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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
OECD	Organization for Economic Co-operation and Development
PER	Price Earnings Ratio
RD	Royal Decree
RDL	Royal Decree Law
ROE	Return On Equity
SENAF	Sistema Electrónico de Negociación de Activos Financieros/An electronic trading platform for Spanish public debt
SGIIC	Collective investment scheme management company
SIBE	Sistema de Interconexión Bursátil Español/Spanish electronic market
SICAV	Open-end investment company
UCITS	Undertakings for Collective Investment in Transferable Securities

I Reports and analyses

Market survey (*)

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

1 Overview

The performance of international markets over the second quarter of 2007 was conditioned by rising interest rate expectations in both the euro zone and United States. These market expectations were borne out by the European Central Bank's announcement in early June of a new 25 bp hike, lifting its official rates to 4%. However, the declarations of the monetary authority also convinced market analysts to revise up their previous ceiling estimate of 4.25%. In the United States, fears that the positive course of the U.S. economy could provoke an inflation rebound laid to rest expectations of future easing.

This was the trigger for a major sell-off in bonds and earnings taking on equity markets. In exchange markets, the dollar's descent against the euro began to level off. Yields moved sharply higher, especially in the euro-zone government debt market. The positive slope of both U.S. and euro-zone yield curves steepened in the period.

In leading world stock markets, the changing outlook for rates forced a correction of the gains accumulated in April and May. Despite this reverse, the Germany and North American markets closed the period with far from negligible rises of 17% and 9% respectively. In contrast, the Italian and Spanish bourses managed only a muted advance. In year-on-year terms, all main international markets continued to hold out attractive returns, especially the German exchange with a price run-up of 47%. Volatility, meantime, held at historic lows.

Most of the remaining international stock markets secured significant rises, the exception being Venezuela which prolonged its slide. Meantime, China and Peru continued to power ahead with annual returns reaching new heights.

The Spanish market performed divergently from its euro-zone partners, with gains, as stated, trailing the average accompanied by a moderate increase in volatility. The fall in the Madrid General Index was mainly a result of the losses posted by the "Financial and real estate services" sector. Real estate firms particularly found themselves heavily chastised after the bull run of the last two years. Market turnover remained buoyant with average daily trading again exceeding six billion euros.

Summary of financial indicators				TABLE 1
	Dec 2005	**Dec 2006**	**Q1 07**	**Q2 07***
Short-term interest rates (%)[1]				
Official interest rate	2.25	3.50	3.75	4.00
Euribor 3 month	2.47	3.69	3.89	4.12
Euribor 12 month	2.79	3.93	4.11	4.47
Exchange rates[2]				
Dollar/euro	1.18	1.32	1.33	1.34
Yen/euro	138.90	156.93	157.3	165.9
Medium- and long-term interest rates (%)[3]				
Government bond yields				
3 year	2.91	3.73	3.91	4.43
5 year	3.06	3.76	3.94	4.48
10 year	3.36	3.80	4.00	4.54
Corporate bond spreads (basis points)[3]				
3 year	25	31	26	26
5 year	42	37	27	29
10 year	54	46	38	39
Equity markets				
Performance of main world stock indices (%)[4]				
Euro Stoxx 50	21.3	15.1	1.5	8.7
Dow Jones	-0.6	16.3	-0.9	9.2
Nikkei	40.2	6.9	0.4	5.3
Other indices (%)				
Merval (Argentina)	12.2	35.5	0.6	5.9
Bovespa (Brazil)	27.7	32.9	3.0	18.0
Shanghai Comp (China)	-8.3	130.4	19.0	31.3
BSE (India)	38.3	41.0	-5.7	13.0
Spanish stock market				
Ibex 35 (%)	18.2	31.8	3.5	2.7
P/E of Ibex 35 [5]	12.9	14.3	14.0	13.9
Volatility of Ibex 35 (%)[6]	10.6	13.1	14.6	16.8
SIBE trading volumes[7]	3,311.2	4,513.3	6,539.7	6,372.4
Listed company earnings[8]	22.0	23.3	na	na

Source: CNMV, Thomson Datastream, Reuters, Banco de España, Bolsa de Madrid, MEFF and AIAF.
* Latest available data at the time of preparing this report.
na: not available.
1 Monthly average of daily data. Data for first quarter 2007 correspond to March; data for the second quarter correspond to the closing month up to 20 June. The official interest rate corresponds to the marginal rate at weekly auctions.
2 Data at period end. Data for the second quarter 2007 correspond to 20 June.
3 Average daily data. Data for the second quarter 2007 – up to 20 June.
4 Annual percentage change in 2005 and 2006. In 2007, cumulative quarterly change in each period, up to 20 June in the case of the second quarter.
5 Price-earnings ratio. Data for the second quarter 2007 correspond to 20 June.
6 Implied at-the-money (ATM) volatility on nearest expiry. Data for the second quarter correspond to 20 June.
7 Daily average in million euros. Data for the second quarter correspond to April and May.
8 Annual % change in the EBITDA of companies quoting on the continuous electronic market (SIBE).

