to the UCITS Directive, and those where the most rational course from a cost/benefit standpoint is to leave the matter to industry self-regulation or legislators in each country.

— The second group includes measures to tighten up investor safeguards. Here, amendments to the UCITS Directive are combined with the monitoring of implementing measures to Directive 2004/38/EC of 21 April on markets in financial instruments, known by its English acronym MiFID, which sets in train a battery of measures for the protection of investor interests.

— Finally, the third group deals with matters relating to non-harmonised vehicles like real estate funds and hedge funds. On this point, the White Paper makes no proposals to change the existing Directive, at least for the moment, and opts instead for a painstaking analysis of the current situation.

# 2 Improving Market Efficiency

## 2.1 Proposed amendments to the UCITS Directive

### 2.1.1 Removing administrative barriers to cross-border marketing

The present system whereby passported funds have to furnish prior notification to the host authority has proved an excessively slow and cumbersome one, due to the copious documentation that must be filed, and the time the authorities take to verify it and get back to the applicant. The result is that funds must often wait beyond the two months that the Directive states as the decision deadline.

Accordingly, the White Paper proposes that the Directive be amended to reduce this two-month waiting period. As an auxiliary measure, prior notification should be on a regulator-to-regulator basis, replacing the current system where the manager of the passported fund and its local representatives deal directly with the host authorities. Obviously meeting these objectives will hinge on the existence of efficient cooperation and information-exchange mechanisms between national authorities or supervisors. This coordinating effort, which we will later discuss, merits its own section in the White Paper. The format of choice, then, seems to be ex-post verification by the authorities of the country receiving the passported fund.

### 2.1.2 Facilitating cross-border fund mergers

The European collective investment landscape is an extremely fragmented one, populated by countless small funds. This stands in contrast to the United States where average fund size is considerably larger. The Spanish industry is no exception to the European rule, to the extent that the CNMV registers list more than 6,000 schemes, many of sub-optimal size. This structural shortcoming bars access to economies of scale, which in turn pushes up the cost of the end product. Of course, domestic fund mergers occasionally occur as a part of wider consolidating movements. A case in point is Spain, where the bank sector mergers of past years left groups with a large number of duplicate funds, which were consequently merged in turn. However, the line taken by the White Paper is that intranational mergers are not enough and that steps must be taken to facilitate cross-border operations. As the Directive does not provide a unified regime for fund mergers, the White Paper proposes adding in a dedicated section that facilitates mergers with due regard for investor protection (in this case, by ensuring effective disclosure and giving unitholders in the merging funds the option of redeeming their holdings free of charge). The role of depositaries and auditors will also have to be considered. The next step is to clarify the tax implications of fund mergers, without which the new rules would be ineffective. Here the plans are for the European Commission to issue a communication based on European Court of Justice case law, clarifying the tax-neutral status of cross-

border fund mergers. This will evidently be a much swifter route than the harmonisation of national tax rules.

### 2.1.3 Asset pooling

Another mechanism to harness economies of scale, and thereby bring down industry costs, goes by the name of asset pooling – basically, the pooling together of the assets of several funds which are then handled by a single manager. There are two ways to do this:

a) *Entity pooling*: using a master-feeder structure, in which one or several funds (the feeders) invest almost all their assets in another fund (the master) which takes on their management.

b) *Virtual pooling*: various funds' assets are managed in common without the legal transfer of ownership.

The first pooling technique is ruled out by the Directive provision capping UCITS' investments in other collective investment schemes at 20% of their assets. The White Paper accordingly proposes removing this limitation. It bears mention here that Spanish legislation already allows for master-feeder structures, and has done so for some time, by releasing schemes whose policies are based round investment in a single fund from compliance with the above investment ceiling.

On the subject of virtual pooling, it seems the White Paper prefers to open a period of reflection about the kind of regulatory framework that can best guarantee the soundness and supervision of this kind of arrangement, given the evident operational risk entailed.

### 2.1.4 Management company passport

The UCITS Directive establishes that the domicile of mutual funds without legal personality ("contractual funds") shall be the country where the manager has its registered offices. Contrast this with the treatment accorded corporate funds, whose domicile is the country that the company is based in. This rule basically invalidates the management company passport, since, for instance, a Spanish manager could never manage a fund established under French law without setting up a full functional management company in France. The White Paper accordingly proposes amending the Directive to remove the above domiciliation rule so the management passport is fully effective. It also calls for a closer analysis of the nature and extent of passportable services. The question is to strike the right balance, because the requirement to keep back-office functions in the state where the fund is authorised could undermine the passport, while there is also the risk that management companies could find themselves emptied of all real substance. Finally, the management company passport could lead to a certain fracturing of supervision (funds supervised by one country while their management company is supervised by another).

#### 2.1.5 Strengthening supervisory cooperation

The above changes to the Directive will call for tighter mechanisms of cooperation, coordination and information exchange between the relevant national supervisors. This will apply to both regulator-to-regulator passport notifications and the cross-border structures arising from mergers, pooling and management company passports. Note in this respect that the Commission of European Securities Regulators (CESR) has set up an expert group on investment management to study key issues in the European mutual fund industry. The White Paper opts for inserting text in the UCITS Directive about the necessary cooperation between European supervisors, with reference to the relevant provisions of the recent Prospectuses Directive and Markets in Financial Instruments Directive (MiFID). It seems, in any case, that the remit of the CESR expert group will extend beyond coordination and information sharing to the effective convergence of European supervisory practices.

### 2.2 Other proposals (not requiring changes to the Directive)

#### 2.2.1 Strict deadline for authorisation in country of domicile

The aforementioned delays in responding to the prior notifications of passported UCITS are joined by similar delays in obtaining fund approval in countries of origin, frequently without any explicable reason. This constitutes a competitive hurdle for the European fund industry, compared to the considerably shorter time-to-market of rival financial products. The White Paper make no proposals on this point, leaving each country free to pursue the legitimate interest of maximising the efficiency of its own national industry, and simply urges national supervisors to take the necessary steps to expedite fund approvals if they wish to foster a stable and competitive sector. This recommendation is especially pertinent in today's context of intense competition between products and financial markets.

#### 2.2.2 Fund order processing and settlement

As stated, cross-border transactions are a common feature in the European investment fund industry, and likely to be more so once the above measures take effect. Yet sub-standard fund subscription and redemption processing and settlement procedures have resulted in high costs and excessive delays as well as entailing an unacceptable degree of operational risk. Again, the White Paper refrains from advocating legislative measures, presumably because of the technical complexity of these systems, and instead puts its trust in self-regulation, i.e., in the industry developing its own improvement strategy. And work is already underway. EFAMA, the European fund and asset management association, is working to achieve the standardisation of order processes and to establish a kind of "subscription and redemption" passport. The support of leading banking groups will be crucial in this respect.

### 2.2.3 Depositary passport

Depositaries are a vital cog in the investment fund machinery, in their dual function of asset custody and management oversight. For some time now, voices in different quarters have been calling for a passport for depositaries. However this cannot be done without first harmonising depositary functions in different states, which would require major changes in the Directive. On this point, the White Paper concludes that the cost of the changes would far outweigh the potential benefits, given the relatively low value-added contributed by the depositary function. In any case, it proposes some liberalising measures, urging that national laws should allow branches of banks authorised in other Member States to act as depositaries via the delegation of asset custody, with reference to a possible future Communication or Recommendation in this respect. In fact, Spanish legislation expressly authorises such arrangements, though specifying that liability remains with the first depositary.

# 3 Improved Investor Protection

These White Paper measures have the basic aim of lowering costs to the end investor. However, perfecting investor safeguards is not just about providing a cheaper product, it also means ensuring the right climate for decision-making, as regards both investor information and the services rendered by the intermediaries and agents involved in the distribution process. The White Paper addresses both these questions, the first with reference to the simplified prospectus and the second with reference to the MiFID.

## 3.1 The simplified investment fund prospectus

The simplified prospectus has been criticised from all sides as an overly long and complex document bewildering to most investors. To make matters worse, the rules governing its contents have been written into national legislations in highly divergent form. The White Paper concurs that the product has sufficient shortcomings to warrant an urgent review of the corresponding European Commission Recommendation. The goal of this review should be to re-centre its contents on costs, expenses and expected returns. In parallel, it proposes a change in the terms of the existing Directive to turn the simplified prospectus into a short, concise, easy-to-read document of genuine use to the investor. It seems, in other words, that the eventual format may be closer to a fact-sheet. The White Paper also stresses the importance of working with the industry and distributors to define and verify the effectiveness of proposed changes. Naturally, input will also be sought from the document's readership, i.e., the investor public.

## 3.2 Investment fund distribution

Distribution is a vital link in the investment fund product chain, as the final step and for its cost impact (in Europe, specifically, the bulk of fund management fees go to remunerate the distribution function). It is also a process in which conflicts of interest and their adequate prevention are of capital importance, with agents under conflicting pressures to sell investors the best product for their needs and financial profile and to maximise their own fees and profits. The White Paper proposes no specific measures, since the MiFID already deals extensively with financial product marketing and the prevention of conflicts of interest. It simply echoes the European Commission's pledge to carefully monitor the implementation of MiFID provisions on intermediated fund sales, with reference to the future preparation of a vademecum or basic handbook setting out the MiFID rules of conduct for UCITS.

# 4 Some Reflections on Non-harmonised Financial Products

The European financial industry is populated by other investment products aside from UCITS, which are marketed to retail investors but are not subject to harmonised regulations, i.e., they do not possess a European passport authorising their cross-border sale. Their number includes such common products as guaranteed funds, real estate funds and hedge funds. Indeed, analysts put the volume of assets under management in non-harmonised funds at around 10% of the industry total.

The White Paper takes a cautious line, influenced no doubt by the enormous scale and complexity of harmonising such products, and first calls for an exhaustive and systematic study of the costs, benefits and risks involved. It also insists that this analysis should consider the best tool for such harmonisation: whether it be the extension of the present UCITS Directive, possibly involving its end-to-end reorganisation, or legislating for each product on a case-by-case basis, conserving the UCITS brand as it currently stands but threatening regulatory fragmentation and the emergence of regulatory arbitrage. An example here, drawn from past legislative experience, would be the classing of real estate funds as collective investment schemes of a non-financial nature, while funds of hedge funds are classed as a sub-category of financial schemes. Yet both types of fund are treated as financial collective investment schemes in all general respects.

We can see that harmonising non-UCITS products promises to be an arduous process, the more so if it coincides in time with the aforementioned package of regulatory and other measures to improve the UCITS product. In any event, the White Paper sets a 2008 deadline for the presentation of a report on these products to the European Council and Parliament. The first step will be the creation of an expert group on real estate funds, to report back by autumn 2007.

The White Paper completes its review of the European investment fund industry by looking at the marketing and sale of products to non-retail investors, i.e., the institutions and professionals comprising what is known as the "qualified" investor public. These, basically, are more sophisticated investors in less need of protection, who tend to opt for diversification products like private equity or hedge funds.

Again, there is no standard European regime for this type of investment, though the Prospectus Directive and the MiFID provide some common elements, especially the latter's strictures on suitability tests prior to the selling of financial products. The White Paper proposes a study into the obstacles imposed by national legislations on the private offering of financial instruments, as a first step to designing and deploying a common private placement regime (as an example of regulatory divergence, the minimum threshold for hedge fund investment has

been set at 50,000€ in Spain but is significantly higher in other countries). The findings of this study, it suggests, should be presented in autumn 2007. The likeliest outcome, then, would seem to be the granting of a European passport for cross-border transactions in these products (what the industry is lobbying for), but restricted to the investor collective classified as requiring a lower degree of protection.

# 5 Conclusions

In this article, we have looked at the measures the White Paper proposes to enhance the European framework for investment funds. What we have is a mixed bag, combining amendments or additions to the UCITS Directive (for instance, on passport procedures, the contents of simplified prospectuses and cooperation between supervisors) with non-legislative initiatives (the simplified prospectus Recommendation or the monitoring of the MiFID's rollout to the investment fund industry). Finally, a further set of measures dealing with non-harmonised products will involve analysis and consultation on the current state of play before moving to any formal decision.

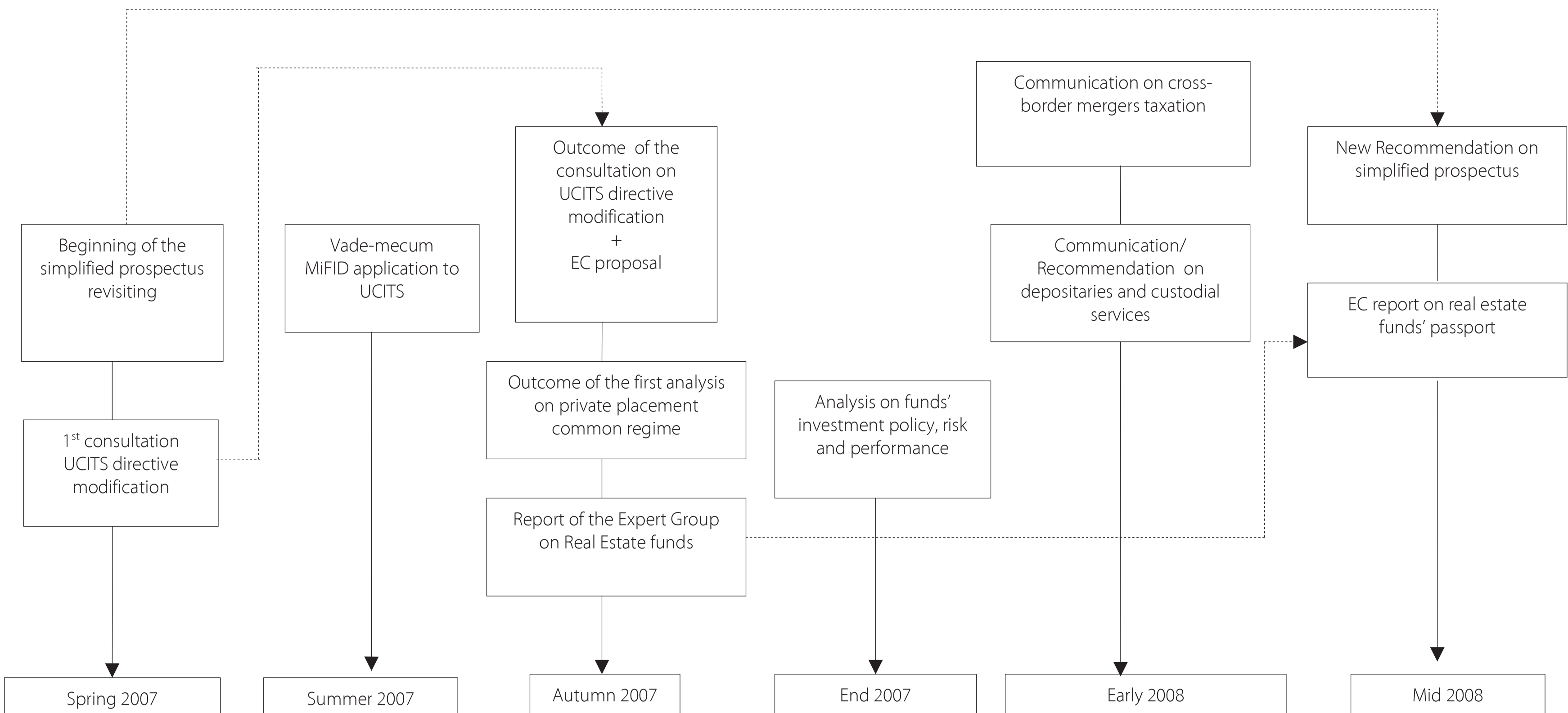
The calendar for actions pursuant to the White Paper will run through 2007 and 2008 at least, punctuated by the corresponding public consultations. As regards the Directive, we would expect a formal draft of the proposed changes by autumn 2007. However, as some measures will foreseeably engender others, the full time horizon for consultations, initiatives and legislative amendments will probably stretch to several years. The expected timing of each action is set out in the calendar that follows this article.

In view of the scale of the task and speed of change in an industry constantly turning out new products and management techniques, the European Commission has opted for a mosaic of measures that will facilitate the operating environment, with amendments to the UCITS Directive kept to the strict, necessary minimum. It has also attempted to avoid the pitfall of cumbersome or excessive legislation, aware no doubt that industry dynamism presents a constant threat of obsolescence. Finally, in areas where it considers the current state of knowledge insufficient, it prescribes further consultations and analyses so eventual decisions are fully and reliably informed.

In conclusion, we are entering a time of change in the European investment fund industry with a busy legislative and analytical agenda that may herald the birth of UCITS IV. The fact that just over twenty years have passed since the first in the series confirms both the adaptable and dynamic nature of the European financial industry and the will of the competent authorities to encourage its progress while guaranteeing investors every protection.

## EC working plan's indicative calendar, according to the White Paper proposals

TABLE 1



# Board Independence in Listed Companies

**Rodrigo Buenaventura Canino (*)**

(*) Rodrigo Buenaventura Canino is director of Secondary Markets of the CNMV.

# 1 Introduction

The Madrid-based International Organization of Securities Commissions (OICV-IOSCO), representing securities supervisors around the world, has currently been the subject of the corporate governance of listed companies. The most recent result of this work has been the publication of the report[1] *Board Independence of Listed Companies* (referred to below as the Independence Report).

The origins of this report go back to the reaction of IOSCO to the global financial scandals of the first half of this decade. At that time, previously reputable international issuers became immersed in financial crises brought on by the fraudulent behaviour of their executives. The cases of Enron, Parmalat and Worldcom are examples of situations in which a series of weaknesses and other factors led to events which would have an enormous impact both on shareholders' interests and the integrity of capital markets. The IOSCO published a report in 2005[2] on strengthening capital markets against financial fraud, in which it identified the most significant weaknesses giving rise to these cases of fraud. Among the weaknesses the report uncovered was that best corporate governance practices were insufficiently developed in most securities issuers. Three elements in particular were identified as clearly capable of improvement in this respect: the supervision of related-party transactions; specific protection mechanisms for minority shareholders when there is a controlling shareholder; and the independence of members of the board of directors.

It could be claimed that corporate governance has traditionally been a subject closer to company law than to the regulation of securities markets. Nevertheless, market supervisors have clearly identified this subject as inescapably linked to two of the goals many have set themselves: market integrity and protection of investors. Both goals suffer when mechanisms of corporate governance are inadequate, and both benefit when misconduct or questionable business decisions are prevented.

It should be pointed out that IOSCO's initial interest in this field was closely linked to specific cases of corporate fraud. Of course, this in no way means that the term 'corporate governance' should only be associated with misconduct (or with tackling misconduct). To a great extent the different standards of corporate governance are based on an attempt to achieve corporate efficiency, competitiveness and soundness. The reasons why the international securities supervisors are involved in this issue are linked to the integrity of the securities markets, and do not prejudge the reasons for which companies or secondary markets promote the development of these standards.

1 Available since March 2007 from the IOSCO website: www.iosco.org.
2 Strengthening capital markets against financial fraud, IOSCO, 2005. Available from www.iosco.org

The history of the development of corporate government practice is too wide-ranging to be described in this brief note, but it is worth highlighting some landmarks, particularly related to board independence. We will refer here to public standards generally applicable to listed companies, rather than the (best) practices of particular issuers. In the most developed markets, board independence requirements for listed companies did not exist until the end of the 20th century. There were however references in some markets (NYSE) to the idea of including 'non-executive' members on boards as early as 1956. Apart from this precedent, the earliest reference to this idea is the Cadbury Report (1992), which opens up a period of 'codification' in Europe, with successive waves of country-based analyses (the Vienot, Cromme, Preda, Olivencia, Combined Code etc. reports) trying to establish non-binding recommendations under the general 'comply or explain' principle.

The initial phase of development culminated in the landmark publication of the Principles of Corporate Governance by the OECD in 1999 (revised edition in 2004). This constitutes the first and most important example of international standards on this matter. In the same year the NYSE included the requirement to have a majority of independent board members in its market rules.

As can be seen, the key moves towards formal and specific recommendations on board independence took place during a first phase lasting less than a decade (1992-1999).

## 2 The Role of IOSCO in Corporate Governance

The interest of IOSCO and securities supervisors in general in corporate governance is not based on the need to determine new international standards (in which the OECD principles fulfil a very important role). Rather, they aim to analyse to what extent the situation in the most developed markets is notably different or on the contrary is converging towards common mechanisms or solutions. Although it may at times seem a cliché, in fact globalization in securities markets demands, at the very least, an ongoing comparison of successive regulatory regimes, if not convergence in approaches towards key questions. Thus IOSCO decided in 2006 to undertake a comparative study of the mechanisms each market used to apply Principle VI.E of the OECD which states that boards "should be able to exercise objective independent judgement on corporate affairs".

The securities supervisors are not generally regulators, in the sense of having full capacity to issue rules themselves. In fact, they have to apply standards and legal instruments which have been developed at a national level and at times independently from international trends in corporate governance. In addition, they have the legitimate interest (and duty) to examine common elements in corporate governance practice and to analyse the extent of differences between capital markets. This is the aim of the Independence Report, which tries to offer an objective and neutral overview of how the principle of board independence is applied in the rules governing the main markets around the world.

The publication of the Independence Report was the result of a project submitted to a special task force of the IOSCO Technical Committee, composed of representatives of the 15 most liquid capital markets, in addition to some of those in emerging countries[3]. The task force is co-chaired by the President of the CNMV and the Vice-President of the Australian Securities and Investments Commission (ASIC). The group has recently begun work on a second project related to protecting minority shareholders, which will be published in 2008.

3 Australia, Brazil, Canada, France, Germany, Holland, Hong Kong, India, Italy, Japan, Mexico, Portugal, Spain, Switzerland, Thailand, Turkey, the U.K. and the U.S.

## 3 The Independence Report's Methodology and Approach

The IOSCO Independence Report aimed simply to offer a descriptive overview of the mechanisms which each country has chosen to adopt in applying the principle of board independence and to find common patterns, if they exist. Thus from the start it consciously shied away from trying to establish any kind of recommendations. They would have been extraordinarily complicated to apply, not only because of the different nature of the source of standards in each country, but also because of the different structure and tradition of each country's corporate model.

The Report is based on an extensive survey completed by IOSCO members belonging to the task force and a series of meetings held throughout 2006 to determine its progress. The contents of the report are solely the responsibility of the Technical Committee of the IOSCO, but they were subjected to consultation and review from the OECD Secretariat on a number of occasions and to a final public consultation phase at the end of 2006, as is the case with all IOSCO documents[4].

4 The CNMV has a policy of posting the IOSCO reports for public consultation on its website www.cnmv.es. They can be accessed via the links 'Publicaciones y otros documentos' > 'Documentos en fase de consulta'. The submission of comments by Spanish entities is an extremely useful way of improving the final texts and ensuring that the special characteristics of the Spanish market are included in the final version of the documents.

# 4 Differences between Countries in Market Structure and the Legal Framework

One of the main sources of the different ways in which countries approach corporate governance is their different legal framework and tradition. In some countries company law is based on case law. This system is opposed to that which is typical on the European continent, where codes of positive law play a central role. On the other hand, there are countries that have chosen to implement mandatory provisions as a way of introducing some elements related to board independence; countries that have chosen to publish codes of guidelines; and others that have left the development of standards to secondary markets (listing rules). The most interesting part of what the IOSCO document makes clear in this respect is that regardless of the form in which the principles have been implemented in each country (and their surveillance by authorities or participants), the specific mechanisms and recommendations are in many cases surprisingly similar. In other words, very different forms co-exist with fairly similar basic structures.

To give an example, compare the Combined Code in Britain with the listing rules of the NYSE. The contents of these two standards are relatively similar to each other on many points, although the former is simply a recommendation to British listed companies and the latter is an indispensable requirement for companies listed on the New York market.