2 International financial background

2.1 Short-term interest rates

Official interest rates rose a further 25 basis points following the European Central Bank's decision of 6 June, such that the marginal rate at weekly auctions closed the period at 4%. This marks a combined run-up of 2% since the start of the tightening cycle in December 2005. Euro-zone money markets priced in the news with a rise of 25-35 basis points (see table 2). The Euribor 12-month touched 4.47% in June, a rise of more than one full point versus the year-ago rate.

The market had been expecting latest hike in official interest rates, but not so the accompanying message from the European monetary authority that monetary policy would stay accommodative in view of the prevailing risks for mid-term price stability in the zone and the positive economic outlook. The market responded to this pronouncement by adjusting upside expectations for official rates to a maximum of 4.5% against 4.25% previously.

Short-term interest rates[1] TABLE 2

	Dec 04	Dec 05	Dec 06	Jun 06	Sep 06	Dec 06	Mar 06	Jun 07[2]
Euro zone								
Official[3]	2.00	2.25	3.50	2.75	3.00	3.50	3.75	4.00
3 month	2.17	2.47	3.69	2.99	3.34	3.69	3.89	4.12
6 month	2.21	2.60	3.79	3.16	3.53	3.79	4.00	4.26
12 month	2.30	2.79	3.93	3.40	3.72	3.93	4.11	4.47
U.S.								
Official[4]	2.25	4.25	5.25	5.25	5.25	5.25	5.25	5.25
3 month	2.50	4.49	5.36	5.38	5.38	5.36	5.35	5.36
6 month	2.72	4.67	5.35	5.49	5.41	5.35	5.32	5.39
12 month	3.02	4.84	5.24	5.60	5.38	5.24	5.20	5.43
Japan								
Official[5]	0.15	0.15	0.25	0.15	0.25	0.25	0.50	0.50
3 month	0.05	0.07	0.56	0.33	0.42	0.56	0.70	0.71
6 month	0.07	0.08	0.63	0.42	0.48	0.63	0.72	0.81
12 month	0.09	0.12	0.74	0.58	0.60	0.74	0.78	0.94

Source: Thomson Datastream.
1 Average daily data except official rates, which correspond to the last day of the period.
2 Average from 21 May to 20 June.
3 Marginal rate at weekly auctions.
4 Federal funds rate.
5 Monetary policy rate.

This change in interest-rate expectations in the euro zone is reflected in the three-month forward rates (FRA) in table 3, which show a significant increase versus end-March in the interval of 25 to 55 basis points. The FRA 12x15 climbed to 4.77%, while its spread to the spot rate widened to 60 basis points compared to 30 basis points at the end of March.

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

	Dec 04	Dec 05	Dec 06	Jun 06	Sep 06	Dec 06	Mar 06	Jun 07[2]
Euro zone								
Spot	2.16	2.49	3.73	3.06	3.42	3.73	3.92	4.16
FRA 3x6	2.23	2.74	3.94	3.38	3.69	3.94	4.13	4.37
FRA 6x9	2.36	2.91	4.07	3.63	3.78	4.07	4.21	4.57
FRA 9x12	2.49	3.00	4.13	3.78	3.81	4.13	4.25	4.68
FRA 12x15	2.64	3.07	4.13	3.86	3.79	4.13	4.23	4.77
U.S.								
Spot	2.56	4.54	5.36	5.48	5.37	5.36	5.35	5.36
FRA 3x6	2.95	4.81	5.31	5.59	5.30	5.31	5.25	5.35
FRA 6x9	3.22	4.84	5.21	5.60	5.15	5.21	5.06	5.35
FRA 9x12	3.41	4.81	5.06	5.57	4.99	5.06	4.87	5.31
FRA 12x15	3.57	4.76	4.94	5.53	4.85	4.94	4.74	5.29

Source: Thomson Datastream.
1 Data at period end.
2 Data corresponding to 20 June.

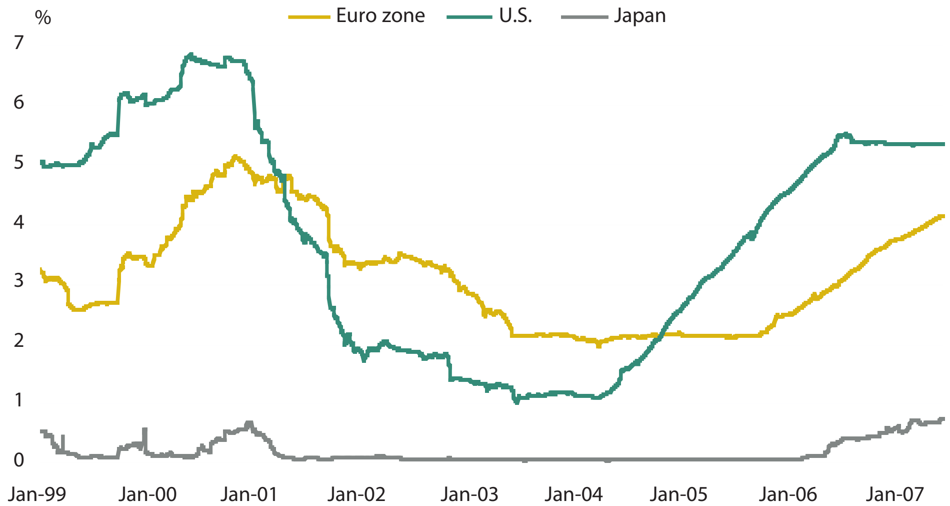
The United States too saw a re-assessment of rate expectations. The good growth readings for the U.S. economy and fears of an upturn in inflation put paid to expectations of a future easing move. Instead, the market switched to expecting that official rates would remain at their current level of 5.25%.