No correlation can be established between the type of capital market or the legal tradition of either country and the form in which it has chosen to reflect the standards relating to board independence. Although the use of listing rules is normal in some Anglo-Saxon countries (Australia and the U.S.), others such as the U.K. have opted for a general code of guidelines. Similarly, some countries on continental Europe combine statutory mandatory mechanisms with stock market listing rules, as in Italy, and codes (Spain, France and Germany). However, it is in Europe where the use of codes with the 'comply or explain' requirements is most extended.

The U.S. stands out from all other countries for its peculiar regulations and importance in the world market. Its federal structure means that company law is different in each state, although the state of Delaware is considered the most representative in this respect because it is where many companies have their registered offices. There are no generally applicable voluntary codes, and it is the listing rules of individual markets (mainly the NYSE and Nasdaq) that determine the requirements as to board independence in each case.

What does influence the solutions adopted in each country is the ownership structure of the listed companies. On the one hand, there are some markets in which there are relatively few controlling shareholders and capital distribution is

diffused among many owners. The classic examples of this type of market are the U.S. and more recently the U.K. On the other, there are countries where core or controlling shareholders are relatively frequent in listed companies. This is the case in France, Spain, Germany or Brazil. Although the Independence Report leaves aside the question as to whether there is a relationship between the degree of capital market development and the degree of diffused ownership, it does deal with the effect that the degree of shareholder concentration has on the exercise of control and the way that the board of directors operates. Among questions it discusses are the role of the proprietary director (who is or represents a significant shareholder), the system of voting to elect directors, or the way that the size of the holding affects the classification of independence.

Another key aspect in understanding the mechanisms related to the concept of independence is the model of company management, and in particular whether the board has a 'unitary' or 'dual' structure. Whereas in many countries, including Spain, there is a single board, in others there are two tiers, typically called the board of directors and the supervisory board. In these cases, the supervisory board tends to be elected by the general shareholders' meeting and it then appoints the members of the board of directors. Germany is the international archetype of this model, which exists in many countries around the world, often as an alternative to a single-tier board (as in Portugal, France, Italy, and Japan). In some cases the supervisory board does not really supervise. It is a board of internal auditors who oversee, but are not hierarchically superior to, the board of directors.

In countries with two-tier structures it is often the case that measures designed to ensure board independence are targeted at the supervisory board or the audit committee rather than the board of directors.

# 5 Development of and Compliance with the Standards

When the Independence Report refers to standards of corporate governance, it does so in a broad sense, including any standard, principle or regulation which proposes mechanisms or methods for enhancing the independent judgment of the board. This is because of the wide variety of instruments (laws, market rules, voluntary codes) used in different countries. Although the process of developing standards and the degree to which the different institutions participate is enormously varied, secondary markets tend to be involved to a significant extent in the development of standards (as in Australia, Italy, the U.S., etc.).

There has also been a trend in recent years to involve supervisors (particularly securities market supervisors) in the development of standards. One way in which the securities commissions become involved is via the approval of listing rules for stock markets when these rules contain corporate governance standards. A second way is by commissions or working groups participating in developing the standards (as is the case in Spain or Canada). The third, which until now has been limited to the U.K., is the creation of a specific supervisory body for corporate governance matters (and above all for auditing), in this case the Financial Reporting Council. In other countries, supervision of both auditing and corporate governance of listed companies lies with the securities supervisor (as in Australia or Italy).

Nevertheless, in most cases it is difficult to talk about the 'enforcement' of corporate governance standards, because many of these standards are only recommendations. In such cases, nearly all the countries have moved towards transparency and extensive compliance by the listed companies themselves, usually through an annual corporate governance report or a specific section in the annual report itself. In some countries such as Spain the securities supervisor channels this information and draws up a comparative report with statistical data.

# 6 Fiduciary Duties and Liability of Directors

Although it is a typical and classic subject of company law, the duties of directors and their civil or criminal liabilities when they do not comply with them are cited by all the jurisdictions taking part in the IOSCO study as the most important element promoting the board's independent judgement. We shall use the Anglo-Saxon term 'fiduciary duties', even though it is not an accepted term in all legal traditions.

If the actions of the board are to be brought into line with the interests of all the shareholders and its criteria are to be independent, then the first two elements that should be analysed are the duties of loyalty and care. In a brief outline, the Independence Report concludes that the various duties of directors (loyalty, acting in the interests of the shareholders, confidentiality, care, avoiding conflicts of interest, promoting the success of the company) may be summed up in two categories under the headings of 'loyalty' and 'care'. These two concepts exist in all the countries analysed. Although there may be differences which are occasionally relevant, they represent the basic duties of company directors. Of course, they are also the common requirements for all companies, not only listed ones, and for all directors, whether executive or non-executive.

The directors' liability for non-compliance with their fiduciary duties tends to be criminal in nearly all countries when it involves fraud or misappropriation, and civil when it is a case of a breach of their duties in good faith, particularly the duty of care. The differences of approach can basically be divided into two aspects: who can seek remedy, and what limitations are applied.

With respect to who can initiate proceedings to establish liability, in all jurisdictions it is the company itself, and in some cases its shareholders or certain third parties. Often an individual shareholder may claim for damages suffered because of an allegedly disloyal board of directors. It is also common for the company itself to be able to claim for compensation for such damages. However, a number of countries go further and allow individual shareholders to take action in the name of the company against directors for breach of their duties. In this case, in many countries the general shareholders' meeting has to vote before initiating legal proceedings against a director in the company's name. However, some countries allow a group of shareholders to begin the process in the name of the company without the need for the general shareholders' meeting to vote (or even with a vote against). This is the case in Australia, Canada, Germany, Hong Kong, Spain, and the U.S. (although some countries require the shareholders involved to hold a certain percentage of the capital). In a few countries, securities regulators or supervisors can initiate legal action against board members.

# 7 Appointment and Termination of Board Members

This point tends to be the focus of debates about board independence. However, at the end of the day the independence of board members is a question of defending particular interests (all the shareholders), and controlling any conflicts which may arise with other sets of interests (those of the executives or majority shareholders). In this sense, determining who nominates, appoints and dismisses board members, and how, is a question that is closely related to their ability to be independent and objective in their judgements.

The Independence Report assesses the various methods which affect the nomination, election, mandate, term and dismissal of independent directors. With a few exceptions (such as the requirement in some countries that the independent directors should be proposed by a nomination committee), the rules for appointing and dismissing independent directors are not different from those applicable to other directors. The Independence Report outlines the proportional or cumulative voting rules designed to ensure that minority shareholders are represented. Cumulative voting is the most common among them. It allows minority shareholders to assign their votes to a single candidate or, more importantly, requires in practice that the majority shareholders spread their votes between various candidates instead of concentrating them on a single closed list.

An interesting subject is the set of measures adopted to verify that when independent directors resign or are dismissed this was not the result of reprisals by the rest of the board arising from differences of opinion caused by the independence of the member involved. For example, some countries require or recommend the issue of a public statement (or one to the shareholders at the next general meeting) explaining why each board member left.

# 8 Compensation of Board Members

The link between compensation and independence is based on the incentives offered for doing a truly independent job. Excessively small remuneration will not create sufficient incentive for qualified people who can add value to the company to be attracted to the job. On the other hand, excessive remuneration may make the board member captive to certain interests and less likely to challenge the proposals made by executives or the chairman.

In addition, some forms of remuneration based on financial performance indicators may contain unsuitable elements that incite board members to achieve objectives which are not always related to the long-term interests of the shareholders, and on occasions even involve outright fraud.

Most countries in the study do not establish limits to board members' remuneration, apart from certain vague references about avoiding over-compensation. More common is the establishment of restrictions on certain forms of remuneration, including stock options for independent board members. Five countries do not allow this practice and seven others require its specific approval by the general shareholders' meeting as well as public disclosure of the options scheme. The United Kingdom and Spain establish minimum time limits for keeping the shares received to prevent incentives from leading to extremely short-term strategies.

In nearly all jurisdictions, the general shareholders' meeting can offer an opinion or vote on the remuneration policy. There are also standards relating to the public disclosure of the individual or collective remuneration of board members.

# 9 The Concept of Independence: Independence from whom?

Traditionally, the need to have independent board members has been a response to the classic 'agency problem', the conflict of managers' interests with those of the shareholders. This is why in the first references to external board members in listed companies (in the 1950s) they were referred to as 'non-executive'. According to this logic, it was enough to remove the board member from executive responsibilities to ensure his independent judgement. To a certain extent, this approach is not mistaken when there is diffused share ownership, with extremely reduced levels of concentration.

As the theory of corporate governance has developed, particularly in the markets where controlling shareholders are common, the 'non-executive' concept has been found insufficient to include all the situations in which conflicts of interest may affect the objectivity of the board's judgement. Potential conflicts between controlling and minority shareholders have led to the ownership factor being introduced into the independence equation. In fact, some of the most audacious recent authors[5] have even suggested that there are two agency problems: managers vs. owners and controlling owners vs. minority owners.

For this reason, nearly all countries consider that being a significant shareholder in the company's capital is one of the limiting factors to a board member's independence. A small number of these countries also create a category of 'proprietary' director separate from that of the independent and executive director, with the idea that should any conflicts of interest arise their probable cause is easily discernible.

The concept of the independent board member exists in all the countries that took part in the report except for two: Germany and Japan. In Germany, the two-tier structure of company governance means that the mechanisms designed to ensure the independence of managers do not involve the appointment of directors with specific 'qualities'. In the case of Japan, the lack of independent members on the board of directors is particularly striking, although there is a board of auditors.

The form of defining the *a priori* or minimum independence requirements varies enormously from country to country. In some, it takes the form of a statutory rule defining the minimum requirements which an independent member of the board should meet; most countries use non-binding recommendations. In the majority of countries, the board itself has the power to classify a member as 'independent'. In some cases (the U.K., France) a board member may not comply with a particular criterion, but still be classified as independent, on a 'comply or explain' basis. In

5 Reinier Kaakman et al., The anatomy of corporate law. A comparative and functional approach, Oxford University Press 2004.

others (the U.S., Spain and Italy), all the minimum requirements have to be complied with if the member is to be classified as independent.

The difficult subject of defining independence has been tackled in all countries without exception from the negative point of view. In other words, by identifying what may impede independence rather than what may promote it. Thus seven criteria can be identified which, with very few exceptions, make it difficult or impossible for a board member to qualify as independent:

— Not to be a director of the company

— Not to be an employee of the company

— Not to receive compensation from the company (other than directorship fees)

— Not to have material business relations with the company

— Not to have been an employee of the external auditor of the company

— Not to exceed some maximum tenure as a board member

— Not to be or represent a significant shareholder

These criteria are dealt with in detail in the Independence Report. Here we shall only point out that some of the tests used include family relationships with the company (not being a member of a director's family), the group dimension (not being the external auditor of the company or a company in the group, not having business relations with affiliates or parent companies), and time ('look-back' periods after having been a director or external auditor to qualify as independent).

# 10 Number of Independent Board Members

All the countries which recognize the figure of independent board member (except for the Netherlands and Portugal) have established a minimum number or percentage of independent board members. The lowest rate (Brazil and Mexico) begins in the range of 20-25% of the board; this is followed by one third (Hong Kong, India, Spain, Thailand and Turkey); and extends to 50% of the board in most countries with developed markets (Australia, Canada, France, the U.K. and the U.S.). A number of countries establish absolute minimums of two or three members. In the U.S. the minimum percentage does not apply to controlled companies (with one shareholder holding more than 50% of the capital).

# 11 The Role and Powers of Independent Board Members: Board Committees

Although many countries recognize and enshrine the role of independent board members, none assign them specific functions within the board, apart from the recommendations (in the case of Australia, Canada and the U.K.) that an independent member should be chairman of the board. However, nearly all standards have tried to establish special roles or duties within the board. These may be difficult to reconcile with the fact all the directors have identical duties.

What nearly all the countries have tried to do is give the independent members an important role in certain board committees. Table 1 shows the main board committees which are typical or required by law. As can be seen, the most common is the audit committee. In most cases it should be chaired by an independent member and more than half of its members should be independent. Appointments and remuneration committees (usually separate, but not in the case of Spain and France) are also very common, although they are hardly ever required by law. They always have a majority of independent members. The rest of the committees are of marginal importance at the present time. However, in the future some may gain acceptance and become the norm across many countries.

**Number of countries that have specific committees** TABLE 1

| Committee | Mandatory [1] | Common[2] | Chaired by an independent | Minimum % of independents | | |
|---|---|---|---|---|---|---|
| | | | | 50 % | 66 % | 100 % |
| Audit | 13 | 17 | 11 | 6 | 2 | 7 |
| Nomination | 1 | 11 | 6 | 8 | | 3 |
| Remuneration | 1 | 11 | 8 | 7 | | 4 |
| Evaluation of the board | 2 | 2 | 2 | 1 | | 1 |
| Related parties | 1 | 2 | 2 | | | 2 |
| Risk management | 0 | 3 | 2 | | | |
| Internal control | 1 | 1 | 1 | 1 | | |

1. There is a legal/statutory requirement to have this committee.
2. Common in listed companies (including mandatory committees).

# 12 Conclusion

The different legal approaches and the reality of the securities markets in each country give rise to varieties of regulatory frameworks for board independence. National peculiarities in this respect have not been completely smoothed out by the tendency to reinforce independence requirements which began at the start of the 1990s. However, the content of the standards of each country does show a clear convergence around certain principles: what prevents a board member from being independent; what proportion of independents there should be; how the fact of being a shareholder affects independence; what extra mechanisms (remuneration, appointment) are relevant to true independence, etc.

The changes in the recommendations or rules in this field have been very quick and taken place within a short space of time. They are probably not over yet. There are likely to be at least four issues which over the next ten years will lead to a new wave of progress on the exercise of independent judgement by boards of directors. These are: the increased awareness of minority shareholders, internationalization and active participation by institutional investors, the presence of major issuers in more than one capital market, and the trend towards the international integration of secondary markets. However, progress does not mean being unnecessarily prescriptive, as the Independence Report recognizes and demonstrates. It considers that similar results can be achieved in very different ways.

# Annex

## Main Corporate Governance Codes

TABLE 2

| Country | Short name | Full original name | Website | Year (last version) |
|---|---|---|---|---|
| Australia | ASX Corporate Governance Principles | | www.asx.com.au/resources/publications/index.htm | |
| Brazil (I) | IBGC Code | Código de Melhores Práticas de GovernanÇa Corporativa do IBGC | www.ibgc.org | 1999 |
| Brazil (II) | CVM Code | Cartilha de GovernanÇa Coorportiva de CVM | http://www.cvm.gov.br | |
| Canada | Corporate Governance Guidelines | Corporate Governance Code | http://www.lautotite.qc.ca/userfiles/File/reglementation/valeurs-mobilieres/Normes/58-201PsAng.pdf | 2005 |
| France | Corporate Governance Code | Rapport AFEP-MEDEF: « Le gouvernement d´enterprise des sociétés cotées » | www.medef.fr | 2003 |
| Germany | Cromme Code | Deustscher Corporate Govemance-kodex | http://www.corporate-governance-code.de/ger/kodex/index.html | 2002 |
| Italy | Preda Code | Codice di Autodisciplina delle società quotate | http://www.borsitalia.it/documenti/regolamenti/corporategovernance/corporategovernance.htm | 2006 |
| Japan | Principles of Corporate Governance | Jyoujyou Kaisha Corporate Governance Gensoku | www.tse.or.jp/english/listing/cg/index.html | 2004 |
| Mexico | Best Practices Code | Código de Mejores Prácticas Corporativas | http://www.cnbv.gob.mx/recursos/circula/Emisoras/Emisoras_Compilada2005.doc | 2003 |
| Netherlands | | Tabaksblat Code | http://commissiecorporategovernance.nl/ | 2003 |
| Portugal | CMVM Recommendations | RecomendaÇóes da CMNM sobre o Governo das Sociedades Cotadas | www.cmvm.pt | 2005 |
| Spain | Unified Code | Código Unificado de Recomendaciones sobre Buen Gobierno de las sociedades cotizadas | www.cnmv.es | 2006 |
| Switzerland | Best Practices Code | Code of best Practice for Corporate Governance | www.economiesuisse.ch/ | |
| Thailand | Principles of Corporate Governance | | www.set.or.th/en/educatio/infoserv/files/CG15-ENG.pdf | 2001 |
| Turkey | Principles of Corporate Governance | | www.cmb.gov.tr | |
| UK | Combined Code | The Combined Code on Corporate Governance | www.frc.org.uk/corporate/combinedcode.cfm | 2003 |

## Main listing requirements with corporate governance provisions

TABLE 3

| Country | Name | Website |
|---|---|---|
| Australia | AXL Listing Rules | www.asx.com.au/resources/publications/index.htm |
| Brazil | Bovespa Listing Requirements | www.bovespa.com |
| Hong Kong | Listing Rules | www.hkex.con.hk |
| India | Shouden Torihiki ho | www.nseindia.com |
| Switzerland | SWX Directive on Corporate Governance (DCG) | http://www.swx.com/admission/being_public/governance_en.html |
| Thailand | SEC Notification No. Kor Jor 12/2543 | http://capital.sec.or.th/webapp/nrs/data/499p.doc |
| UK | LSE Rules | www.londonstockexchange.com/en-gb/products/membershiptrading/rulesreg/ruleslse/ |
| US | Listing requirements | www.nasdap.com ; www.nyse.com ; www.amex.com |

# IV Regulatory Novelties

# MiFID: New Regulatory Approach and Risk-oriented Oversight

**Mª José Gómez Yubero (*)**

(*) Mª José Gómez Yubero is director of Investors of the CNMV.

# 1 Risk Management in the New Regulatory Framework

From an integral perspective, risk management has become a priority for all kinds of institutions, financial and non-financial, listed and unlisted. The same applies to the regulators, in the broadest sense of the term, including the overseers[1].

As the COSO report[2] stresses, risk management not only makes a contribution to achieving company aims in the widest sense (in its 4 categories, strategic, operative, information and complying with regulations) but it is also a security generating factor in the sense that it enables the institution and its management to efficiently and effectively face up to uncertainty and, as a consequence, the associated risks and opportunities.

The regulatory response to the new context, determined by financial and accounting scandals, has played a decisive role in spreading and consolidating the risk management and control culture in company management and decision-making in regulated sectors. In fact, in recent years, the way that regulations have evolved in all the regulated sectors has been clearly biased towards risk control. Let's see some classic examples.

## 1.1 Prudential and solvency regulations

Based upon the Basle capital agreements and their transfer into compulsory legal regulations are one of the main exponents. The new Basle II Agreement, which introduces operational risk as a an element that drives capital requirements, in an additional capacity to those that were already required beforehand (credit and market), is conducive to adopting the best practices in measuring and controlling them through establishing a system of options, with less demands where own resources are concerned for the companies that manage best.

The new Agreement has major effects on the institutions, not only methodological effects but also effects upon human, governance and organisation resources. Its range will determine the need to comprehensively manage all the risks that affect a financial institution's business. Furthermore, the inclusion of the oversight revision and market discipline as Pillars 2 and 3, respectively, of the New Agreement is going to have an unprecedented effect on the practice of oversight. To solvency overseers, the New Agreement means the need to link an institution's

1 In English, the reference to the regulators includes agents with both regulating and oversight powers. In Spain, it is necessary to make a distinction, because the regulation powers are bestowed upon administrative bodies other than those that are responsible for oversight.

2 Committee of Sponsoring Organizations of the Treadway Commission.

risk profile - in which quantitative and qualitative elements come into play -, and its degree of solvency.

Although risk analysis and evaluation, and consideration of the processes established for its management and control, are by no means new to oversight practice, establishing a link between that evaluation and the degree of solvency is new to oversight practice.

### 1.2 Governance standards and the behaviour of the financial institutions

Not only credit institutions but also securities companies and agencies, insist on the existence of risk control and management mechanisms as an essential requirement for obtaining and conserving authorisation. In the sphere of the new Markets in Financial Instruments Directive, better known in Spain by its English acronym (MiFID), risk control in the broadest sense of the term and, in particular, the control over certain risks such as conflicts of interest between the institution and its clients, takes on special relevance.

The methodology and principles that serve to inspire this risk management is the same as the one that appears in the COSO Report, valid for the management of any type of risk; this will be dealt with in greater detail in the third part of this article.

### 1.3 Transparency standards and governance of listed companies

Aimed at guaranteeing that the financial information and information of all kinds that is supplied to the market is true, has also made a contribution towards spreading the culture of internal control and risk control, requiring such mechanisms as audit committees and the presence of independent board members that, all in all, serve to corroborate that company risk management constitutes the essential basis for decision making and a generating security in companies.

The accounting scandals that have affected certain listed companies have undermined investors' trust in financial information and in the mechanisms of corporate governance. The economic authorities reacted swiftly by passing and implementing standards, even recommendations, which tend to strengthen the responsibility of administrators and directors, as well as to improve the accessibility and reliability of financial information. In July 2002, the US Government passed the Sarbanes-Oxley Act. The aim of this Act is to reduce the risk of the information published by the companies being uncertain, incomplete or incorrect. With a view to achieving this, the new piece of legislation imposes new

obligations on all those involved in the process of producing, certifying and analysing the financial information about the companies[3].

As a result of an agreement reached by a Council of Ministers, a Task Force was set up in Spain, within the framework of the European Commission's Plan of Action with respect to "Modernising the Right of Companies and improving corporate governance within the European Union". The Task Force, chaired by the President of the CNMV (National Securities Market Commission), which is already known as the Conthe Commission, was established to comply with the mandate to prepare one single document on corporate governance with the existing recommendations, which at that time were the ones contained in the so-called Olivencia and Aldama Reports, as well as updating them, incorporating the latest breakthroughs on an international level.

The Code, which was eventually published in May 2006, is not compulsory in nature, although the listed companies must state in their Annual Corporate Governance Reports whether or not follow the Code's recommendations, a total of 58, in matters concerning statutes, board of shareholders', composition and operation of the board of directors and its delegated bodies and the retribution for the board members and top executives.

3 The companies themselves are required to set up an audit committee composed of independent board members with powers to appoint, oversee and dismiss the external auditor, and it prohibits them from granting loans to the administrators and directors. Those who are responsible for the company are required to prepare the annual and periodical accounts in accordance with the generally accepted principles of accountancy, and to return the bonuses and options on shares in the event of manipulation of financial information. Furthermore, the general and financial directors are required to certify the annual and quarterly accounts.
Furthermore, the external auditor is prohibited from simultaneously providing the same company with services other than auditing services, or from auditing a company whose CEO, CFO or accountancy manager has been employed in the auditing firm, and rotation every 5 years is compulsory.
The financial analysts and investment banks are also subjected to obligations to prevent conflicts of interests that could lead to biased information.

## 2 Adapting the Oversight Practices

Risk control and risk management are a *priority for overseers*, not only *solvency overseers* but also *behaviour standard overseers*, the reasons for this being twofold in both cases:

— Suitable risk management by the overseen companies is, as we have already seen, one of the objectives and requirements that can be demanded of institutions that act in sectors that are regulated and overseen, and the overseers attempt to ensure that the institutions act in suitable control environments.

— The practice of oversight is carried out under the risk management methodology that enables those involved to effectively and efficiently fulfil the oversight objectives. The practice is based upon identifying, evaluating, managing and controlling both the internal and external risks that affect the sectors under control[4].

In both cases, the aims that they are trying to cover converge into one single objective: keeping the financial system stable. In its most modern conception, stability does not mean only the absence of crisis, and neither is stability based solely upon the solvency of the banking institutions. As a result the expansion and transformation of the financial markets, remaining stable requires an effective and efficient allocation of economic resources, suitable control over financial risks and the institutions' capacity to continue to carry out their essential functions, even in situations of crisis and imbalance[5].

Therefore, one of the links that forms part of the chain that conserves the stability of a modern, larger, complex, market-dependent financial system with greater risks and permanently evolving, is the *protection of the investor* because this contributes towards keeping and increasing the investors' and the markets' confidence and trust in the financial system, because the latter is fulfilling effectively and efficiently, its socioeconomic function of intermediation, channelling savings towards investment, efficiently allocating resources and distributing risks.

4 See Chapter 11 of the Annual Report of the CNMV for the year 2005, where a description is given of the oversight methodology developed under a risk approach where the risks are evaluated both on an individual and a sector level.

5 Conserving financial stability. Garry J. Schinasi. Economy Subjects 36. IMF.

# 3 From the DSI to the MiFID: Improving Protection for the Users of the Investment Services

When the Markets in Financial Instruments Directive - as we have stated, better known in Spain by its English acronym (MiFID) -, comes into force in the near future, it will bring about a major change in the regulatory framework that applies to providing investment services. Some authors, including some overseers, have gone as far as to describe it as the next *Big Bang* for the financial markets, in the belief that it will have an even greater impact on the banking institutions than adapting to the new Basle II Agreement.

However, there is no general disagreement when it comes to accepting that the MiFID will have far-reaching effects[6]. In fact, all people and institutions that act on the securities markets will be affected. It will change the architecture of the markets and will likewise affect not only the way financial agents operate, but also the way they organise themselves and how they establish their relationships with their current and potential clients.

This final drive to create one single financial services market will make the access conditions for agents uniform throughout the European Union, which, together with the measures for strengthening the organising requirements and standards of behaviour, will improve the overall quality of investor protection, especially where minority shareholders are concerned.

## 3.1 The MiFID´s modern, flexible, preventive and dynamic approach

The MiFID begins with a modern regulatory approach that is inherent to mature, globalised and interrelated financial systems. As is the case with other contemporary regulations (the Second Capital Adaptation Directive, the Directive concerning the Transparency of Listed Companies, the Directive against Market Abuse, etc.). It has a generalist vocation where application is concerned and it focuses upon preventive aspects. It is a regulation of principles, not at all casuistic, and it is applicable to all kinds of financial institutions. Throughout the MiFID document, reference is constantly made to the fact that the individualised application of the measures that guarantee its fulfilment must be suitable and in proportion to the size, type of business and the structure of the institution concerned.

6 Hereinafter, the term MiFID is used to refer to the set of general Level 1 and 2 Standards that regulate the investment services and the institutions that provide them, that is to say, the Level 1 Directive (published in April 2004) and Level 2 (published in September 2006) as one single regulatory body.

This new approach, which is particularly *flexible* where the action regime of financial institutions is concerned, does not try to limit the capacity of action and, it certainly does not endeavour to curtail the expansion of regulated institutions. All in all, the aim of the regulation process is not to subjugate the institutions' business, but rather to conserve market integrity, to guarantee the stability of the financial system and to protect the investor. Therefore, the regulatory approach clearly opts for promoting, still further, organisation requirements, procedures and control within the institutions, with a view to suitably managing the risks, in general, and for guaranteeing that not only companies' strategic and business aims are achieved, but also compliance with the regulatory requirements.

In fact, it can be stated that the standard opts for a clearly *preventive* approach, which moves on from being a system that requires the institutions to comply with the rules that apply to them and includes a system of responsibilities (which includes disciplinary measures), to being a system that aims to prevent or mitigate the effects of any possible non-fulfilments. The overseeing experience has demonstrated the effectiveness of preventing non-fulfilment. That is why the new regulations not only establish a set of principles, duties and loyalties within the framework of which the institutions must carry out their activities, but it also regards any non-fulfilment of the regulations as being one more risk that has to be managed and prevented, making it compulsory for the institutions to apply and implement policies and procedures that for control and minimisation of this risk, applying the same criteria as it does to the risks concerning the activity, processes and systems.

Adapting to the MiFID must not be regarded as an isolated event coming from an isolated event resulting from a static process and analysis. Quite the contrary, adapting to and complying with the principles of the MiFID requires all those affected, especially the financial agents, to make a *dynamic adjustment* as a result of an ongoing internal process that enables them to continually redesign and update their risk profile and needs and, all in all, be in a position to compete in a market that is becoming increasingly prepared and well equipped, more versatile and with a better ability to adapt to a constantly changing demand for financial services and investment.

### 3.2 Main areas of impact for the Spanish finance industry

We shall now see the most novel aspects for the Spanish finance industry, which are undoubtedly those that play the biggest part in achieving the ultimate aim of the MiFID, i.e. to improve the competition conditions in the single European market and the global quality of protecting the investor. The aspects that we are going to refer to are those that interact most with the general principles of good corporate governance and that most affect the distribution and sale of finance products.

With respect to the governance and organisation structure block, we would mention the responsibilities of the board of directors and top management, the defining of control functions and dealing with conflicts of interest. The most interesting aspects in the behavioural standards in relationships with clients block, are classifying clients and evaluating the advisability of the products and services on the basis of client profiles.

### 3.2.1 Governance and organisation structure block

Certain effective corporate governance practices are essential in order to achieve and keep public confidence in the financial system, which is necessary to guarantee that this system runs smoothly and that the economy in general operates well.

Recent experience has shown that corporate governance inefficiencies can have significant costs and effects, with such macroeconomic impact and consequences as the risk of contagion, loss of confidence and trust and effects upon financial stability.

That is why regulators and overseers in different areas of financial activity (solvency, transparency of listed companies and investor protection) focus their attention on this matter.

The MiFID approach to governance and organisation structures is based upon the same principles and is very similar to the recommendations issued by the Basle Committee on Banking Supervision[7]. This was hardly surprising, because the advisory process that the CESR Committee developed on these questions and on which the European Commission eventually passed the Level 2 Directive, was developed in complete coordination with the Committee of European Banking Supervisors (CEBS), to the extent that the MiFID affects all the agents that provide investment services, not only securities companies and agencies, but also, and basically, credit institutions. The novelty in this case is that up until now, they were recommendations for financial institutions, but with the MiFID they came to be general rules of a compulsory nature.

#### 3.2.1.1 The role of the board of directors and top management

Thus, the MiFID brings together a series of principles about corporate governance that are considered to be vital and are widely accepted, according to which the board of directors and top management are called upon to play a fundamental role in risk management. In this sense, the board of directors and top management are compelled to be aware of the institution's risk profile and to guarantee that their reserves of capital are suitable for that level (aim of the solvency standards) an that the organisation structure, the policies, the procedures, the internal communications channels, the technical and human resources and the internal control, risk and fulfilment mechanisms are sufficient to guarantee that the strategic decisions and aims are achieved and that procedures and functions as well as the regulatory requirements are all fulfilled.

In contrast to the modulated application of the behavioural standards, the organisation requirements are required in a general way, that is to say, without making distinction between the types of clients to whom the service is provided. However, neither the recommendations given by the Basle Committee nor the MiFID itself prescribe one single recipe or define one single ideal structure for universal application. In view of the diverse nature of the institutions that are actively involved in the financial markets, as well as the variety of legal and

7 See the document "Enhancing corporate governance for banking organisations". February 2006. Basle Committee on Banking Supervision.

oversight systems that coexist in a globalised world, the standard anticipates the coexistence of several ideal models, depending on the specific characteristics of each individual business and structure, whose adaptation to the standard will be the responsibility of the institutions themselves.

Therefore, the MiFID does not regulate legal figures, but rather functions whose effectiveness, regardless of the form that any given financial institution has, will depend on the existence of several management and monitoring levels: (1) the board of directors or the oversight committee; (2) persons who do not take part in the everyday activities of the different business units; (3) those responsible for the different business lines; and (4) independent enactment, that is to say, not subjected to undue influence, of the functions of complying with the regulations, internal auditing and risk control.

According to the MiFID, the independence of a control function is conditioned by its hierarchical position, the availability of resources, retribution systems and the proximity to or distance from the functions and objectives of areas, departments and even committees, mainly aimed at developing the business[8].

Within the context of the MiFID, the aim is to achieve a suitable organisation that is oriented towards creating a general culture of risk control and, in particular, a control over risks that are harmful to the market and to the investors as a result of conflicts of interest in the heart of the institutions and between the constituent groups.

#### 3.2.1.2 Dealing with conflict of interests

That is why a special mention must be made of coping with conflicts of interest as being just another risk to be managed and controlled by implementing an all-encapsulating policy, at a group level, for pinpointing and managing such conflicts by business lines and activities within the group (therefore, the product providers, that is to say, the SGIIC, are included in this policy).

The MiFID proposes a control methodology equivalent to the one that was traditionally applied in the control and management of other risks, with the ultimate aim, in this case, of preventing these conflicts, actual or potential, from damaging the clients. Once again, the MiFID proves to be innovative, because it establishes a preventive approach that requires the institutions and their groups to make ongoing diagnoses, and to design and permanently update their preventive and corrective measures.

In view of this, the institutions must take action in the following stages:

i) They must identify the persons and areas that are liable to enter into conflict (according to the MiFID, the following areas are especially prone to conflicts of interest: the activity of managing the own account, management of portfolios and corporate advice and financial analysis prepared for

8 With respect to the independence criteria when performing the control functions, refer to the document "Compliance and the compliance function in banks". April 2005. Basle Committee on Banking Supervision.

distribution to third parties), and the risk that these conflicts could have a negative effect on clients,

ii) They must define and give approval to a policy containing specific measures for ensuring that the persons who work in an organisation act loyally and behave independently, both on an individual and group level, so that it can be managed with a view to preventing negative effects on clients, and

iii) Only when conflicts cannot be managed with a guarantee that the element that could be damaging to the client is removed, the latter must be informed in writing about the operations that could potentially be affected by the conflict.

The publicity given to conflicts is the last resort that the institution must turn to. This resort is a means for trying to prevent confusion and the risk of causing even greater damage to clients through their being exposed to an excessive amount of information and the potential abuses in the institutions' search for express consent from their clients with a view to safeguarding the interests of the institution itself instead of the clients' interests.

### 3.2.2 Standards for acting in the relationship with clients

The classification of clients and the obligation of the financial agents to adapt their offer of products and services to the risk profile of current and future clients will have a particular impact. This aspect will especially affect the distribution of investment funds, which up to the present is the main investment product aimed at minority investors.

#### 3.2.2.1 Classifying clients

For the first time in our classification system, the regulations offer a modulated application of behavioural standards, that is to say, these are established gradually on the basis of the type of client at which they are aimed, in an attempt to adapt them as much as possible to the specific characteristics and needs for protection that are inherent to each investment category and not to overburden the institutions that have to apply them.

In contrast to the professional clients, the ones considered to be minority clients are those who receive the greatest protection, for the purpose of which the institutions must take into account their awareness and experience in taking their own investment decisions and in correctly assessing the risks that are inherent to those decisions.

#### 3.2.2.2 Adapting the offer of products and services to the clients´profile

The MiFID will require the institutions to adapt their offer of products to each investor's profile, for the purpose of which they will take into consideration their level of knowledge and experience (which is known as the suitability test). That is to say, it is not only necessary to have sufficient information and transparency, but also for an active role to be played y the product distributors, who have to assess the risk profiles of the investors to whom the products are aimed, with a view to offering them only the products that are in keeping with that profile.

The most recent social and economic changes, which have coincided with a major evolution and development of the markets, have created an environment of increased interest in the innovation of financial products and in more complex products, which, in turn, has exposed minority investors to greater vulnerability and higher risk, so they could purchase products that are not consistent with their risk profiles.

Past experience resulting from an analysis of claims made and complaints lodged by minority investors has revealed that an inadequate sales policy for financial products not only generates uncertainties, incorrect expectations and a lack of protection for the minority investor, but it also jeopardises the reputations of the institutions involved, while at the same time increasing uncertainties of a legal nature and where complying with the regulations is concerned. Cases of inadequate commercialisation practices leading to claims or complaints against institutions with a risk of severely damaging their reputation, are becoming increasingly frequent and, at the same time, this slows down the development of new products that could enhance their expansion and growth if they were distributed through a commercialisation policy that aimed the ideal product at a suitable investor, together with clear and easy-to-understand information and a reasonable amount of advice that could serve to guide the investor.

Although it is important for the institutions to take their own measures for mitigating and managing risk, the CNMV has enhanced the updating of the practices sued by institutions for compliance with the behavioural standards that guarantee protection for the investor and the transparency and integrity of the markets.

At an initial stage, an attempt has been made to make the institutions aware of the importance of having suitable procedures for commercialising their financial products, in favour of the institutions voluntarily registering their commercialisation manuals. Later on, in the awareness that this is one of the main areas of the impact of the MiFID that affords the greatest protection to the investor, the CNMV has adapted its oversight practice as from 2005, by encouraging oversight actions on the commercialisation activity, with a view not only to ensuring that the institutions comply with the behavioural standards established in the Ley del Mercado de Valores (Securities Market Act) and the legislation that expands upon it[9], but also to being conducive to the adoption of better codes of practice and to monitoring the process of adaptation to the MiFID.

Under MiFID, protecting the investor is not seen to be a regulatory limitation so that the investors take on certain risks or make losses, but rather as the investors' ability to understand and take on the risks that are inherent to the investments that they make.

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9 Articles 4 and 5 of the General Securities Market Behaviour Code (Appendix to Royal Decree 629/1993) requires the institutions to obtain from their clients information about their financial situation, investment experience and investment aims when the latter is of relevance for the services and, furthermore, that they devote to each one suitable time and attention to find the products and services that are best suited to their objectives.
This requires the institutions to establish procedures for identifying the client's risk profile and the risk profile for the products that the client commercialises.

Therefore, with a view to managing and mitigating the effects of the risks arising from the practices known in English as misselling, the regulation and oversight policies are aimed at requiring prudential and organisational behavioural standards, at improving the quality and diffusion of information and at educating and imbuing the investors with skills.

# 4 Conclusions

Comprehensive risk management and control is a challenge and a priority not only for the institutions but also for the overseers. The context and the regulatory response have amounted to an incentive to consolidating the risk culture.

The MiFID's new approach requires all those involved in the markets to adapt: institutions, markets and also the overseers. The first challenge is to know how to adapt successfully.

The CNMV has been immersed, for several years, in a process of adapting to the new approach and methodology promoted by the MiFID, and it is particularly committed to encouraging and being responsible for the institutions' adaptation process.

Reference must be made to recent decisions aimed at enhancing and strengthening the area of investors within the CNMV, as part of its adaptation process.

In the forthcoming references, we will continue to refer to the challenges that are involved in adapting to the MiFID under the modern approach within the framework of a strategic vision of comprehensive management of the risks inherent to the system. Therefore, a special mention must be made of the policies that, with a view to mitigating the risk of investors purchasing unsuitable products, must be adopted from regulatory and oversight perspectives, aimed at achieving an improvement in the training and education of investors in order to achieve a balance between their negotiation capacity and the capacities of the financial middlemen, thereby reducing the risk of their purchasing unsuitable products and encouraging the financial brokers to adapt their offer of products to the profile of each investor, whose protection is a question of paramount importance.

# Regulations for the Public Offer of Securities and Admission to Trading: One Year on

**Sol Bourgón Camacho (*)**

(*) Sol Bourgón Camacho is deputy director of CNMV Legal Services.

# 1 Legislative Framework and Main Novelties

The reform of the legal framework governing public offers for the sale or subscription of securities and admission to trading on official secondary markets commenced with Royal Decree-Law 5/2005 of 11 March on urgent reforms to spur productivity and improve public procurement (RDL 5/2005). Among its provisions were a series of amendments to other legislative texts, including Title III of the Securities Market Law ("The Primary Market in Securities") and other articles of the same.

These changes were followed up by Royal Decree 1310/2005 of 4 November, partially implementing Securities Market Law (SML) 24/1988 of 28 July with regard to the admission of securities to trading on official secondary markets, public sale and subscription offerings and the corresponding prospectus, and Order EHA/3537/2005 of 10 November implementing article 27.4 of Securities Market Law 24/1988 of 28 July.

The motive of the reform was basically the writing into Spanish law of Directive 2003/71/EC of 4 November, on the prospectus to be published when securities are offered to the public or admitted to trading. However it also draws a number of provisions from Directive 2001/34/EC of 28 May of the European Parliament and of the Council on the admission of securities to official stock exchange listing and on information to be published on those securities. Other matters addressed in Directive 2003/71/EC were given detailed treatment in Commission Regulation (EC) 809/2004 of 29 April which, among its other provisions, harmonises the models of prospectus to be used for any public offer or admission to trading on a regulated EU market. This Regulation was recently amended by (EC) 211/2007 of 27 February, dealing with the financial information to be contained in prospectuses when the issuer has a complex financial history or has made a significant financial commitment.

The reason the principles established by an EU Directive have been applied through a Commission Regulation lies in the need for closer harmonisation in the target area. Regulations, remember, are directly applicable in Member States without going through the national transposition process.

Note also that the CESR (Committee of European Securities Regulators) issued two Recommendations on 28 January 2005 further to the uniform application of the Directive and the Regulation.

The above texts, though mainly about the implementation of European Union legislation, also incorporate certain measures that issuers have long been lobbying for, with the goal of scaling back the formalities involved in issuance, especially of fixed-income securities.

These measures were accompanied by a reduction in the fees charged for filing prospectuses with the Comisión Nacional del Mercado de Valores (CNMV), approved by Law 23/2005 of 18 November on tax reforms to enhance productivity.[1] Further, fixed-income market AIAF has collaborated with the CNMV in drawing up a standard model of securities note for fixed-income issues (bonds, debentures, subordinated debt instruments and mortgage and territorial covered bonds), which can also be processed electronically through the regulator's Cifradoc system. Since this note is the part of the prospectus given over to a description of the legal and economic nature of the securities being issued, its text and format lend themselves to unification and simplification. Conversely, the section describing the issuer, known in EU parlance as the registration document, is less amenable to standardisation.

The main novelties of the regulations are by now well enough known to anyone engaging habitually in this kind of transaction. However some of the most relevant are summarised below:

— A single EU standard is provided for the prospectuses to be published when securities are offered to the public or admitted to trading on regulated markets. Also, the prospectus can be presented and filed with supervisors as a single or separate documents. When filed as a single document, it must include all the mandatory particulars which, generally speaking, divide into two main parts: the registration document (describing the issuer's legal and financial situation) and the securities note (describing the characteristics and conditions of the securities on offer or whose admission is being sought). If the securities in question have a unit value of under 50,000 euros, a summary must also be produced. By this means, a single registration document can be accompanied by successive securities notes and, if necessary, summaries on the occasion of each issue.

— The information to be supplied by the prospectus need not always figure in the document itself, as long as a reference indicates where it is published (the issuer's website, for example) and the same particulars are filed with the supervisory agency.

— Rules are laid down for determining the home competent authority and, therefore, which supervisory body the prospectus should be filed with. Issuers of fixed-income securities with face value over 1,000 euros are able to exercise freedom of choice, whereas for equity securities the home competent authority corresponds to the country where the issuer is domiciled.

— In contrast to the previous legislation which allowed host member states to impose additional disclosure requirements, even on issuers with a passported prospectus, the latest provisions grant prospectuses a fully effective European passport. This means host country authorities cannot take issue with the contents of a prospectus approved by the home competent authority.

— In the case of cross-border offers, prospectuses may be filed in languages that are customary in the sphere of finance, with no need to translate them to the

1 Subsequently updated by the National Budget Laws for 2006 and 2007.

local tongue (though host authorities may insist on the summary being translated).

- The term public offer is given legal definition and certain additions made to the list of exemptions from the requirement to publish a prospectus when securities are offered to the public for sale or subscription and/or admitted to trading on official secondary markets.
- A new term is coined, that of qualified investor, which subjectively extends the existing concept of institutional investor to include, for instance, non authorised or regulated firms whose sole activity is investing in securities, as well as natural persons or SMEs meeting certain characteristics (article 39.1.a), d) and e) of RD 1310/2005).

Since we have no room in these pages to look at every aspect of the reform, and the repercussions of its entry to force, we will confine ourselves to questions of special interest for their practical consequences or because they often tend to be overlooked.

## 2 Formal Aspects

The first reflection prompted by the recasting of Title III of the Securities Market Law (SML) has to do with its formal nature and legal systematics. On the one hand, the text takes its cue from Directive 71/2003 in regulating access conditions for trading on secondary markets (articles 26 to 30 of the SML), and finally addresses public sale and subscription offerings in its article 30 *bis* via a reference to the regulations governing admissions (article 30 *bis*.1). This represents a break with the earlier tradition, under which the legislator was prolific in regulating both the issue of securities (primary market) and, basically in article 32 of the SML, the requirements for their subsequent admission to secondary market trading. As previously worded, this same article 32 made reference to a regulatory development completed by the former Royal Decree 291/1992 (now derogated by RD 1310/2005)[2] and the Stock Exchange Regulations[3]. This being so, it seems contradictory to retain the old Title III heading of "The Primary Market in Securities", given that the content now extends to conditions for admission to trading on official secondary markets, or regulated markets in the European terminology.

2 Single derogatory provision of RD 1310/2005 of 4 November.

3 Regulation of Official Exchanges approved by Decree 1506/1967 of 30 June, still partially in force.

# 3 Change in General Principles

Formal considerations aside, the reform of Title III of the SML marks, in our view, a welcome change in the principles or, rather, the philosophy informing issues and public offers. As previously worded, articles 26 onwards of the SML laid down the general principle that every securities issue – whether or not it was the object of a public offer – would entail certain filing requisites with the CNMV (prior notification, supporting documents, audit reports and prospectus). Subsequently, the Law itself softened this interventionist stance. Specifically, its article 30 exempts issues of securities by the state, the autonomous regional governments and other public law or international organisations that it may subsequently determine from these filing requirements, adding that *"(...)the Government may grant full or partial exemption from compliance with the requirements referred to in articles 26, 27, 28 and 29 with regard to certain categories of issues, due to the nature of the issuer, the small amount of the issue, the limited number or special characteristics of the investors to which the issue is offered, or other circumstances making exemption from said requirement advisable, except where regulations establish otherwise".*

Further ahead, Royal Decree 291/1992 implementing the said Title III of the SML reversed the principle established in its article 26, configuring a general exemptions regime (article 6 of former RD 291/1992, regulating the issues exempt from registering any documents with the CNMV) and a partial one (article 7 of the said RD 291/1992, addressing issues exempt from filing a prospectus or audit report, or requiring only the latter). Most of the cases previously considered wholly or partially exempt from filing requirements are exempt under the terms of current regulation, either because they fall outside the definition of a public offer (for instance, offers to qualified or fewer than one hundred investors) or because the text specifically exempts them from publishing a prospectus (for instance, the offer of shares to employees, bonus issues, or shares allotted in exchange for others in the same company or in connection with a merger or takeover bid). In some cases, this exemption is contingent on the issuer having already produced a document with the same information as the prospectus (shares offered in connection with a merger or takeover bid) or setting out the characteristics of the securities (offers to employees)[4].

Also, most of the cases which the text exempts from elaborating an offer prospectus are also exempted from elaborating a listing prospectus, meaning the securities can be admitted to trading without any CNMV filing.

We believe that the above change of approach is not only warranted, it is also at the root of the greater ease and flexibility that now characterises this area of law.

4 Article 41 of RD 1310/2005 of 4 November.

In effect, the legislator's requirements are now confined, in principle, to the production and distribution of a prospectus and supplementary documentation in cases of public offers of securities or applications for admission to trading on a regulated market. Supporting this principle is a definition of public offer (article 30 *bis.* 1 of the SML) and a series of conditions which could perhaps theoretically be subsumed within the former, but are left outside by operation of the law (paragraph two of article 30 *bis.* 1). Finally, the legislator specifies a series of exemptions from the need to draft, file and publish information in the case of public offers (article 26 of R.D. 1310/2005) or market admissions (article 41 of RD 1310/2005).

So once the changes introduced by RDL 5/2005 come into effect, filing requirements with the CNMV will cease to be the general rule or, more precisely, will only be the general rule (with the corresponding exceptions) in cases of a public offer or application for market trading.

This reform has eliminated what were once known as "partial exceptions", i.e., offers deemed to be private so not subject to prospectus filing with the CNMV, though other data had to be provided. Now what we have is an "all or nothing" situation with regard to public offers of securities: if a prospectus must be filed, then all other mandatory documents (audits and supporting documents) must be supplied as well. Conversely, if no prospectus is required, then no other information need be submitted to the CNMV[5]. The case of market admissions is somewhat different, because the admission itself may not require the production or publication of a prospectus, but supporting documentation may have to be provided along with other mandatory documents under articles 32 of the SML and 27 of Exchange Regulations.

It is clear from the above that the CNMV's intervention in issues and market admissions has considerably diminished. But it is no less true that the reduction in paperwork also does away with a level of administrative control of special importance for the protection of investor rights.

The removal of administrative controls – in line with EU legislation – means investors must lend even closer attention to certain transactions that have ceased to be supervised by the CNMV. This is the case, for instance, of capital increases with the waiver of preferential subscription rights (article 159 of the Public Limited Companies Law), the more so if the deal is concluded with a related party.

This kind of issue was invariably vetted by the CNMV in the case of listed companies, pursuant to the former article 3 of RD 291/1992. But exceptions will arise under the new regulations, because no issue or admission prospectus need be filed with the CNMV if the issue is targeted on fewer than a hundred investors (meaning it lies outside the definition of public offer)[6] and the sum of the new shares plus others admitted to trading in the previous twelve months does not exceed ten percent of share capital[7].

5 Article 30 bis 3 of the SML. .

6 Article 30 bis 1b of the SML. .

7 Article 26.1.a) of RD 1310/2005.

Given the CNMV's less interventionist role in this kind of operation, controls must lie, firstly, in the limits set by legislation, the company's bylaws or its board and general meeting regulations, along with those set voluntarily in its rules of conduct or good corporate governance. Secondly, we have the constraints that shareholders can impose on directors through Shareholders' Meeting resolutions, though here there is little room for optimism given the absenteeism and ownership dispersion that generally presides. Thirdly, all transactions in listed company shares must subsequently be entered in the Mercantile Registry and, finally, we have the legal recourse available to shareholders who consider their interests harmed by such agreements. In any case, it would be a good thing if the removal of controls led to a debate on the real effectiveness of these alternatives.

# 4 Novelties regarding Fixed-income and Book-entry Securities

The reform of Title III of the SML and its implementing provisions impacts particularly on fixed-income securities, through a series of measures to speed up their issuance procedures. The main novelties in this respect are the lifting of the requirements to execute a public instrument with regard to the book entry of these securities, and to have the issue entered in the Mercantile Registry and published in the corresponding gazette (BORME) if it is subject to prospectus obligations with the CNMV. These changes ensue from the recasting of SML article 6 and the incorporation of a new article 30 *ter*.

Article 6 of the SML, as it was worded prior to RDL 5/2005, called for the book entry of securities to be formalised through a public instrument. This instrument, as well as being entered in the Mercantile Registry in certain cases, was to be deposited both with the CNMV, for the purpose of the records described in article 92 of the SML, and with the entity in charge of securities registration, Iberclear in the Spanish case. The reworded article 6 makes it optional to execute this instrument. Specifically:

*"In order to represent securities by book entry, the issuer will have to draw up a document, which may optionally be made a public deed, containing the information required to identify the securities comprising the issue.*

*The issuer will have to deposit a copy of the document at the entity responsible for the book entry records and at the National Securities Market Commission. When the securities are to be admitted to trading on an official secondary market, the issuer will also have to submit a copy to its governing body.*

*The issuer and the firm responsible for the book entry records will have to keep a copy of the aforesaid document available at all times for the owners and the interested public in general.*

*The document referred to in the first paragraph will be replaced by:*

*i) The prospectus, provided that the issuer is obliged to submit said prospectus for approval and registration by the National Securities Market Commission, pursuant to this Act.*

*ii) Publication of the terms of the issue in the pertinent Official Gazette, for Government or Autonomous Regional Governments Debt issues, and in other situations where required by law.*

*Nor will said document need to be drawn up for financial instruments traded in official secondary futures and options markets, and in the other situations, and with the conditions stipulated by regulation".*

From the literal tenor of the first paragraph, we deduce that a public instrument is not obligatory for securities to be represented by book entries. Instead, the same information can be provided in a private document, or else through the prospectus filed with the CNMV when mandated by regulations. However, the CNMV and Iberclear have been asking for both a deed and a Mercantile Registry certificate as conditions for admitting listed company shares to the book-entry system. This is because the Public Limited Companies Law (PLCL)[8], with regard to these entities, equates changes in share capital with a bylaw amendment[9] meaning they must be entered in the Mercantile Registry by means of the corresponding public instrument. Furthermore, PLCL article 62 stipulates that no shares may be distributed until the capital increase has been so registered. In sum, the new rules have made little difference as regards the representation of shares comprising the capital of listed companies. Thus the standard practice is to enter shares in the book-entry system using the deed inscribed in the Mercantile Registry, as a less cumbersome alternative to executing two instruments for capital increases – for the issue and the increase itself – followed by a third certifying the securities' representation by book entries.

In all, where the amended article 6 has proved most effective is with fixed-income issues, for which article 30 *ter*[10] removes the obligations to authorise by public instrument, enter in the Mercantile Registry and publish in the BORME, provided they are to be the object of a public offer or admission to trading on an official secondary market and come under the requirement to submit a prospectus to the Comisión Nacional del Mercado de Valores.

There follows the text of article 30 *ter* in its sections 1 and 2:

*i)* *"The provisions of this chapter shall be applicable to issues of bonds or other securities which recognise or create a debt claim which are to be the object of a public offering for sale or are to be listed on an official secondary market and in respect of which a prospectus is required to be drawn up, subject to approval and registration by the National Securities Market Commission in the terms set out in the preceding chapter.*

*Issues of bonds or other securities that recognise or create a debt claim which are referred to in Chapter X of Legislative Royal Decree 1564/1989 of 22 December, which approved the Consolidated Text of the Spanish Public Companies Law, shall also be subject to the provisions of the preceding paragraph provided that they meet the conditions established there. This chapter shall also apply to the issuance of bonds envisaged in Law 211/1964, of 24 December, regulating the issue of bonds by companies which have not adopted the form of public limited companies or by associations or other legal entities, and the incorporation of a syndicate of bond-holders.*

8 Legislative Royal Decree 1564/1989 of 22 December approving the Consolidated Text of the Public Limited Companies Law.

9 Articles 9, 103, 144, 152.

10 Article 30 ter is the only article included in chapter II of the SML "issues of bonds or other securities which recognise or create a debt claim". This article, rather confusingly worded in its first appearance in RDL 5/2005, was later amended by Law 25/2005 of 11 March. The present wording of article 30 ter could, in our view, have done without the second paragraph of section 1, which adds nothing to the first.

ii) *The equity securities referred to in the second paragraph of article 26.2 of this Law, such as bonds convertible into shares, shall not be classified as bonds or other securities that acknowledge or create a debt claim provided that they are issued by the issuer of the underlying shares or by an entity belonging to the same group as the issuer."*

Taking both SML articles together (6 and 30 *ter*) it follows that when issuers of fixed-income securities make a public subscription offering subject to the prior requirement of filing a prospectus with the CNMV, the latter document will suffice for entering the said securities in the book-entry system.

Conversely, if an issuer opts for a placement format that is exempt from the prospectus requirement (for instance, offering the securities to institutional investors or fewer than one hundred natural or legal persons), but has settled that the securities will be traded on some official secondary market, it may file the private document identifying the book-entry securities with the CNMV, then go on to place the securities and, further ahead, present the prospectus required for their admission to trading[11].

Article 30 *ter* of the SML is thus "extremely special" in its treatment of bonds and other debt securities compared to the general rules set forth in the PLCL and in Law 211/1964 on securities issues by entities other than public limited companies, in that both require execution of a public instrument, entry in the Mercantile Registry and disclosure in the BORME[12] for the issues of companies or entities with their registered offices in Spain. In effect, it removes these obligations in the case of securities offered to the public or to be admitted to trading on a regulated market (i.e., for which a prospectus must be filed with the CNMV). For all other issues, the formalities of the aforementioned laws will continue to apply.

There were weighty economic policy considerations behind this change. The transactions concerned were already subject to a dual verification, through the Mercantile Registry and the CNMV, and it seemed advisable to reduce this to just one check in line with regulatory trends elsewhere in Europe. Another motive was to discourage the regulatory arbitrage that was already taking shape. Specifically, certain regular Spanish issuers of this kind of instrument had begun setting up subsidiaries in European Union states with more flexible regulations, and were issuing their securities there with the idea of then placing them in other EU countries, including Spain.

Moreover Law 37/1998 had established similar conditions for commercial paper with fairly good results. In particular, its fourteenth additional provision stipulated that: *"The public deed requirement envisaged in article 6 of Law 24/1988 of 28 July on the Securities Market will not apply in the case of commercial paper issues to be traded on a secondary market, provided their characteristics are detailed in the corresponding prospectus".*

The addition of articles 6 and 30 *ter* also posed at least two practical quandaries. Firstly, what contents were required of these private documents and, secondly,

11 The issuer can file the admission prospectus before placing the securities, in which case the same document will be admissible for entry to the book-entry system.

12 Article 9.11 of the Civil Code relative to article 5 of the PLCL and article 1 of Law 211/1964 of 24 December.

were the bondholders syndicate regulations set out in the PLCL and Law 211/1964 still to be considered valid. In both cases, the response was the same: since the reform deals with very concrete points to do with the elimination of formalities, the abovementioned laws are still applicable in every other respect.

For this reason, the private documents for the entry of such instruments to the book-entry system or the prospectuses fulfilling the same purpose for fixed-income securities must meet all the criteria the two laws stipulate regarding their numbering, conditions and characteristics, as well as referring to the formation of the bondholders syndicate and its regulations, and identifying the person appointed as trustee.

In practice, it is increasingly apparent that the bondholders syndicate is an institution in disuse, and only rarely do we hear of a meeting being held. However, the formal provisions for its existence and operation may occasionally be useful in cases of conflict like, for instance, the early redemption of securities whose interest rate at issuance stands significantly below the market rate, causing the issuer a commercial problem with its clients. In any case, as some authors have pointed out,[13] one of the big problems associated with this assembly is deciding exactly where its competences lie and whether there may, as we suspect, be a handful of matters on which bondholders hold absolute rights.

In sum, the changes to the SML relative to the book entry of securities, and the lighter requirements for issuers of fixed-income securities have done much to expedite the corresponding transactions. They have also placed more onus on the CNMV to verify their legal compliance.

What the legislator has done, essentially, is not to limit the role of the CNMV, as in the case referred to in our previous section, but to eliminate that of notaries and mercantile registrars.

13 F. J. Alonso Espinosa. Asociación y derechos de los obligacionistas. Librería Bosch 1988.

# 5 Novelties regarding Equity Securities and their Stock Exchange Listing

The 2005 regulatory reform also sought to facilitate share issues and admissions to trading. On the one hand, by imposing more flexible conditions for first-time access and, on the other, by eliminating the need to file an admission or issue prospectus for shares in the same class as those already traded.

As regards stock exchange flotations, it bears mention that RD 1310/2005 imposes two types of requisite regarding the suitability of the securities and public disclosure. On the first score, the issuer must be legally incorporated and doing regular business[14], while the securities being offered must comply with the relevant legal standards; be represented by book entry (without prejudice to the specialities of foreign instruments); and be freely transferable[15]. So far, this is nothing new, though the text then adds the following provisions[16].

i) Accreditation by the company that it has been in operation for a minimum period prior to the flotation and has earned profits in the preceding years. Under Exchange Regulations (article 32.1.c) companies applying for first-time listing must certify that *"the profits obtained in the previous two years or in three non consecutive years within a five-year period were sufficient to pay a dividend of at least six percent of paid-in capital after tax provisions and appropriations to the corresponding legal or compulsory reserves".* But current regulations make no such demands. The profits condition is not even mentioned in RD 1310/2005. And though its article 12 stipulates regarding the firm's pre-existence that it must furnish audited accounts for the last three years, it immediately authorises the CNMV to dispense with this requirement in three cases, two of which are germane here: when the admission request refers to the New Market (an unlikely event, since the future of this segment is far from certain) or when *"the CNMV so decides in the interest of the issuer or the investor public, provided it is sure that investors have sufficient information to form a reasoned judgement on the issuer and on the securities whose admission is being sought".*

ii) Market capitalisation. Until the entry to force of RD 1310/2005, the relevant provisions of the Exchange Regulations stated that companies seeking admission to trading must have a minimum capital of two hundred million

14 Article 8 of RD 1310/2005.

15 Article 9 of RD 1310/2005.

16 This part of the article is based in a subjective interpretation of the second additional, third transitory and single derogatory provisions of Royal Decree 1310/2005. These provisions – in our view – imply that unless stock exchange governing bodies issue their own Regulations with their own rules on admission to trading (second additional provision), the terms of Chapter V of the Exchange Decree will continue to apply except where they clash with those of Royal Decree 1310/2005.

pesetas (article 32.1.a). Royal Decree 1310/2005, in contrast, requires *"in the case of shares, six million euros, based on their expected market value. Compliance with this condition will be determined with reference to the price paid by investors in the public offer preceding admission, should such an offer have taken place"* (article 9.6). However, it also authorises the CNMV to admit shares below this amount when it believes they will meet with a sufficiently liquid market.

As such, the capitalisation requirement has been dropped in favour of estimated market value in a preceding public offer, if any. In the event that the stock market placement was effected by means of an offer to qualified investors, we infer that the same criteria would apply although the text is not explicit on this point.

iii) Ownership dispersion. Exchange Regulations (article 32 b) and f)) combined two different rules: first that the capital of shareholders owning more than 25% would not compute for the purposes of the two hundred million pesetas required for admission; and second that the number of shareholders owning below 25% of capital should be no fewer than one hundred.

Article 9.7 of the Royal Decree makes the fairly blanket provision that by the date of the shares' admission to trading, their ownership must be sufficiently widely distributed across one or more European Union states, or in any non member states where they are traded. Regarding the interpretation of 'sufficiently widely distributed', the closing paragraph of the article states that *"distribution will be construed as sufficiently wide if at least 25% of the shares for which admission is being sought are distributed among the public, or if the market can operate effectively with a smaller percentage due to the large number of shares of the same class and their degree of distribution among the public".* But then the very same provision goes on to say this requirement will not apply when shares are to be sold to the public through a stock exchange, provided the CNMV believes that such a move is imminent.

Certainly, the dispersion required by the Exchange Regulations is fairly out of date, in that two hundred million pesetas spread over one hundred shareholders, each with an ownership stake below 25%, seems nowhere near the depth needed for a share to trade on a stock exchange. However nor are the parameters used to measure compliance with this requisite especially taxing, while the discretionary powers conferred on the CNMV go considerably far.

iv) The possibility of partially paid-in shares being exchange traded if the CNMV judges that there are no restrictions on their transferability and investors have sufficient information for their trading to proceed under conditions of transparency (article 9.4 of RD 1310/2005). So far, no applications have been received for this type of share; understandably given the special regime dictated for capital calls in the PLCL (articles 42 to 46), which tends to militate against their stock market trading. As a token, article 46 states that *"the acquirer of the part-paid share is jointly and severally liable with all preceding transferors for the payment of the unpaid portion, at the discretion of the company's directors".* As we can see, this liability is at odds with the admission requirement that shares should be fungible and the fact that the

registration, clearing and settlement systems for secondary markets do not allow the back-tracing of share ownership.

v) The possibility of only one class of shares being exchange traded. This option was barred under the previous legislation, with SML article 46.b) literally stating that *"the following may not be traded on any official secondary market other than stock exchanges: a) shares and securities convertible into shares or securities conferring the right to acquire or subscribe for shares. The admission to trading of said securities shall refer to all of the securities issued, with the exceptions or restrictions to be established by the Government."* The Government never used this power and the rule applied was that listed companies should have all the shares representing their capital admitted to stock market trading. Article 9.8 of RD 1310/2005 would appear to relax this requirement when it says *"applications for the admission to trading of shares of a particular class should extend to all shares in that class. If shares of a given class are already trading, they must extend to all new shares in that class issued or scheduled for admission".* A sensu contrario, it could be deduced that it is not obligatory for listed companies to list all classes of shares; the only requirement is to list all shares in the same class as those already admitted to trading.

   This would certainly help solve the practical problems arising when a concerted or family group holds a percentage of shares in a listed company without any intention of offering them for trading.

vi) A wider range of issues relieved of the prospectus requirement. As we remarked at the beginning of this section, one of the factors that has facilitated the stock exchange admission of shares of already listed companies is that many transactions that once required the filing of an issue or admission prospectus with the CNMV have been freed of this obligation under the exemptions stated in articles 26 and 41 of RD 1310/2005. Here we are referring principally to stock splits and reverse splits, securities offered in connection with a takeover bid or merger, shares allotted to shareholders free of charge or in lieu of dividend payments, or those offered to employees or directors, providing they are of the same class as already traded shares. However, to take up some of these exemptions (in the case, for instance, of shares allotted in takeover bids or mergers), the company must publish a document with information equivalent, in the CNMV's judgement, to the disclosures made in a prospectus. In other cases (shares allotted free of charge, in lieu of dividends or in employee or director schemes), the issuer has to publish a document setting out the number and nature of the securities and the purpose and details of the offer. Apparently, in this case, the document would not need the approval of the CNMV: compliance is left to the issuer's judgement as long as the minimum conditions are met. However in the case of the exemptions contemplated for share deliveries pursuant to takeover bids or mergers, it seems as if the CNMV must formally pronounce whether the document replacing the prospectus makes equivalent disclosures.

# 6 Conclusions

The regulatory reform initiated with RDL 5/2005 of 11 March with regard to the public offering of shares and admission to market trading has provided a faster, more flexible process by cutting down administrative intervention.

The new rules work substantial changes in Title III of the Securities Market Law. Under previous legislation, the general principle was that all issues were subject to the prior approval by the CNMV of a prospectus and other information, though a number of regulations lightened these requirements by introducing exemptions. In contrast, current regulations confine the prospectus obligation to issues involving a public offer, to which end the legislator has defined the term 'public offer' excluding certain cases that could arguably fall within.

Regarding the issue of fixed-income securities, the new rules go further and remove certain formalities (execution of a public instrument and entry in the Mercantile Registry) affecting both the issue *per se* and the form of representing securities in the book-entry system.

Regarding equity securities, the general tenor is to make it easier for firms to float on the stock market, at the same time as the CNMV is given more discretionary powers to decide if they comply or not with access conditions. In the case of the admission of shares in already listed companies, more cases are envisaged where there is no requirement to file a prospectus with the CNMV (either for issues or admissions).

The reasons for these reforms lie not only in the need to transpose EU provisions, but also in the will to meet the industry's demand for a faster, more agile process of issue design and placement that will prevent "regulatory arbitrage" with other Member States already working to more flexible rules.

Of course removing administrative formalities also means removing controls, and requires that we review the effectiveness of remaining checks with a view to their improvement. Two kind of controls are of interest here: what we might call prior or preventive controls, established by administrative and corporate regulations, upholding the rights of investors, and shareholders in particular, to receive information, attend general meetings, exercise their votes, etc. And a posteriori controls, or remedial measures, that basically involve investors taking legal action if they feel themselves harmed by issuer decisions.

# V Statistics Annex

# 1 Markets

## 1.1 Equity

### Share issues and public offerings [1]

TABLE 1.1

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I [2] |
|---|---|---|---|---|---|---|---|---|
| **CASH VALUE** [3] (Million euro) | 21,735.6 | 2,960.5 | 5,048.4 | 271.9 | 2,362.5 | 1,472.6 | 941.4 | 673.7 |
| Capital increases | 18,748.0 | 2,803.4 | 2,562.9 | 121.1 | 756.0 | 1,188.4 | 497.5 | 673.7 |
| Of which, primary offerings | 1,101.9 | 0 | 644.9 | 58.0 | 487.3 | 0 | 99.7 | 0 |
| With Spanish tranche | 537.9 | 0 | 613.6 | 58.0 | 456.0 | 0 | 99.7 | 0 |
| With international tranche | 564.0 | 0 | 31.3 | 0 | 31.3 | 0 | 0 | 0 |
| Secondary offerings | 2,987.6 | 157.1 | 2,485.4 | 150.8 | 1,606.5 | 284.2 | 443.9 | 0 |
| With Spanish tranche | 1,664.4 | 54.7 | 2,194.2 | 150.8 | 1,390.9 | 208.5 | 443.9 | 0 |
| With international tranche | 1,323.2 | 102.5 | 291.3 | 0 | 215.6 | 75.7 | 0.0 | 0 |
| **NO. OF FILES** [4] | 42 | 27 | 30 | 3 | 13 | 7 | 7 | 5 |
| Capital increases | 37 | 25 | 23 | 3 | 10 | 4 | 6 | 5 |
| Of which, primary offerings | 4 | 0 | 10 | 1 | 6 | 1 | 2 | 0 |
| Of which, bonus issues | 15 | 6 | 0 | 0 | 0 | 0 | 0 | 0 |
| Secondary offerings | 7 | 2 | 15 | 1 | 7 | 4 | 3 | 0 |
| **NO. OF ISSUERS** [4] | 37 | 24 | 23 | 3 | 12 | 6 | 6 | 5 |
| Capital increases | 31 | 23 | 18 | 3 | 9 | 4 | 5 | 5 |
| Of which, primary offerings | 3 | 0 | 6 | 1 | 5 | 1 | 1 | 0 |
| Secondary offerings | 6 | 1 | 10 | 1 | 7 | 3 | 2 | 0 |

1. Total files registered with the CNMV (including supplements of initial files).
2. Available data: February 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 I | II | III | IV | 2007 I [1] |
|---|---|---|---|---|---|---|---|---|
| **PRIMARY OFFERINGS** | 1,101.9 | 0 | 644.9 | 58.0 | 487.3 | 0 | 99.7 | 0 |
| Spanish tranche | 536.4 | 0 | 613.6 | 58.0 | 456.0 | 0 | 99.7 | 0 |
| Private subscribers | 348.1 | 0 | 0 | 0 | 0.0 | 0 | 0 | 0 |
| Institutional subscribers | 188.3 | 0 | 613.6 | 58.0 | 456.0 | 0 | 99.7 | 0 |
| International tranche | 564.0 | 0 | 31.3 | 0 | 31.3 | 0 | 0 | 0 |
| Employees | 1.5 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **SECONDARY OFFERINGS** | 2,987.6 | 157.1 | 2,485.5 | 150.8 | 1,606.5 | 284.2 | 443.9 | 0 |
| Spanish tranche | 1,657.9 | 54.7 | 2,191.1 | 150.8 | 1,389.4 | 208.5 | 442.4 | 0 |
| Private subscribers | 657.4 | 27.3 | 398.7 | 31.3 | 253.9 | 31.8 | 81.7 | 0 |
| Institutional subscribers | 1,000.5 | 27.3 | 1,792.4 | 119.5 | 1,135.5 | 176.7 | 360.7 | 0 |
| International tranche | 1,323.2 | 102.5 | 291.3 | 0 | 215.6 | 75.7 | 0 | 0 |
| Employees | 6.5 | 0 | 3.1 | 0 | 1.6 | 0 | 1.5 | 0 |
| Others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

1. Available data: February 2007.

### Admission to listing. Files registered with the CNMV

TABLE 1.3

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I [1] |
|---|---|---|---|---|---|---|---|---|
| **NOMINAL VALUE** (Million euro) | | | | | | | | |
| With issuance prospectus | 1,909.6 | 498.0 | 963.4 | 30.4 | 259.6 | 620.0 | 53.5 | 3.6 |
| Capital increases | 1,699.3 | 494.0 | 575.9 | 30.4 | 176.2 | 340.9 | 28.4 | 3.6 |
| Of which, primary offerings | 45.4 | 0 | 145.3 | 0 | 145.2 | 0 | 0.1 | 0 |
| Secondary offerings | 210.3 | 4.0 | 387.5 | 0 | 83.4 | 279.1 | 25.1 | 0 |
| Without issuance prospectus | 564.6 | 167.3 | 564.7 | 47.2 | 213.0 | 185.9 | 118.6 | 89.0 |
| **NO. OF FILES** | | | | | | | | |
| With issuance prospectus | 36 | 26 | 18 | 2 | 7 | 5 | 4 | 1 |
| Capital increases | 34 | 25 | 13 | 2 | 5 | 3 | 3 | 1 |
| Of which, primary offerings | 2 | 0 | 5 | 0 | 4 | 0 | 1 | 0 |
| Secondary offerings | 3 | 1 | 9 | 0 | 5 | 2 | 2 | 0 |
| Without issuance prospectus | 16 | 27 | 61 | 10 | 14 | 17 | 20 | 12 |

1. Available data: February 2007.

## Companies listed [1]

TABLE 1.4

| | 2004 | 2005 | 2006 | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | | | | I | II | III | IV | I [2] |
| Total electronic market [3] | 128 | 126 | 135 | 125 | 131 | 133 | 135 | 135 |
| Of which, without Nuevo Mercado | 115 | 115 | 124 | 114 | 120 | 122 | 124 | 124 |
| Of which, Nuevo Mercado | 13 | 11 | 11 | 11 | 11 | 11 | 11 | 11 |
| Of which, foreign companies | 6 | 5 | 6 | 5 | 5 | 6 | 6 | 6 |
| Second Market | 17 | 14 | 12 | 14 | 14 | 14 | 12 | 12 |
| Madrid | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Barcelona | 12 | 10 | 9 | 10 | 10 | 10 | 9 | 9 |
| Bilbao | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Valencia | 3 | 2 | 1 | 2 | 2 | 2 | 1 | 1 |
| Open outcry ex SICAV | 53 | 47 | 38 | 43 | 42 | 40 | 38 | 34 |
| Madrid | 28 | 22 | 16 | 19 | 19 | 17 | 16 | 14 |
| Barcelona | 31 | 28 | 24 | 24 | 24 | 24 | 24 | 21 |
| Bilbao | 15 | 14 | 10 | 13 | 12 | 11 | 10 | 9 |
| Valencia | 21 | 18 | 13 | 16 | 16 | 16 | 13 | 11 |
| Open outcry SICAV | 3,086 | 3,111 | 744 | 3,110 | 3,015 | 2,642 | 744 | 199 |
| MAB [4] | - | - | 2,405 | - | 86 | 497 | 2,405 | 2,957 |
| Latibex | 30 | 32 | 34 | 32 | 33 | 34 | 34 | 34 |

1. Data at the end of period.
2. Available data: February 2007.
3. Without ETF (Exchange Traded Funds).
4. Alternative Stock Market.

## Capitalisation [1]

TABLE 1.5

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| Million euro | 2004 | 2005 | 2006 | I | II | III | IV | I [2] |
| Total electronic market [3] | 525,695.1 | 616,684.7 | 813,764.7 | 686,438.7 | 673,851.3 | 735,680.9 | 813,764.7 | 840,195.2 |
| Of which, without Nuevo Mercado | 511,770.8 | 607,062.8 | 800,144.5 | 674,907.8 | 663,180.9 | 724,521.4 | 800,144.5 | 825,652.3 |
| Of which, Nuevo Mercado | 13,924.3 | 9,621.9 | 13,620.2 | 11,530.9 | 10,670.3 | 11,159.5 | 13,620.2 | 14,542.9 |
| Of which, foreign companies | 54,734.6 | 64,312.7 | 105,600.9 | 71,558.9 | 66,388.0 | 96,456.9 | 105,600.9 | 118,429.0 |
| Ibex 35 | 344,240.2 | 407,797.4 | 502,828.0 | 450,328.6 | 438,870.8 | 464,171.3 | 502,828.0 | 515,455.6 |
| Second Market | 292.5 | 307.4 | 392.7 | 416.4 | 447.3 | 828.7 | 392.7 | 604.9 |
| Madrid | 11.0 | 9.2 | 18.9 | 9.4 | 15.8 | 14.6 | 18.9 | 33.7 |
| Barcelona | 184.1 | 154.4 | 184.2 | 264.5 | 271.8 | 649.3 | 184.2 | 379.6 |
| Bilbao | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Valencia | 97.3 | 143.8 | 189.6 | 142.5 | 159.7 | 164.8 | 189.6 | 191.5 |
| Open outcry ex SICAV | 5,311.3 | 6,142.5 | 7,905.3 | 6,601.5 | 6,778.8 | 7,184.5 | 7,905.3 | 8,804.9 |
| Madrid | 2,411.2 | 2,754.4 | 2,698.1 | 2,838.8 | 2,910.7 | 3,119.7 | 2,698.1 | 3,124.5 |
| Barcelona | 2,517.2 | 3,129.2 | 4,966.3 | 3,471.0 | 3,614.0 | 3,817.6 | 4,966.3 | 6,820.1 |
| Bilbao | 317.1 | 405.9 | 59.5 | 386.3 | 381.7 | 28.8 | 59.5 | 1,100.3 |
| Valencia | 1,556.7 | 836.1 | 741.9 | 588.3 | 706.8 | 699.8 | 741.9 | 1,678.1 |
| Open outcry SICAV | 28,972.7 | 33,997.6 | 9,514.9 | 34,811.0 | 32,544.5 | 30,466.0 | 9,514.9 | 4,476.9 |
| MAB [4] | - | - | 29,864.4 | - | 1,040.0 | 5,460.6 | 29,864.4 | 36,692.7 |
| Latibex | 124,754.8 | 222,384.1 | 271,641.8 | 252,447.4 | 228,834.9 | 233,979.4 | 271,641.8 | 272,326.8 |

1. Data at the end of period.
2. Available data: February 2007.
3. Without ETF (Exchange Traded Funds).
4. Alternative Stock Market.

## Trading

TABLE 1.6

| Million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| Total electronic market[2] | 636,527.4 | 847,663.7 | 1,144,562.9 | 270,084.0 | 261,343.7 | 263,333.6 | 349,801.5 | 254,653.2 |
| Of which, without Nuevo Mercado | 618,574.3 | 817,834.7 | 1,118,546.1 | 264,165.1 | 255,857.2 | 257,271.8 | 341,252.0 | 247,430.7 |
| Of which, Nuevo Mercado | 17,953.1 | 29,829.0 | 26,016.8 | 5,918.9 | 5,486.5 | 6,061.8 | 8,549.6 | 7,222.4 |
| Of which, foreign companies | 6,165.7 | 15,115.1 | 11,550.3 | 3,060.8 | 2,446.7 | 3,664.0 | 2,378.8 | 3,046.0 |
| Second Market | 21.3 | 25.9 | 49.3 | 8.3 | 11.1 | 11.4 | 18.6 | 47.8 |
| Madrid | 4.7 | 1.8 | 7.2 | 0.7 | 1.0 | 3.5 | 1.8 | 3.6 |
| Barcelona | 16.1 | 22.9 | 41.6 | 7.5 | 9.9 | 7.8 | 16.5 | 43.7 |
| Bilbao | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Valencia | 0.6 | 1.3 | 0.5 | 0.0 | 0.2 | 0.1 | 0.2 | 0.5 |
| Open outcry ex SICAV | 423.9 | 860.6 | 736.3 | 300.9 | 60.6 | 107.6 | 267.2 | 186.7 |
| Madrid | 122.6 | 187.8 | 257.6 | 100.3 | 35.6 | 45.8 | 75.9 | 38.1 |
| Barcelona | 293.3 | 667.0 | 297.8 | 43.5 | 21.2 | 58.8 | 174.3 | 147.5 |
| Bilbao | 1.7 | 1.1 | 159.2 | 155.5 | 1.8 | 1.4 | 0.5 | 0.0 |
| Valencia | 6.2 | 4.6 | 21.8 | 1.6 | 1.9 | 1.7 | 16.5 | 1.1 |
| Open outcry SICAV | 4,770.0 | 5,037.9 | 4,581.9 | 1,478.0 | 1,146.4 | 866.6 | 1,090.9 | 221.3 |
| MAB[3] | - | - | 1,814.2 | - | 16.9 | 92.8 | 1,704.5 | 1,108.0 |
| Latibex | 366.4 | 556.7 | 723.3 | 204.7 | 200.5 | 160.2 | 158.0 | 133.1 |

1. Available data: February 2007.
2. Without ETF (Exchange Traded Funds).
3. Alternative Stock Market.

## Trading on the electronic market by type of transaction[1]

TABLE 1.7

| Million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[2] |
|---|---|---|---|---|---|---|---|---|
| Regular trading | 599,874.2 | 798,934.5 | 1,081,224.9 | 261,712.6 | 247,945.4 | 239,121.5 | 332,445.3 | 252,449.5 |
| Orders | 353,532.0 | 488,416.3 | 659,351.0 | 163,741.7 | 153,077.2 | 138,920.0 | 203,612.1 | 156,228.9 |
| Put-throughs | 71,360.1 | 82,403.1 | 106,491.1 | 27,620.1 | 24,232.9 | 22,051.5 | 32,586.6 | 25,142.1 |
| Block trades | 174,982.0 | 228,115.1 | 315,382.7 | 70,350.9 | 70,635.3 | 78,149.9 | 96,246.6 | 71,078.5 |
| Off-hours | 26,037.3 | 27,863.0 | 11,917.4 | 1,704.0 | 512.6 | 2,699.5 | 7,001.3 | 888.1 |
| Authorised trades | 1,367.2 | 4,773.4 | 4,454.8 | 347.3 | 559.9 | 303.4 | 3,244.2 | 530.4 |
| Art. 36.1 SML trades | 826.0 | 1.3 | 6,439.7 | 0.0 | 0.0 | 6,439.7 | 0.0 | 0.0 |
| Tender offers | 1,698.8 | 6,682.8 | 18,094.6 | 2,182.2 | 29.7 | 11,960.2 | 3,922.5 | 466.0 |
| Public offerings for sale | 3,057.2 | 226.3 | 3,264.0 | 0.0 | 1,584.6 | 1,102.5 | 576.8 | 0.0 |
| Declared trades | 278.5 | 2,298.9 | 10,399.2 | 1,209.6 | 8,337.3 | 637.3 | 215.0 | 307.9 |
| Options | 3,388.3 | 5,268.0 | 8,279.8 | 2,177.0 | 1,754.7 | 1,274.8 | 3,073.3 | 114.8 |
| Hedge transactions | - | 1,615.4 | 2,315.6 | 751.3 | 619.5 | 403.8 | 541.1 | 340.9 |

1. With ETF (Exchange Traded Funds).
2. Available data: February 2007.

## Margin trading for sales and securities lending

TABLE 1.8

| Million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| **TRADING** | | | | | | | | |
| Securities lending[2] | 306,056.7 | 393,964.1 | 550,850.4 | 123,227.0 | 147,751.3 | 116,996.8 | 162,875.2 | 132,979.0 |
| Margin trading for sales of securities[3] | 139.2 | 152.2 | 379.9 | 82.4 | 106.6 | 96.7 | 94.2 | 74.5 |
| Margin trading for securities purchases[3] | 401.8 | 465.0 | 511.9 | 147.6 | 106.3 | 105.7 | 152.3 | 106.9 |
| **OUTSTANDING BALANCE** | | | | | | | | |
| Securities lending[2] | 54,518.5 | 66,737.5 | 62,058.2 | 80,866.5 | 60,024.0 | 52,604.7 | 62,058.2 | 65,648.9 |
| Margin trading for sales of securities[3] | 18.2 | 28.5 | 73.6 | 62.2 | 88.1 | 74.2 | 73.6 | 76.8 |
| Margin trading for securities purchases[3] | 46.7 | 52.3 | 70.1 | 66.1 | 48.4 | 60.9 | 70.1 | 84.9 |

1. Available data: February 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 registered [1] at the CNMV

TABLE 1.9

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2006 | I | II | III | IV | I [2] |
| **NO. OF ISSUERS** | 157 | 155 | 159 | 59 | 61 | 48 | 69 | 36 |
| Mortgage covered bonds | 9 | 9 | 11 | 7 | 4 | 5 | 6 | 5 |
| Territorial covered bonds | 2 | 2 | 5 | 0 | 1 | 2 | 3 | 0 |
| Non-convertible bonds and debentures | 50 | 49 | 46 | 19 | 23 | 20 | 18 | 11 |
| Convertible bonds and debentures | 2 | 4 | 1 | 1 | 0 | 0 | 0 | 0 |
| Backed securities | 48 | 53 | 61 | 11 | 15 | 11 | 28 | 4 |
| Commercial paper | 58 | 68 | 68 | 27 | 22 | 13 | 20 | 18 |
| Of which, asset-backed | 3 | 3 | 3 | 0 | 2 | 1 | 0 | 0 |
| Of which, non-asset-backed | 55 | 65 | 65 | 27 | 20 | 12 | 20 | 18 |
| Other fixed-income issues | 4 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| Preference shares | 12 | 6 | 9 | 0 | 1 | 2 | 6 | 2 |
| **NO. OF ISSUES** | 257 | 264 | 335 | 86 | 85 | 66 | 98 | 48 |
| Mortgage covered bonds | 17 | 21 | 37 | 11 | 8 | 11 | 7 | 6 |
| Territorial covered bonds | 2 | 3 | 6 | 0 | 1 | 2 | 3 | 0 |
| Non-convertible bonds and debentures | 95 | 93 | 115 | 32 | 30 | 27 | 26 | 18 |
| Convertible bonds and debentures | 3 | 4 | 1 | 1 | 0 | 0 | 0 | 0 |
| Backed securities | 48 | 54 | 82 | 14 | 23 | 11 | 34 | 4 |
| Commercial paper | 62 | 81 | 83 | 28 | 22 | 13 | 20 | 18 |
| Of which, asset-backed | 3 | 3 | 3 | 0 | 2 | 1 | 0 | 0 |
| Of which, non-asset-backed | 59 | 78 | 80 | 28 | 20 | 12 | 20 | 18 |
| Other fixed-income issues | 5 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| Preference shares | 26 | 7 | 11 | 0 | 1 | 2 | 8 | 2 |
| **NOMINAL AMOUNT** (Million euro) | 329,962.3 | 414,147.2 | 523,131.4 | 134,758.3 | 120,852.7 | 121,497.2 | 146,023.2 | 99,734.6 |
| Mortgage covered bonds | 19,074.0 | 35,560.0 | 44,250.0 | 21,200.0 | 7,070.0 | 10,950.0 | 5,030.0 | 8,050.0 |
| Territorial covered bonds | 1,600.0 | 1,775.0 | 5,150.0 | 0.0 | 150.0 | 1,800.0 | 3,200.0 | 0.0 |
| Non-convertible bonds and debentures | 38,093.6 | 41,907.1 | 46,687.5 | 14,189.4 | 14,246.1 | 9,980.0 | 8,272.0 | 6,762.0 |
| Convertible bonds and debentures | 97.4 | 162.8 | 68.1 | 68.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Backed securities | 50,524.8 | 69,044.3 | 91,607.7 | 19,423.2 | 22,645.8 | 9,772.4 | 39,766.4 | 7,631.0 |
| Spanish tranche | 38,099.5 | 63,908.3 | 85,099.9 | 19,423.2 | 21,696.6 | 9,772.4 | 34,207.8 | 7,631.0 |
| International tranche | 12,425.3 | 5,136.0 | 6,507.8 | 0.0 | 949.2 | 0.0 | 5,558.6 | 0.0 |
| Commercial paper [3] | 214,602.8 | 264,252.7 | 334,457.0 | 79,877.5 | 76,710.8 | 88,897.9 | 88,970.8 | 77,211.6 |
| Of which, asset-backed | 3,723.6 | 2,767.0 | 1,992.7 | 874.4 | 179.0 | 802.3 | 137.0 | 98.0 |
| Of which, non-asset-backed | 210,879.2 | 261,485.7 | 332,464.3 | 79,003.1 | 76,531.8 | 88,095.6 | 88,833.8 | 77,113.6 |
| Other fixed-income issues | 428.1 | 89.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Preference shares | 5,541.5 | 1,356.0 | 911.0 | 0.0 | 30.0 | 97.0 | 784.0 | 80.0 |
| **Pro memoria:** | | | | | | | | |
| Subordinated issues | 8,871.2 | 11,078.5 | 27,361.5 | 5,516.8 | 3,961.7 | 4,725.8 | 13,157.2 | 4,875.0 |
| Underwritten issues | 97,791.9 | 94,368.0 | 92,213.5 | 19,740.6 | 22,634.1 | 9,772.4 | 40,066.4 | 7,631.0 |

1. This Includes the volume of issues admitted to trading without register issuance prospectuses.
2. Available data: February 2007.
3. The figures for commercial paper refer to the amount placed in the year.

### Issues admitted to trading on AIAF

TABLE 1.10

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| Nominal amount (million euro) | 2004 | 2005 | 2006 | I | II | III | IV | I [1] |
| Total | 353,772.2 | 425,137.4 | 507,525.3 | 124,138.9 | 121,163.7 | 126,312.2 | 135,910.4 | 103,799.8 |
| Commercial paper | 211,984.5 | 263,728.9 | 332,328.4 | 80,313.4 | 74,889.3 | 89,005.7 | 88,120.0 | 78,246.0 |
| Bonds and debentures | 63,878.7 | 56,771.5 | 45,155.4 | 13,508.0 | 13,213.4 | 11,980.0 | 6,454.0 | 6,666.6 |
| Mortgage covered bonds | 20,550.0 | 31,600.0 | 43,720.0 | 20,250.0 | 6,870.0 | 10,100.0 | 6,500.0 | 7,500.0 |
| Territorial covered bonds | 2,300.0 | 1,775.0 | 2,650.0 | 0.0 | 150.0 | 300.0 | 2,200.0 | 1,500.0 |
| Backed securities | 50,884.7 | 67,480.5 | 83,042.5 | 10,067.6 | 26,040.9 | 14,806.6 | 32,127.5 | 9,525.2 |
| Preference shares | 4,174.3 | 3,781.5 | 629.0 | 0.0 | 0.0 | 120.0 | 509.0 | 362.0 |
| Matador bonds | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

1. Available data: February 2007.

## AIAF. Issuers, issues and outstanding balance

TABLE 1.11

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| **NO. OF ISSUERS** | 324 | 384 | 438 | 391 | 402 | 416 | 438 | 444 |
| Commercial paper | 63 | 66 | 69 | 67 | 65 | 69 | *69* | 69 |
| Bonds and debentures | 76 | 82 | 80 | 86 | 88 | 91 | *80* | 92 |
| Mortgage covered bonds | 10 | 12 | 14 | 12 | 14 | 14 | *14* | 15 |
| Territorial covered bonds | 3 | 3 | 5 | 3 | 3 | 4 | *5* | 6 |
| Backed securities | 163 | 211 | 257 | 215 | 226 | 236 | *257* | 262 |
| Preference shares | 33 | 42 | 46 | 42 | 42 | 42 | *46* | 49 |
| Matador bonds | 20 | 20 | 20 | 20 | 20 | 20 | *20* | 19 |
| **NO. OF ISSUES** | 2,459 | 2,836 | 3,681 | 3,131 | 3,362 | 3,507 | 3,681 | 3,965 |
| Commercial paper | 1,593 | 1,724 | 2,242 | 1,977 | 2,138 | 2,199 | 2,242 | 2,467 |
| Bonds and debentures | 271 | 329 | 398 | 346 | 364 | 385 | 398 | 413 |
| Mortgage covered bonds | 41 | 54 | 83 | 61 | 67 | 77 | 83 | 88 |
| Territorial covered bonds | 5 | 8 | 11 | 8 | 9 | 10 | 11 | 12 |
| Backed securities | 468 | 631 | 856 | 650 | 696 | 746 | 856 | 892 |
| Preference shares | 47 | 58 | 65 | 58 | 58 | 60 | 65 | 69 |
| Matador bonds | 34 | 32 | 26 | 31 | 30 | 30 | 26 | 24 |
| **OUTSTANDING BALANCE**[2] (million euro) | 307,428.8 | 448,679.3 | 588,942.3 | 478,512.6 | 513,817.5 | 548,592.0 | 588,942.3 | 615,367.0 |
| Commercial paper | 45,176.7 | 57,719.4 | 70,778.6 | 58,842.1 | 60,110.4 | 67,489.2 | 70,778.6 | 75,906.9 |
| Bonds and debentures | 68,044.8 | 103,250.7 | 131,107.8 | 113,875.2 | 121,429.5 | 128,308.6 | 131,107.8 | 134,644.4 |
| Mortgage covered bonds | 57,324.5 | 90,550.0 | 129,710.0 | 107,240.0 | 114,110.0 | 124,210.0 | 129,710.0 | 137,210.0 |
| Territorial covered bonds | 5,800.0 | 7,575.0 | 9,525.0 | 7,575.0 | 7,725.0 | 8,025.0 | 9,525.0 | 11,025.0 |
| Backed securities | 109,862.5 | 164,810.0 | 222,866.1 | 166,356.4 | 185,878.7 | 195,875.4 | 222,866.1 | 231,444.1 |
| Preference shares | 18,705.1 | 22,486.6 | 23,115.6 | 22,486.6 | 22,486.6 | 22,606.6 | 23,115.6 | 23,417.6 |
| Matador bonds | 2,515.1 | 2,287.6 | 1,839.2 | 2,137.3 | 2,077.2 | 2,077.2 | 1,839.2 | 1,719.0 |

1. Available data: February 2007.
2. Nominal amount.

## AIAF. Trading

TABLE 1.12

| Nominal amount in million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| **BY TYPE OF ASSET. Total** | 572,030.0 | 877,812.1 | 910,493.9 | 209,123.8 | 216,705.3 | 214,330.4 | 270,334.3 | 190,342.0 |
| Commercial paper | 291,902.6 | 408,185.0 | 489,069.5 | 104,399.0 | 104,543.9 | 139,298.9 | 140,827.7 | 105,561.1 |
| Bonds and debentures | 51,263.3 | 86,585.7 | 82,421.1 | 19,847.9 | 25,043.4 | 17,962.7 | 19,567.1 | 18,628.9 |
| Mortgage covered bonds | 46,014.4 | 60,060.9 | 70,113.5 | 20,517.9 | 12,326.1 | 15,466.1 | 21,803.3 | 13,785.0 |
| Territorial covered bonds | 3,356.9 | 2,740.1 | 3,659.1 | 117.1 | 335.1 | 618.0 | 2,588.9 | 620.5 |
| Backed securities | 171,724.6 | 313,778.5 | 257,628.9 | 62,263.9 | 72,344.6 | 39,549.6 | 83,470.8 | 50,259.8 |
| Preference shares | 4,139.4 | 4,046.2 | 4,647.8 | 1,165.5 | 1,018.1 | 952.2 | 1,512.0 | 1,078.1 |
| Matador bonds | 3,628.8 | 2,415.7 | 2,954.1 | 812.4 | 1,094.2 | 482.8 | 564.7 | 408.6 |
| **BY TYPE OF TRANSACTION. Total** | 572,030.0 | 877,812.0 | 910,493.9 | 209,123.8 | 216,705.3 | 214,330.4 | 270,334.3 | 190,342.0 |
| Outright | 242,333.0 | 322,819.0 | 386,368.8 | 90,070.2 | 93,496.4 | 84,178.3 | 118,623.9 | 72,521.4 |
| Repos | 197,778.0 | 284,520.0 | 330,839.9 | 68,363.9 | 72,340.1 | 91,538.6 | 98,597.3 | 80,258.2 |
| Sell-buybacks/Buy-sellbacks | 131,919.0 | 270,473.0 | 193,285.1 | 50,689.7 | 50,868.8 | 38,613.5 | 53,113.1 | 37,562.4 |

1. Available data: February 2007.

## AIAF. Third-party trading. By purchaser sector

TABLE 1.13

| Nominal amount in million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| Total | 430,127.3 | 591,837.2 | 702,608.8 | 155,442.7 | 162,265.7 | 171,695.1 | 213,205.3 | 150,828.4 |
| Non-financial companies | 176,479.7 | 218,139.5 | 260,108.1 | 54,377.2 | 53,542.0 | 74,115.1 | 78,073.8 | 56,044.5 |
| Financial institutions | 138,401.6 | 218,381.1 | 247,876.4 | 57,340.0 | 58,287.2 | 63,569.6 | 68,679.6 | 43,481.0 |
| Credit institutions | 43,446.8 | 71,118.9 | 83,999.1 | 15,192.9 | 23,187.9 | 19,304.5 | 26,313.7 | 10,502.4 |
| CIS[2], insurance and pension funds | 90,163.8 | 138,580.4 | 145,911.5 | 36,906.3 | 31,090.9 | 40,199.8 | 37,714.5 | 27,752.9 |
| Other financial institutions | 4,790.9 | 8,681.8 | 17,965.8 | 5,240.8 | 4,008.4 | 4,065.2 | 4,651.4 | 5,225.7 |
| General government | 1,695.9 | 5,629.4 | 7,058.9 | 1,360.2 | 2,070.3 | 1,311.1 | 2,317.3 | 1,718.7 |
| Households and NPISHs[3] | 16,100.1 | 14,433.3 | 23,675.9 | 6,131.9 | 6,017.3 | 4,445.8 | 7,080.9 | 13,817.3 |
| Rest of the world | 97,450.1 | 135,253.9 | 163,889.4 | 36,233.4 | 42,348.9 | 28,253.5 | 57,053.7 | 35,766.8 |

1. Available data: February 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

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | **2004** | **2005** | **2006** | **I** | **II** | **III** | **IV** | **I** [1] |
| **NOMINAL AMOUNTS** (Million euro) | 113.3 | 1,234.6 | 68.1 | 68.1 | 0 | 0 | 0 | 0 |
| Non-convertible bonds and debentures | 50.0 | 1,140.0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Convertible bonds and debentures | 63.3 | 94.6 | 68.1 | 68.1 | 0 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **NO. OF FILES** | 3 | 6 | 1 | 1 | 0 | 0 | 0 | 0 |
| Non-convertible bonds and debentures | 1 | 3 | 0 | 0 | 0 | 0 | 0 | 0 |
| Convertible bonds and debentures | 2 | 3 | 1 | 1 | 0 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |

1. Available data: February 2007.

## Equity markets. Issuers, issues and outstanding balances

TABLE 1.15

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | **2004** | **2005** | **2006** | **I** | **II** | **III** | **IV** | **I** [1] |
| **NO. OF ISSUERS** | 52 | 56 | 57 | 57 | 55 | 56 | 57 | 56 |
| Private issuers | 35 | 39 | 40 | 40 | 38 | 39 | 40 | 40 |
| Non-financial companies | 12 | 12 | 10 | 13 | 11 | 10 | 10 | 10 |
| Financial institutions | 23 | 27 | 30 | 27 | 27 | 29 | 30 | 30 |
| General government | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 16 |
| Regional governments | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 |
| **NO. OF ISSUES** | 264 | 267 | 264 | 259 | 254 | 261 | 264 | 256 |
| Private issuers | 113 | 122 | 131 | 121 | 115 | 123 | 131 | 130 |
| Non-financial companies | 28 | 22 | 18 | 23 | 20 | 18 | 18 | 17 |
| Financial institutions | 85 | 100 | 113 | 98 | 95 | 105 | 113 | 113 |
| General government | 151 | 145 | 133 | 138 | 139 | 138 | 133 | 126 |
| Regional governments | 87 | 92 | 89 | 91 | 92 | 91 | 89 | 89 |
| **OUTSTANDING BALANCES** [2] (Million euro) | 14,460.0 | 16,323.0 | 17,105.4 | 16,005.2 | 15,767.6 | 16,914.7 | 17,105.4 | 18,011.0 |
| Private issuers | 4,533.2 | 5,507.3 | 6,784.3 | 5,436.4 | 4,961.4 | 5,973.3 | 6,784.3 | 6,665.6 |
| Non-financial companies | 1,244.7 | 835.4 | 492.1 | 846.7 | 492.2 | 491.9 | 492.1 | 486.3 |
| Financial institutions | 3,288.5 | 4,671.9 | 6,292.2 | 4,589.7 | 4,469.2 | 5,481.5 | 6,292.2 | 6,179.3 |
| General government [3] | 9,926.8 | 10,816.1 | 10,321.1 | 10,568.8 | 10,806.2 | 10,941.3 | 10,321.1 | 10,197.9 |
| Regional governments | 7,198.2 | 8,457.2 | 8,319.8 | 8,219.0 | 8,456.4 | 8,591.6 | 8,319.8 | 8,356.3 |

1. Available data: February 2007.
2. Nominal amount.
3. Without public book-entry debt.

## Trading on equity markets

TABLE 1.16

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| Nominal amounts in million euro | **2004** | **2005** | **2006** | **I** | **II** | **III** | **IV** | **I** [1] |
| Electronic market | 227.0 | 220.0 | 257.3 | 36.6 | 160.1 | 22.8 | 37.7 | 23.0 |
| Open outcry | 490.1 | 4,538.3 | 5,009.9 | 356.8 | 112.9 | 2,641.2 | 1,899.0 | 309.5 |
| 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 | 319.7 | 75.3 | 2,616.8 | 1,867.8 | 285.1 |
| Bilbao | 309.2 | 9.2 | 24.8 | 6.9 | 14.0 | 1.3 | 2.6 | 0.9 |
| Valencia | 130.5 | 124.8 | 105.5 | 30.2 | 23.6 | 23.1 | 28.5 | 23.6 |
| Public book-entry debt | 40.8 | 36.1 | 35.6 | 8.0 | 9.9 | 7.9 | 9.9 | 4.4 |
| Regional governments debt | 76,258.8 | 83,204.0 | 84,443.6 | 22,424.6 | 22,471.4 | 21,182.1 | 18,365.4 | 12,301.9 |

1. Available data: February 2007.

## Organised trading systems: SENAF y MTS. Public debt trading by type

TABLE 1.17

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| Nominal amounts in million euro | **2004** | **2005** | **2006** | **I** | **II** | **III** | **IV** | **I** [1] |
| Total | 381.1 | 219.5 | 175.1 | 56.1 | 37.1 | 45.5 | 36.4 | 18.9 |
| Outright | 104.1 | 71.0 | 94.3 | 21.1 | 19.2 | 34.9 | 19.1 | 10.3 |
| Sell-buybacks/Buy-sellbacks | 274.8 | 148.5 | 80.2 | 34.4 | 17.9 | 10.6 | 17.3 | 8.6 |
| Others | 2.2 | 0.1 | 0.6 | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 |

1. Available data: February 2007.

## 1.3 Derivatives and other products

### 1.3.1 Financial derivatives markets: MEFF

**Trading on MEFF** TABLE 1.18

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| No. of contracts | 2004 | 2005 | 2006 | I | II | III | IV | I [1] |
| Debt products | 98 | 46 | 15 | 4 | 4 | 4 | 3 | 0 |
| Debt futures [2] | 98 | 46 | 15 | 4 | 4 | 4 | 3 | 0 |
| Ibex 35 products [3, 4] | 4,767,871 | 5,490,958 | 7,119,853 | 1,597,856 | 1,845,622 | 1,677,721 | 1,998,653 | 1,361,385 |
| Ibex 35 plus futures | 4,354,868 | 4,935,648 | 6,408,961 | 1,427,108 | 1,680,845 | 1,545,699 | 1,755,309 | 1,251,583 |
| Ibex 35 mini futures | 118,250 | 114,563 | 159,830 | 33,899 | 45,390 | 34,313 | 46,228 | 34,987 |
| Call mini options | 148,119 | 232,825 | 288,542 | 71,732 | 52,077 | 48,399 | 116,334 | 31,321 |
| Put mini options | 146,634 | 207,922 | 262,521 | 65,118 | 67,310 | 49,310 | 80,783 | 43,493 |
| Stock products [5] | 20,255,113 | 29,728,916 | 33,655,790 | 11,080,202 | 7,823,784 | 6,354,792 | 8,397,012 | 2,420,485 |
| Futures | 12,054,799 | 18,813,689 | 21,229,811 | 7,383,221 | 4,663,777 | 4,294,517 | 4,888,296 | 699,928 |
| Call options | 5,226,872 | 6,803,863 | 7,664,125 | 2,360,127 | 1,533,493 | 1,183,228 | 2,587,277 | 921,173 |
| Put options | 2,973,442 | 4,111,364 | 4,761,854 | 1,336,854 | 1,626,514 | 877,047 | 921,439 | 799,384 |
| **Pro-memoria: MEFF trading on Eurex** | | | | | | | | |
| Debt products [6] | 2,815,703 | 1,440,370 | 1,117,956 | 318,249 | 319,145 | 258,349 | 222,213 | 112,769 |
| Index products [7] | 1,784,965 | 1,080,801 | 1,423,441 | 300,540 | 461,528 | 374,207 | 287,166 | 122,154 |

1. Available data: February 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

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2006 | I | II | III | IV | I [1] |
| **WARRANTS [2]** | | | | | | | | |
| Premium amount (Million euro) | 1,525.3 | 1,840.0 | 5,144.3 | 1,882.1 | 906.7 | 642.5 | 1,713.0 | 1,186.0 |
| On stocks | 929.0 | 1,180.8 | 3,697.6 | 1,232.9 | 755.8 | 465.8 | 1,243.1 | 949.4 |
| On indexes | 553.8 | 559.9 | 1,064.9 | 390.4 | 124.5 | 135.8 | 414.2 | 158.6 |
| Other underlyings [3] | 42.5 | 99.3 | 381.8 | 258.8 | 26.5 | 40.9 | 55.6 | 78.0 |
| Number of issues | 1,600 | 1,720 | 4.063 | 985 | 755 | 671 | 1,652 | 1,284 |
| Number of issuers | 7 | 6 | 8 | 5 | 5 | 7 | 7 | 6 |
| **OPTION BUYING AND SELLING CONTRACTS** | | | | | | | | |
| Nominal amounts (Million euro) | 247.7 | 112.2 | 206.8 | 45.6 | 18.0 | 101.2 | 42.0 | 31.0 |
| On stocks | 195.3 | 87.8 | 196.2 | 45.0 | 18.0 | 101.2 | 32.0 | 25.0 |
| On indexes | 48.7 | 16.4 | 0.6 | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other underlyings [3] | 3.8 | 8.0 | 10.0 | 0.0 | 0.0 | 0.0 | 10.0 | 6.0 |
| Number of issuers | 31 | 13 | 12 | 4 | 1 | 3 | 4 | 2 |
| Number of issues | 8 | 4 | 4 | 3 | 1 | 2 | 2 | 2 |

1. Available data: February 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 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| **WARRANTS** | | | | | | | | |
| Trading (Million euro) | 1,826.9 | 2,142.4 | 2,907.4 | 730.3 | 773.2 | 554.0 | 849.9 | 718.2 |
| On Spanish stocks | 1,141.7 | 1,431.7 | 1,803.9 | 447.4 | 411.8 | 341.4 | 603.3 | 503.4 |
| On foreign stocks | 95.1 | 155.8 | 294.7 | 85.4 | 66.5 | 45.0 | 97.8 | 89.7 |
| On indexes | 550.7 | 516.8 | 727.4 | 184.7 | 273.9 | 149.6 | 119.2 | 106.5 |
| Other underlyings[2] | 39.3 | 38.0 | 81.4 | 12.8 | 21.0 | 18.0 | 29.6 | 18.6 |
| Number of issues[3] | 2,207 | 2,520 | 4,284 | 1,692 | 1,834 | 1,991 | 2,475 | 2,536 |
| Number of issuers[3] | 8 | 8 | 9 | 8 | 7 | 9 | 9 | 9 |
| **CERTIFICATES** | | | | | | | | |
| Trading (Million euro) | 78.6 | 69.8 | 58.8 | 20.6 | 11.5 | 11.4 | 15.3 | 8.6 |
| Number of issues[3] | 16 | 15 | 14 | 12 | 12 | 11 | 11 | 9 |
| Number of issuers[3] | 5 | 5 | 5 | 5 | 5 | 4 | 4 | 3 |
| **ETF** | | | | | | | | |
| Trading (Million euro) | - | - | - | - | - | 609.1 | 1.218.0 | 444.4 |
| Number of funds | - | - | - | - | - | 2 | 5 | 5 |
| Assets[4] (Million euro) | - | - | - | - | - | 204.4 | 376.8 | na |

1. Available data: February 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 MFAO[1]

TABLE 1.21

| Number of contracts | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[2] |
|---|---|---|---|---|---|---|---|---|
| On olive oil | | | | | | | | |
| Extra – virgin olive oil futures[3] | 10,693 | 21,145 | 35,079 | 14,620 | 7,032 | 7,027 | 6,400 | 10,459 |

1. Olive oil futures market.
2. Available data : February 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 I | II | III | IV | 2007 I [1] |
|---|---|---|---|---|---|---|---|---|
| Broker – dealers | | | | | | | | |
| Spanish firms | 48 | 46 | 47 | 45 | 45 | 46 | 47 | 46 |
| Branches | 90 | 96 | 108 | 96 | 102 | 107 | 108 | 93 |
| Agents | 6,453 | 6,562 | 6,610 | 6,494 | 6,617 | 6,587 | 6,610 | 6,489 |
| Brokers | | | | | | | | |
| Spanish firms | 55 | 56 | 57 | 57 | 59 | 58 | 57 | 56 |
| Branches | 13 | 11 | 11 | 11 | 11 | 10 | 11 | 12 |
| Agents | 363 | 516 | 589 | 549 | 575 | 585 | 589 | 593 |
| Portfolio management companies | | | | | | | | |
| Spanish firms | 21 | 17 | 15 | 17 | 15 | 15 | 15 | 15 |
| Branches | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Agents | 3 | 14 | 5 | 13 | 4 | 4 | 5 | 6 |
| Credit institutions [2] | 207 | 206 | 204 | 205 | 205 | 205 | 204 | 204 |

1. Available data: February 2007.
2. Source: Banco de España.

## Investment services. Foreign firms

TABLE 2.2.

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I [1] |
|---|---|---|---|---|---|---|---|---|
| Total | 1,107 | 1,196 | 1,321 | 1,219 | 1,260 | 1,296 | 1,321 | 1,340 |
| European Economic Area investment services firms | 801 | 867 | 973 | 887 | 923 | 950 | 973 | 993 |
| Branches | 19 | 18 | 22 | 17 | 16 | 17 | 22 | 23 |
| Free provision of services | 782 | 849 | 951 | 870 | 907 | 933 | 951 | 970 |
| Credit institutions [2] | 306 | 329 | 348 | 332 | 337 | 346 | 348 | 347 |
| From EU member states | 297 | 320 | 339 | 323 | 328 | 337 | 339 | 339 |
| Branches | 37 | 38 | 44 | 38 | 40 | 42 | 44 | 45 |
| Free provision of services | 259 | 281 | 294 | 284 | 287 | 294 | 294 | 293 |
| Subsidiaries of free provision of services institutions | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| From non-EU states | 9 | 9 | 9 | 9 | 9 | 9 | 9 | 8 |
| Branches | 8 | 8 | 8 | 8 | 8 | 8 | 8 | 7 |
| Free provision of services | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |

1. Available data: February 2007.
2. Source: Banco de España.

## Intermediation of spot transactions

TABLE 2.3.

| Million euro | IV 2005 Spanish Stock Exchange | IV 2005 Other Spanish markets | IV 2005 Foreign markets | IV 2005 Total | IV 2006 Spanish Stock Exchange | IV 2006 Other Spanish markets | IV 2006 Foreign markets | IV 2006 Total |
|---|---|---|---|---|---|---|---|---|
| **FIXED – INCOME** | | | | | | | | |
| Total | 13,824 | 2,331,405 | 363,124 | 2,708,353 | 4,395 | 2,695,533 | 280,170 | 2,980,098 |
| Broker-dealers | 13,660 | 371,500 | 25,946 | 411,106 | 4,280 | 251,823 | 41,799 | 297,902 |
| Brokers | 164 | 1,959,905 | 337,178 | 2,297,247 | 115 | 2,443,710 | 238,371 | 2,682,196 |
| **EQUITY** | | | | | | | | |
| Total | 334,893 | 1,366 | 24,935 | 361,194 | 536,382 | 2,542 | 25,130 | 564,054 |
| Broker-dealers | 315,638 | 535 | 18,080 | 334,253 | 495,729 | 1,480 | 20,836 | 518,045 |
| Brokers | 19,255 | 831 | 6,855 | 26,941 | 40,653 | 1,062 | 4,294 | 46,009 |

## Intermediation of derivative transactions[1]

TABLE 2.4

| Million euro | IV 2005 | | | | IV 2006 | | | |
|---|---|---|---|---|---|---|---|---|
| | Spanish organised markets | Foreign organised markets | Non-organised market | **Total** | Spanish organised markets | Foreign organised markets | Non-organised market | **Total** |
| Total | 205,698 | 1,129,199 | 794,394 | 2,129,291 | 215,709 | 1,833,111 | 1,052,004 | 3,100,824 |
| Broker – dealers | 89,804 | 223,152 | 25,032 | 337,988 | 108,923 | 253,953 | 5,164 | 368,040 |
| Brokers | 115,894 | 906,047 | 769,362 | 1,791,303 | 106,786 | 1,579,158 | 1,046,840 | 2,732,784 |

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

| | IV 2005 | | | IV 2006 | | |
|---|---|---|---|---|---|---|
| | **Total** | **IIC[1]** | **Other[2]** | **Total** | **IIC[1]** | **Other[2]** |
| **NUMBER OF PORTFOLIOS** | | | | | | |
| Total | 15,911 | 95 | 15,816 | 16,278 | 85 | 16,193 |
| Broker – dealers | 9,239 | 16 | 9,223 | 8,230 | 22 | 8,208 |
| Brokers | 2,648 | 45 | 2,603 | 3,977 | 28 | 3,949 |
| Portfolio management companies | 4,024 | 34 | 3,990 | 4,071 | 35 | 4,036 |
| **ASSETS UNDER MANAGEMENT (thousand euro)** | | | | | | |
| Total | 9,310,619 | 1,023,135 | 8,287,484 | 12,940,268 | 1,256,154 | 11,684,114 |
| Broker – dealers | 3,978,041 | 330,092 | 3,647,949 | 5,195,618 | 646,377 | 4,549,241 |
| Brokers | 2,202,293 | 450,063 | 1,752,230 | 3,498,993 | 328,284 | 3,170,709 |
| Portfolio management companies | 3,130,285 | 242,980 | 2,887,305 | 4,245,657 | 281,493 | 3,964,164 |

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 I** | **II** | **III** | **IV** | **2007 I[2]** |
|---|---|---|---|---|---|---|---|---|
| I. FINANCIAL INCOME | 78,435 | 57,653 | 17,325 | -11,325 | -8,354 | 20,034 | 17,325 | 17,254 |
| II. NET INCOME FROM SECURITIES TRADING | -44,315 | 200,360 | 48,335 | 5,174 | 63,438 | 138,978 | 48,335 | 17,296 |
| III. NET COMMISSION | 539,154 | 653,273 | 775,377 | 194,350 | 358,392 | 548,181 | 775,377 | 73,270 |
| Commission revenues | 700,061 | 847,524 | 1,009,089 | 249,415 | 469,809 | 716,306 | 1,009,089 | 94,031 |
| Brokering | 449,067 | 526,241 | 629,952 | 164,460 | 298,730 | 432,407 | 629,952 | 63,636 |
| Placement and underwriting | 39,904 | 58,685 | 73,278 | 16,566 | 28,009 | 61,443 | 73,278 | 826 |
| Securities deposit and recording | 15,237 | 17,593 | 22,367 | 5,215 | 10,742 | 16,322 | 22,367 | 1,980 |
| Portfolio management | 14,141 | 20,599 | 23,883 | 6,502 | 11,284 | 16,119 | 23,883 | 2,195 |
| Design and advising | 35,131 | 52,180 | 55,918 | 10,976 | 24,910 | 42,403 | 55,918 | 7,765 |
| Stocks search and placement | 12 | 6 | 0 | 3 | 5 | 6 | 0 | 9 |
| Market credit transactions | 128 | 56 | 33 | 8 | 20 | 27 | 33 | 2 |
| IIC subscription and redemption | 104,909 | 118,871 | 141,312 | 33,767 | 67,301 | 102,479 | 141,312 | 12,165 |
| Other | 41,532 | 53,293 | 62,346 | 11,918 | 28,808 | 45,100 | 62,346 | 5,453 |
| Commission expenses | 160,907 | 194,251 | 233,712 | 55,065 | 111,417 | 168,125 | 233,712 | 20,761 |
| IV. TOTAL NET REVENUES | 573,274 | 911,286 | 841,037 | 188,199 | 413,476 | 707,193 | 841,037 | 107,820 |
| V. OPERATING INCOME | 207,113 | 498,362 | 395,105 | 77,226 | 197,008 | 383,776 | 395,105 | 70,303 |
| VII. EARNINGS AFTER TAXES | 215,903 | 266,734 | 430,651 | 102,116 | 211,316 | 484,790 | 430,651 | 96,553 |

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: January 2007.

## Results of proprietary trading. Broker – dealers

TABLE 2.7

| Thousand euro [1] | Total | | Financial income | | Securities portfolio | | Other charges | |
|---|---|---|---|---|---|---|---|---|
| | IV 2005 | IV 2006 | IV 2005 | IV 2006 | IV 2005 | IV 2006 | IV 2005 | IV 2006 |
| Total | 251,640 | 65,239 | 57,653 | 17,325 | 200,360 | 48,335 | -6,373 | -421 |
| Money market assets and public debt | -6,041 | 2,408 | 9,690 | 9,464 | -15,731 | -7,056 | 0 | 0 |
| Other fixed – income securities | 57,296 | 50,950 | 16,573 | 40,820 | 40,723 | 10,130 | 0 | 0 |
| Domestic portfolio | 54,933 | 46,650 | 12,535 | 37,172 | 42,398 | 9,478 | 0 | 0 |
| Foreign portfolio | 2,363 | 4,300 | 4,038 | 3,648 | -1,675 | 652 | 0 | 0 |
| Equities | 85,092 | 192,668 | 42,058 | 69,584 | 43,034 | 123,084 | 0 | 0 |
| Domestic portfolio | 53,885 | 219,189 | 19,435 | 39,294 | 34,450 | 179,895 | 0 | 0 |
| Foreign portfolio | 31,207 | -26,521 | 22,623 | 30,290 | 8,584 | -56,811 | 0 | 0 |
| Derivatives | 137,772 | -66,372 | 0 | 0 | 137,772 | -66,372 | 0 | 0 |
| Repurchase agreements | -853 | -13,452 | -853 | -13,452 | 0 | 0 | 0 | 0 |
| Market credit transactions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Deposits and other transactions with financial intermediaries | -59,909 | -128,602 | -59,909 | -128,602 | 0 | 0 | 0 | 0 |
| Other transactions | 38,283 | 27,639 | 50,094 | 39,511 | -5,438 | -11,451 | -6,373 | -421 |

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 |
|---|---|---|---|---|---|---|---|---|
| | | | | I | II | III | IV | I [2] |
| I. FINANCIAL INCOME | 7,677 | 10,665 | 12,934 | 1,857 | 4,713 | 10,041 | 12,934 | 1,615 |
| II. NET INCOME FROM SECURITIES TRADING | 622 | 3,306 | 3,906 | 1,112 | 1,011 | 1,796 | 3,906 | 147 |
| III. NET COMMISSION | 157,362 | 184,113 | 233,447 | 60,289 | 121,371 | 172,783 | 233,447 | 23,581 |
| Commission revenues | 191,091 | 229,752 | 297,030 | 74,145 | 152,278 | 218,924 | 297,030 | 29,276 |
| Brokering | 88,168 | 97,948 | 114,111 | 29,254 | 57,124 | 83,035 | 114,111 | 10,867 |
| Placement and underwriting | 1,355 | 3,821 | 3,183 | 770 | 1,197 | 2,074 | 3,183 | 119 |
| Securities deposit and recording | 1,389 | 1,357 | 1,520 | 486 | 849 | 1,280 | 1,520 | 82 |
| Portfolio management | 13,747 | 14,868 | 28,672 | 8,083 | 15,925 | 22,916 | 28,672 | 3,133 |
| Design and advising | 1,959 | 2,664 | 2,360 | 329 | 1,302 | 1,703 | 2,360 | 136 |
| Stocks search and placement | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 239 |
| Market credit transactions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| IIC subscription and redemption | 26,452 | 46,171 | 68,513 | 14,426 | 32,237 | 49,242 | 68,513 | 5,928 |
| Other | 58,021 | 62,923 | 78,671 | 20,797 | 43,644 | 58,674 | 78,671 | 8,772 |
| Commission expenses | 33,729 | 45,639 | 63,583 | 13,856 | 30,907 | 46,141 | 63,583 | 5,695 |
| IV. TOTAL NET REVENUES | 165,661 | 198,084 | 250,287 | 63,258 | 127,095 | 184,620 | 250,287 | 25,343 |
| V. OPERATING INCOME | 43,424 | 66,420 | 95,026 | 25,539 | 53,143 | 76,220 | 95,026 | 13,451 |
| VII. EARNINGS AFTER TAXES | 20,763 | 38,264 | 62,449 | 23,682 | 49,040 | 74,660 | 62,449 | 18,172 |

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: January 2007.

## Aggregated income statement. Portfolio management companies

TABLE 2.9

| Thousand euro [1] | 2004 | 2005 | 2006 | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | | | | I | II | III | IV | I [2] |
| I. FINANCIAL INCOME | 550 | 575 | 895 | 142 | 334 | 594 | 895 | 1,615 |
| II. NET INCOME FROM SECURITIES TRADING | 89 | 65 | 6 | 13 | 7 | -5 | 6 | -5 |
| III. NET COMMISSION | 15,155 | 17,164 | 15,195 | 3,447 | 6,789 | 10,146 | 15,195 | 1,434 |
| Commission revenues | 15,868 | 25,508 | 27,625 | 6,529 | 13,196 | 19,789 | 27,625 | 2,620 |
| Portfolio management | 10,450 | 18,813 | 22,068 | 5,582 | 11,190 | 16,893 | 22,068 | 2,138 |
| Design and advising | 3,265 | 4,380 | 4,951 | 771 | 1,494 | 2,252 | 4,951 | 440 |
| IIC subscription and redemption | 320 | 592 | 261 | 159 | 228 | 228 | 261 | 3 |
| Other | 1,833 | 1,723 | 345 | 17 | 284 | 416 | 345 | 39 |
| Commission expenses | 713 | 8,344 | 12,430 | 3,082 | 6,407 | 9,643 | 12,430 | 1,186 |
| IV. TOTAL NET REVENUES | 15,794 | 17,804 | 16,096 | 3,602 | 7,130 | 10,735 | 16,096 | 1,552 |
| V. OPERATING INCOME | 4,528 | 6,051 | 6,352 | 1,103 | 2,232 | 3,496 | 6,352 | 622 |
| VII. EARNINGS AFTER TAXES | 1,730 | 3,465 | 4,112 | 706 | 1,609 | 2,479 | 4,112 | 704 |

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: January 2007.

## Surplus equity over capital adequacy requirements [1]

TABLE 2.10

| Thousand euro | Surplus Total amount | Surplus %[2] | Number of companies according to its surplus percentage < 50[3] | <100 | <150 | <200 | <300 | <400 | <500 | <750 | <1000 | >1000 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total | 993,283 | 352.2 | 23 | 17 | 13 | 12 | 10 | 8 | 8 | 12 | 10 | 6 |
| Broker – dealers | 858,443 | 419.4 | 5 | 6 | 1 | 4 | 5 | 6 | 4 | 6 | 7 | 3 |
| Brokers | 118,522 | 211.2 | 13 | 10 | 9 | 6 | 5 | 1 | 3 | 5 | 2 | 3 |
| Portfolio management companies | 16,318 | 76.9 | 5 | 1 | 3 | 2 | 0 | 1 | 1 | 1 | 1 | 0 |

1. Available data: December 2006.
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 taxes [1]

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 | 57.33 | 11 | 16 | 13 | 14 | 13 | 13 | 6 | 15 | 18 |
| Broker – dealers | 60.70 | 1 | 4 | 2 | 4 | 8 | 7 | 1 | 9 | 11 |
| Brokers | 46.13 | 9 | 11 | 3 | 7 | 5 | 5 | 5 | 5 | 7 |
| Portfolio management companies | 19.12 | 1 | 1 | 8 | 3 | 0 | 1 | 0 | 1 | 0 |

1. Available data: December 2006.
2. Average weighted by equity, %.

# 3 Collective investment schemes (IIC) *

## Number, managements and depositories of collective investment schemes registered with the CNMV

TABLE 3.1

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| Total financial IIC | 5,717 | 5,841 | 6,010 | 5,876 | 5,911 | 5,966 | 6,010 | 6,061 |
| Mutual funds | 2,620 | 2,723 | 2,853 | 2,758 | 2,791 | 2,829 | 2,853 | 2,887 |
| Investment companies | 3,097 | 3,118 | 3,150 | 3,118 | 3,120 | 3,137 | 3,150 | 3,166 |
| Funds of hedge funds | - | - | 2 | - | - | - | 2 | 2 |
| Hedge funds | - | - | 5 | - | - | - | 5 | 6 |
| Total real estate IIC | 9 | 13 | 17 | 13 | 15 | 15 | 17 | 17 |
| Real estate investment funds | 7 | 7 | 9 | 7 | 9 | 9 | 9 | 9 |
| Real estate investment companies | 2 | 6 | 8 | 6 | 6 | 6 | 8 | 8 |
| Total foreign IIC marketed in Spain | 238 | 260 | 340 | 266 | 280 | 312 | 340 | 352 |
| Foreign funds marketed in Spain | 93 | 115 | 163 | 116 | 122 | 144 | 163 | 168 |
| Foreign companies marketed in Spain | 145 | 145 | 177 | 150 | 158 | 168 | 177 | 184 |
| Management companies | 116 | 112 | 114 | 112 | 113 | 113 | 114 | 116 |
| IIC depositories | 137 | 135 | 132 | 133 | 133 | 132 | 132 | 129 |

1. Available data: February 2007.

## Number of IIC investors and shareholder

TABLE 3.2

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| Total financial IIC | 8,261,376 | 8,869,084 | 9,048,207 | 9,448,055 | 9,437,286 | 9,348,199 | 9,048,207 | - |
| Mutual funds | 7,880,076 | 8,450,164 | 8,637,781 | 9,026,533 | 9,015,250 | 8,924,673 | 8,637,781 | 8,652,801 |
| Investment companies | 381,300 | 418,920 | 410,403 | 421,522 | 422,036 | 423,526 | 410,403 | - |
| Funds of hedge funds | - | - | 2 | - | - | - | 2 | 2 |
| Hedge funds | - | - | 21 | - | - | - | 21 | 29 |
| Total real estate IIC | 86,490 | 119,113 | 151,053 | 127,634 | 131,882 | 140,284 | 151,053 | na |
| Real estate investment funds | 86,369 | 118,857 | 150,304 | 127,181 | 131,416 | 139,818 | 150,304 | na |
| Real estate investment companies | 121 | 256 | 749 | 453 | 466 | 466 | 749 | 750 |
| Total foreign IIC marketed in Spain | 321,805 | 560,555 | 779,134 | 721,697 | 753,416 | 806,305 | 779,165 | - |
| Foreign funds marketed in Spain | 51,364 | 104,089 | 144,108 | 135,069 | 140,263 | 141,164 | 144,139 | - |
| Foreign companies marketed in Spain | 270,441 | 456,466 | 635,026 | 586,628 | 613,153 | 665,141 | 635,026 | - |

1. Available data: January 2007.
na: No available data.

## IIC total net assets

TABLE 3.3

| Million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| Total financial IIC | 261,191.7 | 289,810.7 | 300,584.0 | 300,438.4 | 297,721.9 | 300,523.1 | 300,584.0 | 301,688.2 |
| Mutual funds | 236,088.4 | 262,200.9 | 270,406.3 | 271,765.1 | 269,777.9 | 271,361.1 | 270,406.3 | 270,823.9 |
| Investment companies | 25,103.3 | 27,609.8 | 30,152.7 | 28,673.3 | 27,944.0 | 29,162.1 | 30,152.7 | 30,817.3 |
| Funds of hedge funds | - | - | 0.6 | - | - | - | 0.6 | 0.6 |
| Hedge funds | - | - | 24.4 | - | - | - | 24.4 | 46.4 |
| Total real estate IIC | 4,434.4 | 6,690.8 | 9,052.0 | 7,411.7 | 8,078.3 | 8,450.7 | 9,052.0 | na |
| Real estate investment funds | 4,377.9 | 6,476.9 | 8,595.9 | 7,040.3 | 7,703.9 | 8,072.8 | 8,595.9 | na |
| Real estate investment companies | 56.4 | 213.9 | 456.1 | 371.4 | 374.4 | 377.9 | 456.1 | 456.1 |
| Total foreign IIC marketed in Spain | 17,785.6 | 33,668.1 | 44,102.9 | 41,994.5 | 41,655.8 | 41,595.1 | 44,102.9 | - |
| Foreign funds marketed in Spain | 3,498.1 | 8,267.3 | 12,099.3 | 10,133.9 | 10,687.5 | 10,719.6 | 12,099.3 | - |
| Foreign companies marketed in Spain | 14,287.4 | 25,400.8 | 32,003.5 | 31,860.6 | 30,968.3 | 30,875.5 | 32,003.5 | - |

1. Available data: January 2007.
na: No available data.

* In this document, neither hedge funds nor funds of hedge funds are included in the figures referred to mutual funds.

## Mutual funds asset allocation [1]

TABLE 3.4

| Million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I [2] |
|---|---|---|---|---|---|---|---|---|
| Asset | 236,088.4 | 262,200.9 | 270,406.9 | 271,765.1 | 269,777.9 | 271,361.1 | 270,406.9 | 270,824.5 |
| Cash | 6,506.5 | 8,207.5 | 10,462.9 | 9,092.9 | 9,645.5 | 11,860.2 | 10,462.9 | 9,874.2 |
| Portfolio investment | 230,212.7 | 255,273.6 | 260,002.9 | 263,884.8 | 260,197.9 | 259,249.8 | 260,002.9 | 261,050.3 |
| Domestic securities | 114,058.9 | 123,683.6 | 127,355.4 | 124,440.9 | 126,390.2 | 126,103.1 | 127,355.4 | 129,485.7 |
| Shares | 9,578.3 | 11,602.1 | 13,806.8 | 12,640.3 | 12,095.5 | 13,614.7 | 13,806.8 | 14,038.8 |
| Mutual funds units | 16,782.6 | 17,255.9 | 17,322.8 | 18,231.7 | 18,518.1 | 17,148.5 | 17,322.8 | 16,768.4 |
| Public money market assets | 4,434.9 | 4,149.4 | 2,887.7 | 4,462.7 | 4,265.2 | 3,877.0 | 2,887.7 | 3,243.8 |
| Other public fixed-income | 11,422.9 | 10,088.7 | 9,891.6 | 9,201.4 | 9,436.1 | 9,929.2 | 9,891.6 | 10,259.1 |
| Private money market assets | 19,735.9 | 26,850.7 | 28,483.2 | 25,280.6 | 27,334.4 | 27,931.5 | 28,483.2 | 29,573.9 |
| Other private fixed-income | 14,235.6 | 18,835.6 | 23,105.3 | 19,695.8 | 19,913.9 | 20,985.5 | 23,105.3 | 23,329.7 |
| Spanish warrants and options | 157.0 | 483.1 | 603.3 | 610.5 | 479.6 | 580.0 | 603.3 | 661.0 |
| Repos | 37,706.7 | 34,417.8 | 31,229.4 | 34,317.8 | 34,347.2 | 32,036.3 | 31,229.4 | 31,585.9 |
| Unlisted securities | 5.0 | 0.2 | 25.4 | 0.2 | 0.2 | 0.2 | 25.4 | 25.3 |
| Foreign securities | 116,153.8 | 131,590.0 | 132,647.4 | 139,444.0 | 133,807.6 | 133,146.7 | 132,647.4 | 131,564.6 |
| Euros | 107,682.4 | 118,871.5 | 118,664.1 | 124,128.9 | 120,406.0 | 119,488.4 | 118,664.1 | 117,767.2 |
| Shares | 7,065.6 | 8,925.1 | 11,418.0 | 10,499.0 | 9,713.5 | 10,459.1 | 11,418.0 | 11,963.7 |
| Mutual fund units | 11,184.8 | 15,986.0 | 23,414.2 | 21,995.1 | 24,000.6 | 23,961.8 | 23,414.2 | 22,783.0 |
| Fixed-income | 86,833.3 | 90,220.7 | 78,933.4 | 87,208.2 | 83,048.1 | 80,881.9 | 78,933.4 | 78,009.5 |
| Foreign warrants and options | 2,598.8 | 3,739.7 | 4,898.7 | 4,426.6 | 3,643.8 | 4,185.5 | 4,898.7 | 5,011.0 |
| 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 | 15,315.1 | 13,401.6 | 13,658.3 | 13,983.3 | 13,797.4 |
| Shares | 4,991.0 | 7,019.5 | 7,343.0 | 7,836.9 | 6,898.3 | 6,992.1 | 7,343.0 | 7,468.0 |
| Mutual fund units | 2,576.7 | 4,395.6 | 5,491.5 | 6,026.8 | 5,208.4 | 5,441.2 | 5,491.5 | 5,160.6 |
| Fixed-income | 875.9 | 1,204.8 | 1,011.7 | 1,307.2 | 1,154.6 | 1,103.4 | 1,011.7 | 994.5 |
| Foreign warrants and options | 27.7 | 97.2 | 136.0 | 142.9 | 139.0 | 120.3 | 136.0 | 173.0 |
| Unlisted securities | 0.0 | 1.4 | 1.2 | 1.3 | 1.3 | 1.3 | 1.2 | 1.2 |
| Net balance (Debtors -Creditors) | -630.9 | -1,280.3 | -58.8 | -1,212.6 | -65.5 | 251.1 | -58.8 | -100.0 |

1. Hedge funds are not included in these figures. The information is not available because hedge funds have different accounting regulation.
2. Available data: January 2007.

## Investment companies asset allocation

TABLE 3.5

| Million euro | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I [1] |
|---|---|---|---|---|---|---|---|---|
| Asset | 25,103.3 | 27,610.0 | 30,152.7 | 28,673.3 | 27,944.0 | 29,162.1 | 30,152.7 | 30,817.3 |
| Cash | 632.6 | 728.9 | 802.2 | 711.5 | 809.5 | 813.7 | 802.2 | 820.8 |
| Portfolio investment | 24,338.5 | 26,884.9 | 29,294.1 | 27,973.1 | 27,048.0 | 28,258.3 | 29,294.1 | 29,922.9 |
| Domestic securities | 13,710.4 | 13,851.1 | 15,553.8 | 14,095.7 | 14,030.6 | 14,970.1 | 15,553.8 | 15,658.0 |
| Shares | 4,831.2 | 5,906.5 | 6,727.3 | 6,223.8 | 5,834.2 | 6,581.5 | 6,727.3 | 6,986.4 |
| Mutual funds units | 755.2 | 941.2 | 1,095.0 | 923.7 | 893.6 | 1,093.6 | 1,095.0 | 1,146.5 |
| Public money market assets | 90.0 | 128.1 | 463.4 | 137.2 | 152.0 | 445.8 | 463.4 | 382.5 |
| Other public fixed-income | 754.8 | 897.0 | 678.2 | 835.8 | 867.8 | 754.8 | 678.2 | 691.5 |
| Private money market assets | 152.0 | 359.1 | 555.4 | 377.5 | 442.0 | 497.5 | 555.4 | 603.9 |
| Other private fixed-income | 339.5 | 397.3 | 554.8 | 457.4 | 446.7 | 540.0 | 554.8 | 570.5 |
| Spanish warrants and options | 7.3 | 15.3 | 19.7 | 13.5 | 11.5 | 12.6 | 19.7 | 24.2 |
| Repos | 6,779.2 | 5,206.2 | 5,459.1 | 5,126.4 | 5,382.4 | 5,044.0 | 5,459.1 | 5,251.8 |
| Unlisted securities | 1.2 | 0.3 | 0.8 | 0.4 | 0.3 | 0.3 | 0.8 | 0.8 |
| Foreign securities | 10,628.1 | 13,033.8 | 13,740.3 | 13,877.5 | 13,017.3 | 13,288.3 | 13,740.3 | 14,264.8 |
| Euros | 7,590.0 | 9,178.6 | 9,847.7 | 9,724.4 | 9,361.2 | 9,555.0 | 9,847.7 | 10,176.1 |
| Shares | 2,315.2 | 2,885.6 | 3,379.9 | 3,191.4 | 2,962.4 | 3,064.0 | 3,379.9 | 3,595.5 |
| Mutual fund units | 2,520.8 | 3,351.6 | 4,169.1 | 3,737.3 | 3,758.3 | 4,001.5 | 4,169.1 | 4,286.9 |
| Fixed-income | 2,642.5 | 2,755.8 | 2,041.5 | 2,568.3 | 2,404.3 | 2,236.0 | 2,041.5 | 2,054.7 |
| Foreign warrants and options | 109.8 | 185.7 | 257.2 | 227.5 | 236.1 | 253.5 | 257.2 | 236.6 |
| Unlisted securities | 1.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.3 |
| Other | 3,038.0 | 3,855.2 | 3,892.6 | 4,153.0 | 3,656.1 | 3,733.3 | 3,892.6 | 4,088.8 |
| Shares | 1,888.0 | 2,173.9 | 2,104.7 | 2,261.4 | 2,036.0 | 2,067.3 | 2,104.7 | 2,210.4 |
| Mutual fund units | 934.1 | 1,403.7 | 1,517.7 | 1,641.2 | 1,376.4 | 1,422.5 | 1,517.7 | 1,620.3 |
| Fixed-income | 214.4 | 270.0 | 234.8 | 240.7 | 234.1 | 235.7 | 234.8 | 220.7 |
| Foreign warrants and options | 1.6 | 7.5 | 11.3 | 9.7 | 9.6 | 7.8 | 11.3 | 12.3 |
| Unlisted securities | 0.0 | 0.1 | 24.1 | 0.1 | 0.0 | 0.0 | 24.1 | 25.0 |
| Net balance (Debtors - Creditors) | 132.2 | -3.8 | 56.4 | -11.3 | 86.6 | 90.0 | 56.4 | 73.6 |

1. Available data: January 2007.

## Financial mutual funds: number, investors and total net assets by category [1]

TABLE 3.6

| | | | | 2005 | | | | 2006 |
|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2006 | IV | I | II | III | IV |
| **NO. OF FUNDS** | | | | | | | | |
| Total financial mutual funds | 2,594 | 2,705 | 2,824 | 2,705 | 2,743 | 2,771 | 2,803 | 2,824 |
| Fixed-income [2] | 627 | 624 | 606 | 624 | 611 | 612 | 613 | 606 |
| Mixed fixed-income [3] | 231 | 217 | 212 | 217 | 214 | 208 | 210 | 212 |
| Mixed equity [4] | 232 | 222 | 222 | 222 | 222 | 222 | 222 | 222 |
| Spanish equity | 110 | 116 | 118 | 116 | 117 | 116 | 118 | 118 |
| Foreign equity [5] | 443 | 454 | 467 | 454 | 464 | 465 | 461 | 467 |
| Guaranteed fixed-income | 191 | 211 | 220 | 211 | 215 | 220 | 218 | 220 |
| Guaranteed equity | 474 | 514 | 559 | 514 | 524 | 535 | 559 | 559 |
| Global funds | 286 | 347 | 420 | 347 | 376 | 393 | 402 | 420 |
| Funds of hedge funds | - | - | 2 | - | - | - | - | 2 |
| Hedge funds | - | - | 5 | - | - | - | - | 5 |
| **INVESTORS** | | | | | | | | |
| Total financial mutual funds | 7,880,076 | 8,450,164 | 8,637,781 | 8,450,164 | 9,026,533 | 9,015,250 | 8,924,673 | 8,637,781 |
| Fixed-income | 2,929,836 | 3,071,656 | 2,960,879 | 3,071,656 | 3,022,098 | 3,028,497 | 3,034,437 | 2,960,879 |
| Mixed fixed-income | 457,701 | 492,988 | 524,827 | 492,988 | 539,666 | 534,893 | 544,308 | 524,827 |
| Mixed equity | 447,452 | 408,757 | 357,013 | 408,757 | 407,745 | 393,214 | 377,923 | 357,013 |
| National equity | 333,02 | 365,301 | 317,386 | 365,301 | 417,64 | 391,99 | 371,73 | 317,386 |
| Foreign equity | 1,091,711 | 1,199,460 | 1,258,426 | 1,199,460 | 1,424,214 | 1,340,735 | 1,284,729 | 1,258,426 |
| Guaranteed fixed-income | 459,047 | 455,237 | 497,54 | 455,237 | 462,006 | 472,703 | 482,55 | 497,54 |
| Guaranteed equity [2] | 1,655,196 | 1,849,626 | 1,783,867 | 1,849,626 | 1,869,941 | 1,849,107 | 1,831,944 | 1,783,867 |
| Global funds | 506,113 | 607,139 | 937,843 | 607,139 | 883,223 | 1,004,111 | 997,052 | 937,843 |
| Funds of hedge funds | - | - | 2 | - | - | - | - | 2 |
| Hedge funds | - | - | 21 | - | - | - | - | 21 |
| **TOTAL NET ASSETS** (Million euro) | | | | | | | | |
| Total financial mutual funds | 236,088.4 | 262,200.9 | 270,406.3 | 262,200.9 | 271,765.1 | 269,777.9 | 271,361.1 | 270,406.3 |
| Fixed-income | 120,466.7 | 123,890.7 | 116,511.9 | 123,890.7 | 117,439.6 | 119,929.2 | 118,494.2 | 116,511.9 |
| Mixed fixed-income | 11,795.7 | 14,625.8 | 15,314.5 | 14,625.8 | 16,575.7 | 14,833.4 | 15,103.3 | 15,314.5 |
| Mixed equity | 9,357.3 | 10,005.6 | 10,149.2 | 10,005.6 | 10,714.0 | 10,142.9 | 10,233.6 | 10,149.2 |
| National equity | 8,042.1 | 9,741.7 | 10,416.4 | 9,741.7 | 10,796.8 | 9,206.8 | 10,421.2 | 10,416.4 |
| Foreign equity | 14,623.6 | 20,925.1 | 24,799.6 | 20,925.1 | 24,644.2 | 21,377.3 | 22,361.7 | 24,799.6 |
| Guaranteed fixed-income | 13,803.5 | 13,442.0 | 14,484.8 | 13,442.0 | 13,201.8 | 13,398.2 | 14,139.1 | 14,484.8 |
| Guaranteed equity [2] | 39,658.2 | 45,839.8 | 44,796.6 | 45,839.8 | 46,441.1 | 44,818.0 | 45,642.4 | 44,796.6 |
| Global funds | 18,341.3 | 23,730.1 | 33,933.3 | 23,730.1 | 31,951.9 | 36,072.2 | 34,965.6 | 33,933.3 |
| Funds of hedge funds | - | - | 0.6 | - | - | - | - | 0.6 |
| Hedge funds | - | - | 24.4 | - | - | - | - | 24.4 |

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.

## Financial mutual funds: Detail of investors and total net assets by type of investors

TABLE 3.7

| | | | | 2006 | | | | 2007 |
|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2006 | I | II | III | IV | I [1] |
| **INVESTORS** | 7,880,076 | 8,450,164 | 8,637,804 | 9,026,533 | 9,015,250 | 8,924,673 | 8,637,804 | 8,652,832 |
| Individuals | 7,666,310 | 8,202,638 | 8,389,315 | 8,776,951 | 8,761,826 | 8,674,470 | 8,389,315 | 8,406,349 |
| Residents | 7,558,501 | 8,101,310 | 8,292,264 | 8,675,268 | 8,661,021 | 8,576,300 | 8,292,264 | 8,309,680 |
| Non-residents | 107,809 | 101,328 | 97,051 | 101,683 | 100,805 | 98,170 | 97,051 | 96,669 |
| Legal entities | 213,766 | 247,526 | 248,489 | 249,582 | 253,424 | 250,203 | 248,489 | 246,483 |
| Credit Institutions | 1,378 | 1,634 | 1,609 | 1,654 | 1,655 | 1,600 | 1,609 | 1,675 |
| Other resident Institutions | 210,888 | 244,223 | 244,980 | 246,197 | 249,978 | 246,752 | 244,980 | 242,906 |
| Non-resident Institutions | 1,500 | 1,669 | 1,900 | 1,731 | 1,791 | 1,851 | 1,900 | 1,902 |
| **TOTAL NET ASSETS** (Million euro) | 236,088.4 | 262,200.9 | 294,827.1 | 271,765.1 | 269,777.9 | 271,361.1 | 294,827.1 | 317,253.0 |
| Individuals | 172,068.9 | 193,948.6 | 204,178.5 | 202,152.8 | 200,274.4 | 201,607.3 | 204,178.5 | 204,403.7 |
| Residents | 168,792.7 | 190,753.2 | 200,686.8 | 198,923.9 | 197,152.4 | 198,501.3 | 200,686.8 | 200,882.8 |
| Non-residents | 3,276.2 | 3,195.4 | 3,491.7 | 3,228.9 | 3,122.0 | 3,106.0 | 3,491.7 | 3,520.9 |
| Legal entities | 64,019.5 | 68,252.3 | 90,648.6 | 69,612.3 | 69,503.5 | 69,753.7 | 90,648.6 | 112,849.3 |
| Credit Institutions | 5,128.8 | 4,253.2 | 26,542.7 | 4,912.1 | 5,376.0 | 4,992.6 | 26,542.7 | 46,160.8 |
| Other resident Institutions | 54,271.1 | 62,749.8 | 62,050.3 | 63,293.0 | 62,685.7 | 62,863.6 | 62,050.3 | 64,565.0 |
| Non-resident Institutions | 4,619.6 | 1,249.4 | 2,055.7 | 1,407.1 | 1,441.8 | 1,897.6 | 2,055.7 | 2,123.5 |

1. Available data: January 2007.

## Subscriptions and redemptions of financial mutual funds by category [1]

TABLE 3.8

| Million euro | 2004 | 2005 | 2006 | 2005 IV | 2006 I | II | III | IV |
|---|---|---|---|---|---|---|---|---|
| **SUBSCRIPTIONS** | | | | | | | | |
| Total financial mutual funds | 144,489.9 | 169,807.0 | 194,787.4 | 44,640.6 | 60,310.0 | 50,177.0 | 37,435.8 | 46,864.6 |
| Fixed-income | 90,646.7 | 108,566.1 | 118,705.9 | 27,362.3 | 33,928.7 | 29,928.1 | 25,539.0 | 29,310.1 |
| Mixed fixed-income | 4,164.8 | 6,677.3 | 8,476.6 | 2,213.6 | 3,337.4 | 1,948.5 | 1,208.2 | 1,982.5 |
| Mixed equity | 1,513.1 | 2,065.2 | 2,783.6 | 780.8 | 1,056.6 | 642.6 | 375.6 | 708.7 |
| Spanish equity | 4,031.4 | 5,588.5 | 5,590.4 | 1,266.6 | 1,466.9 | 1,216.2 | 1,500.5 | 1,406.7 |
| Foreign equity | 8,166.6 | 14,006.2 | 17,662.3 | 4,696.2 | 5,979.9 | 4,143.8 | 2,688.1 | 4,850.4 |
| Guaranteed fixed-income | 7,700.7 | 6,923.9 | 6,126.2 | 1,451.4 | 1,397.3 | 1,480.0 | 1,450.3 | 1,798.7 |
| Guaranteed equity | 11,373.3 | 13,520.7 | 8,914.1 | 2,455.2 | 2,399.4 | 2,205.3 | 1,852.2 | 2,457.2 |
| Global funds | 16,893.3 | 12,459.2 | 26,528.3 | 4,414.4 | 10,743.8 | 8,612.5 | 2,821.7 | 4,350.2 |
| Funds of hedge funds | - | - | 0.6 | - | - | - | - | 0.6 |
| Hedge funds | - | - | 24.4 | - | - | - | - | 24.4 |
| **REDEMPTIONS** | | | | | | | | |
| Total financial mutual funds | 125,168.6 | 155,304.2 | 198,600.1 | 42,590.9 | 55,213.2 | 49,106.6 | 41,714.4 | 52,565.8 |
| Fixed-income | 83,463.6 | 107,150.9 | 127,469.1 | 30,353.8 | 40,719.2 | 27,866.4 | 27,519.7 | 31,363.9 |
| Mixed fixed-income | 4,616.9 | 4,339.6 | 7,048.4 | 1,304.9 | 1,515.7 | 2,093.8 | 1,403.6 | 2,035.2 |
| Mixed equity | 2,581.1 | 2,602.5 | 3,644.7 | 643.2 | 788.1 | 966.6 | 723.8 | 1,166.2 |
| Spanish equity | 2,922.1 | 5,323.3 | 7,824.6 | 1,271.4 | 1,493.5 | 2,490.3 | 1,438.9 | 2,401.9 |
| Foreign equity | 7,594.2 | 11,390.2 | 16,490.9 | 3,256.3 | 3,805.5 | 6,038.3 | 2,794.5 | 3,852.6 |
| Guaranteed fixed-income | 5,723.2 | 7,014.0 | 5,029.3 | 1,864.2 | 1,582.7 | 1,306.9 | 695.1 | 1,444.6 |
| Guaranteed equity | 9,411.5 | 8,931.6 | 11,830.1 | 2,040.9 | 2,311.8 | 2,901.7 | 2,486.6 | 4,130.0 |
| Global funds | 8,856.1 | 8,552.1 | 19,263.1 | 1,856.1 | 2,996.6 | 5,442.6 | 4,652.3 | 6,171.5 |
| Funds of hedge funds | - | - | 0.0 | - | - | - | - | 0.0 |
| Hedge funds | - | - | 0.1 | - | - | - | - | 0.1 |

1. Estimated data.

## Financial mutual funds asset change by category: Net subscriptions/redemptions and return on assets

TABLE 3.9

| Million euro | 2004 | 2005 | 2006 | 2005 IV | 2006 I | II | III | IV |
|---|---|---|---|---|---|---|---|---|
| **NET SUBSCRIPTIONS/REDEMPTIONS** | | | | | | | | |
| Total financial mutual funds | 18,424.3 | 14,444.3 | -4,524.5 | 2,067.2 | 5,171.5 | 1,065.6 | -4,292.3 | -6,469.2 |
| Fixed-income | 7,184.0 | 1,445.5 | -9,423.4 | -2,988.7 | -6,760.5 | 2,070.2 | -2,107.6 | -2,625.5 |
| Mixed fixed-income | -440.8 | 2,349.6 | 1,539.2 | 920.7 | 1,796.1 | -166.5 | -36.0 | -54.4 |
| Mixed equity | -1,109.2 | -546.5 | -854.7 | 133.0 | 294.2 | -319.1 | -369.7 | -460.0 |
| Spanish equity | 1,130.0 | 276.0 | -2,219.4 | -2.1 | -25.7 | -1,300.1 | 92.4 | -986.0 |
| Foreign equity | 514.8 | 2,652.4 | 1,133.8 | 1,462.1 | 2,196.7 | -1,831.4 | -159.9 | 928.4 |
| Guaranteed fixed-income | 1,853.1 | -354.4 | 1,018.9 | -433.6 | -205.5 | 176.7 | 694.2 | 353.5 |
| Guaranteed equity | 1,222.3 | 4,693.6 | -3,021.1 | 420.3 | 140.2 | -754.4 | -589.7 | -1,817.2 |
| Global funds | 8,070.1 | 3,928.2 | 7,302.1 | 2,555.5 | 7,736.0 | 3,190.2 | -1,816.0 | -1,808.1 |
| Funds of hedge funds | - | - | 0.3 | - | - | - | - | 0.3 |
| Hedge funds | - | - | 24.3 | - | - | - | - | 24.3 |
| **RETURN ON ASSETS** | | | | | | | | |
| Total financial mutual funds | 7,038.9 | 11,670.2 | 12,733.7 | 1,450.3 | 4,393.3 | -3,052.0 | 5,876.3 | 5,516.1 |
| Fixed-income | 1,870.5 | 1,837.6 | 2,260.2 | 301.5 | 312.6 | 426.2 | 794.8 | 726.6 |
| Mixed fixed-income | 444.6 | 620.3 | 606.6 | 54.5 | 190.2 | -127.8 | 305.8 | 238.4 |
| Mixed equity | 567.8 | 1,053.4 | 984.2 | 125.1 | 401.6 | -250.3 | 454.1 | 378.7 |
| Spanish equity | 1,182.8 | 1,623.7 | 2,882.9 | -53.1 | 1,069.6 | -290.0 | 1,122.0 | 981.2 |
| Foreign equity | 851.9 | 3,507.1 | 2,736.1 | 784.3 | 1,528.2 | -1,427.0 | 1,150.6 | 1,484.3 |
| Guaranteed fixed-income | 334.0 | 222.8 | 112.3 | -36.2 | -34.7 | 11.4 | 101.0 | 34.6 |
| Guaranteed equity | 1,470.5 | 1,635.5 | 1,995.2 | 34.5 | 463.2 | -773.0 | 1,381.3 | 923.7 |
| Global funds | 316.8 | 1,169.8 | 1,156.2 | 239.7 | 462.6 | -621.5 | 566.5 | 748.6 |
| Funds of hedge funds | - | - | 0.0 | - | - | - | - | 0.0 |
| Hedge funds | - | - | 0.1 | - | - | - | - | 0.1 |

## Financial mutual funds return on assets. Detail by category

TABLE 3.10

| % of daily average total net assets | 2004 | 2005 | 2006 | 2005 IV | 2006 I | II | III | IV |
|---|---|---|---|---|---|---|---|---|
| **MANAGEMENT YIELDS** | | | | | | | | |
| Total financial mutual funds | 4.31 | 5.87 | 5.73 | 0.85 | 1.91 | -0.84 | 2.44 | 2.15 |
| Fixed-income | 2.51 | 2.31 | 2.51 | 0.44 | 0.44 | 0.56 | 0.84 | 0.67 |
| Mixed fixed-income | 4.96 | 6.18 | 5.30 | 0.73 | 1.54 | -0.51 | 2.39 | 1.89 |
| Mixed equity | 7.46 | 12.96 | 11.31 | 1.73 | 4.31 | -1.99 | 4.94 | 4.14 |
| Spanish equity | 19.40 | 20.10 | 30.10 | -0.09 | 10.85 | -2.44 | 11.94 | 9.65 |
| Foreign equity | 7.80 | 22.82 | 13.82 | 4.56 | 7.15 | -5.59 | 5.80 | 6.75 |
| Guaranteed fixed-income | 3.49 | 2.45 | 1.67 | -0.05 | -0.05 | 0.30 | 0.95 | 0.44 |
| Guaranteed equity | 5.47 | 5.26 | 5.86 | 0.46 | 1.38 | -1.31 | 3.43 | 2.39 |
| Global funds | 3.30 | 7.41 | 4.84 | 1.44 | 2.06 | -1.46 | 1.94 | 2.58 |
| Funds of hedge funds | - | - | ns | - | - | - | - | ns |
| Hedge funds | - | - | ns | - | - | - | - | ns |
| **EXPENSES. MANAGEMENT FEE** | | | | | | | | |
| Total financial mutual funds | 1.08 | 1.07 | 1.04 | 0.27 | 0.27 | 0.25 | 0.27 | 0.26 |
| Fixed-income | 0.78 | 0.73 | 0.63 | 0.18 | 0.17 | 0.17 | 0.16 | 0.14 |
| Mixed fixed-income | 1.29 | 1.24 | 1.21 | 0.31 | 0.30 | 0.30 | 0.31 | 0.31 |
| Mixed equity | 1.64 | 1.69 | 1.63 | 0.42 | 0.42 | 0.38 | 0.42 | 0.42 |
| Spanish equity | 1.80 | 1.77 | 1.83 | 0.42 | 0.47 | 0.40 | 0.49 | 0.47 |
| Foreign equity | 1.65 | 1.80 | 1.78 | 0.46 | 0.45 | 0.37 | 0.46 | 0.49 |
| Guaranteed fixed-income | 0.84 | 0.77 | 0.75 | 0.19 | 0.19 | 0.19 | 0.19 | 0.18 |
| Guaranteed equity | 1.44 | 1.38 | 1.34 | 0.34 | 0.34 | 0.34 | 0.34 | 0.33 |
| Global funds | 1.26 | 1.41 | 1.26 | 0.33 | 0.35 | 0.24 | 0.32 | 0.37 |
| Funds of hedge funds | - | - | ns | - | - | - | - | ns |
| Hedge funds | - | - | ns | - | - | - | - | ns |
| **EXPENSES. DEPOSITORY FEE**[1] | | | | | | | | |
| 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 | 0.03 | 0.03 | 0.03 | 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 | 0.02 | 0.02 | 0.03 | 0.03 | 0.03 |
| Funds of hedge funds | - | - | ns | - | - | - | - | ns |
| Hedge funds | - | - | ns | - | - | - | - | ns |

1. 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 | 2005 IV | 2006 I | II | III | IV |
|---|---|---|---|---|---|---|---|---|
| Total financial mutual funds | 3.38 | 5.00 | 5.59 | 0.60 | 1.90 | -0.97 | 2.31 | 2.28 |
| Fixed-income | 1.65 | 1.53 | 1.95 | 0.25 | 0.25 | 0.38 | 0.68 | 0.63 |
| Mixed fixed-income | 3.79 | 5.00 | 4.18 | 0.37 | 1.26 | -0.79 | 2.09 | 1.58 |
| Mixed equity | 6.20 | 11.85 | 10.34 | 1.28 | 3.98 | -2.26 | 4.61 | 3.78 |
| Spanish equity | 19.06 | 20.60 | 33.25 | -0.54 | 11.12 | -2.34 | 11.90 | 9.73 |
| Foreign equity | 7.55 | 24.18 | 14.98 | 4.34 | 7.54 | -5.15 | 5.74 | 6.60 |
| Guaranteed fixed-income | 2.62 | 1.66 | 0.83 | -0.25 | -0.26 | 0.10 | 0.75 | 0.24 |
| Guaranteed equity | 4.07 | 3.95 | 4.66 | 0.12 | 1.04 | -1.64 | 3.12 | 2.12 |
| Global funds | 2.17 | 6.16 | 4.01 | 1.06 | 1.78 | -1.60 | 1.61 | 2.21 |
| Funds of hedge funds | - | - | ns | - | - | - | - | ns |
| Hedge funds | - | - | ns | - | - | - | - | ns |

ns: it is not significant.

## Management companies. Number of portfolios and assets under

TABLE 3.12

| | 2004 | 2005 | 2006 | 2006 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| **NUMBER OF PORTFOLIOS** | | | | | | | | |
| Mutual funds | 2,620 | 2,723 | 2,853 | 2,758 | 2,791 | 2,829 | 2,853 | 2,865 |
| Investment companies | 2,962 | 2,989 | 3,049 | 2,992 | 2,995 | 3,025 | 3,049 | 3,055 |
| Funds of hedge funds | - | - | 2 | - | - | - | 2 | 2 |
| Hedge funds | - | - | 5 | - | - | - | 5 | 5 |
| Real estate investment fund | 7 | 7 | 9 | 7 | 9 | 9 | 9 | 9 |
| Real estate investment companies | 2 | 6 | 8 | 6 | 6 | 6 | 8 | 8 |
| **ASSETS under management** (Million euro) | | | | | | | | |
| Mutual funds | 236,088.4 | 262,200.9 | 270,406.3 | 271,765.1 | 269,777.9 | 271,361.1 | 270,406.3 | 270,823.9 |
| Investment companies | 22,923.8 | 25,486.0 | 28,992.7 | 27,129.2 | 26,644.0 | 27,959.5 | 28,992.7 | 29,624.4 |
| Funds of hedge funds | - | - | 0.6 | - | - | - | 0.6 | 0.6 |
| Hedge funds | - | - | 24.4 | - | - | - | 24.4 | 46.4 |
| Real estate investment fund | 4,377.9 | 6,476.9 | 8,595.9 | 7,040.3 | 7,703.9 | 8,072.8 | 8,595.9 | na |
| Real estate investment companies | 56.4 | 213.9 | 456.1 | 371.4 | 374.4 | 377.9 | 456.1 | 456.1 |

1. Available data: February 2007.
na: No available data.

## Foreign Collective Investment schemes marketed in Spain

TABLE 3.13

| | 2004 | 2005 | 2006 | 2005 IV | 2006 I | II | III | IV |
|---|---|---|---|---|---|---|---|---|
| **INVESTMENT VOLUME**[1] (thousand euro) | 17,785.6 | 33,614.7 | 44,090.2 | 33,614.7 | 41,994.5 | 41,655.8 | 41,595.1 | 44,102.9 |
| Mutual funds | 3,498.1 | 8,267.2 | 12,086.6 | 8,267.2 | 10,133.9 | 10,687.5 | 10,719.6 | 12,099.3 |
| Investment companies | 14,287.4 | 25,347.4 | 32,003.5 | 25,347.4 | 31,860.6 | 30,968.3 | 30,875.5 | 32,003.5 |
| **INVESTORS/SHAREHOLDERS** | 321,805 | 560,555 | 779,134 | 560,555 | 721,697 | 753,416 | 806,305 | 779,165 |
| Mutual funds | 51,364 | 104,089 | 144,108 | 104,089 | 135,069 | 140,263 | 141,164 | 144,139 |
| Investment companies | 270,441 | 456,466 | 635,026 | 456,466 | 586,628 | 613,153 | 665,141 | 635,026 |
| **NUMBER OF SCHEMES** | 238 | 260 | 340 | 260 | 266 | 280 | 312 | 340 |
| Mutual funds | 93 | 115 | 163 | 115 | 116 | 122 | 144 | 163 |
| Investment companies | 145 | 145 | 177 | 145 | 150 | 158 | 168 | 177 |
| **COUNTRY** | | | | | | | | |
| Luxembourg | 164 | 161 | 189 | 161 | 165 | 175 | 183 | 189 |
| France | 25 | 47 | 83 | 47 | 48 | 48 | 68 | 83 |
| Ireland | 34 | 35 | 46 | 35 | 38 | 42 | 44 | 46 |
| Germany | 11 | 11 | 12 | 11 | 11 | 11 | 12 | 12 |
| UK | 3 | 5 | 6 | 5 | 3 | 3 | 3 | 6 |
| The Netherlands | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Austria | - | - | 1 | - | - | - | 1 | 1 |
| Belgium | - | - | 1 | - | - | - | - | 1 |
| Malta | - | - | 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 I | II | III | IV | 2007 I[1] |
|---|---|---|---|---|---|---|---|---|
| **REAL STATE MUTUAL FUNDS** | | | | | | | | |
| Number | 7 | 7 | 9 | 7 | 9 | 9 | 9 | 9 |
| Investors | 86,369 | 118,857 | 150,300 | 127,181 | 131,416 | 139,818 | 150,304 | na |
| Asset (Million euro) | 4,377.9 | 6,476.9 | 8,595.9 | 7,040.3 | 7,703.9 | 8,072.8 | 8,595.9 | na |
| Return on assets (%) | 6.65 | 5.35 | 6.12 | 1.79 | 1.88 | 1.52 | 0.80 | na |
| **REAL STATE INVESTMENT COMPANIES** | | | | | | | | |
| Number | 2 | 6 | 8 | 6 | 6 | 6 | 8 | 8 |
| Shareholders | 121 | 256 | 749 | 453 | 466 | 466 | 749 | 750 |
| Asset (Million euro) | 56.4 | 213.9 | 456.1 | 371.4 | 374.4 | 377.9 | 456.1 | 456.1 |

1. Available data: January 2007. In this case, the return on assets is monthly.
na: No available data.

# VI Legislative Annex

The following is the significant national legislation passed in the first quarter of 2007:

— Order PRE/3/2007, dated 10 January, on the agreements promoting asset securitization funds designed to boost opportunities for business finance.

  This Order modifies the administrative procedure for providing collateral and adds new requirements for setting up asset securitization funds under the agreements concluded between central government and the securitization fund managers. It also allows a commission to be paid for providing the collateral and establishes that these funds are closed funds.

— Agreement of 30 January 2007 of the National Stock Market Commission (CNMV) Board on the delegation of powers to the President, Vice President and Executive Committee of the CNMV.

  The delegation of powers covers various fields: listing permission, communication of significant holdings, suspensions of trading and delistings, collective investment schemes (IIC), investment services firms (ESI) public share offers, takeover bids, etc.

— Royal Decree 361/2007, of 16 March, implementing Law 24/1988 of 28 July governing the stock market, in matters relating to holdings in companies managing secondary securities markets and companies managing systems of securities registration, clearing and settlement.

  The Royal Decree aims to increase the transparency and flexibility of the system of rules governing entities holding shares in these companies. There are two main aspects: (1) it establishes special rules for entities owning a significant or controlling holding in such companies; and (2) it specifies the information which should be disclosed before the government may grant authorization for a controlling holding in these companies.

— Royal Decree 362/2007, of 16 March, modifying the Regulation implementing Law 35/2003 of 4 November on collective investment schemes, passed by Royal Decree 1309/2005 of 4 November.

  The main objective of this Royal Decree is to make the rules governing redemption of hedge funds and funds of hedge funds more flexible, and thus ensure they can be fully developed in the Spanish market. For example, it will allow a maximum sum of redemptions or minimum holding periods to be established. In addition, hedge funds will not be able to target retail investors with their advertising, although such investors will be able to buy shares or holdings in the hedge funds.

— Royal Decree 363/2007 of 16 March, modifying the following legislation: Royal Decree 726/1989 of 23 June on stock market governing bodies and members of stock markets, Sociedad de Bolsas, and the collective surety; Royal Decree 1814/1991 of 20 December, regulating the official futures and options markets; and Royal Decree 116/1992 of 14 February, on the book-entry of securities and clearing and settlement of stock market trading.

Three changes have been introduced: (1) it clarifies the objections that may be made to the appointment of members of the board of directors of the governing body of a stock exchange, the Sociedad de Bolsas or governing bodies of futures and options markets; (2) it make the financial rules governing the above bodies more flexible, as their annual budget will not have to be approved by the CNMV nor will the CNMV be able to modify it; and (3) it introduces changes to the rules governing tied loans from the Sociedad de Sistemas, to prevent a temporary inflation effect on securities which could occur in certain circumstances related to settlements of securities trading.

— Royal Decree 364/2007 of 16 March, modifying the following legislation: Royal Decree 685/1982 of 17 March implementing certain aspects of Law 2/1981 of 25 March, regulating the mortgage market; Royal Decree 1343/1992 of 6 November implementing Law 13/1992 of 1 June governing the equity and supervision on a consolidated basis of financial entities; Royal Decree 867/2001 of 20 July, on the rules governing investment services companies; and Royal Decree 1333/2005 of 11 November, implementing Law 24/1988 of 28 July governing the stock market with regard to market abuse.

This Royal Decree modifies a further four covering financial matters. Its main aspects are as follows: (1) it eliminates the maximum interest rate variation of variable interest rate bonds, because the loans which act as their collateral are now variable interest and not fixed-interest; (2) it clarifies the list of assets which can form the equity of credit entities; (3) it puts the solvency rules for fund managers on a level with those for broker-dealers and brokers; and (4) with regard to market abuse, it extends the range of persons linked to administrators and directors of an issuer who are obliged to disclose deals with the issuer's securities.