The slope at the short end of the US yield curve (spread between 12- and 3-month rates) switched from a negative 15 points at end-March to a positive 5-10 basis points in June (see table 2). The three-month FRA 12x15 moved up 55 basis points while the spread to spot rates narrowed to -5 basis points from March levels of -60 basis points (see table 3).

Japan left its official interest rates unchanged at 0.50% with economic activity still restrained and price indicators showing no upward movement.

In keeping with the monetary decisions made, three-month money market rates continued moving higher in the euro zone against their flat progress in the United States and Japan (see figure 1).

Three-month interest rates [1] FIGURE 1



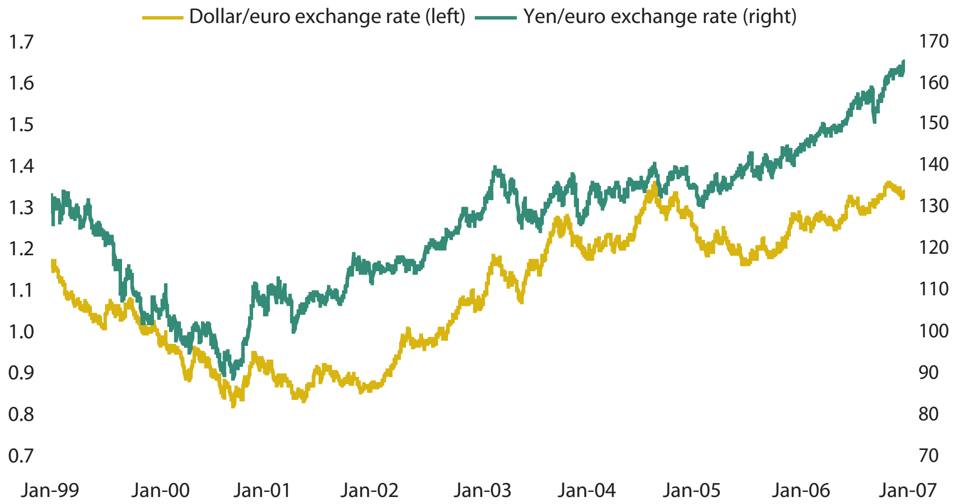
Source: Thomson Datastream.
1 Data to 20 June.

2.2 Exchange rates

The dollar's descent against the euro since mid-2001 was prolonged through the second quarter of 2007. However the trend levelled versus the two preceding quarters as expectations of a U.S. rate cut faded to nothing (see figure 2). Hence the June exchange rate was $1.34 compared to the $1.36 recorded from mid April to May. In all the dollar lost 0.82% in the second quarter, against a cumulative loss of 1.95% since December 2006. This makes a 60% run-down for the US currency against the euro since 2001.

Growth and interest rate differentials, real and projected, between the euro zone and Japan steepened the yen's decline against the euro over the second quarter of 2007 (see figure 2). Specifically, the early June exchange rate of ¥165.9/euro signified a 5.4% loss compared to end-March against the 0.3% loss of the opening quarter.

Euro/dollar and euro/yen exchange rates[1] FIGURE 2



Source: Thomson Datastream.
1 Data to 20 June.

2.3 Long-term interest rates

The selling round in U.S. and euro-zone government bond markets intensified in the second quarter. Medium- and long-term rates started edging higher in mid May as the markets priced in future tightening moves in the euro zone and fears spread of an inflation upturn in the United States.

In the euro zone, average monthly yields rose 50-55 basis points across all maturities. The trend was similar in the United States, with a slightly smaller increase of 45 basis points in medium and long segments of the curve (see table 4). Looking at the daily data, what first stands out is that U.S. ten-year yields have been moving above 5% since the first week of June, a level unmatched since July 2006. The result has been further narrowing of the yield spread between the United States and the euro zone. By the measure of average monthly yields, the spread has reduced almost 10 basis points with respect to March to the current level of 50-55 basis points.

In Japan, government bond sales were also the order of the day though rather less so than in the euro zone or United States. Average monthly yields moved 20-25 basis points higher the length of the curve between March and June.

Medium and long government bond yields[1]

TABLE 4

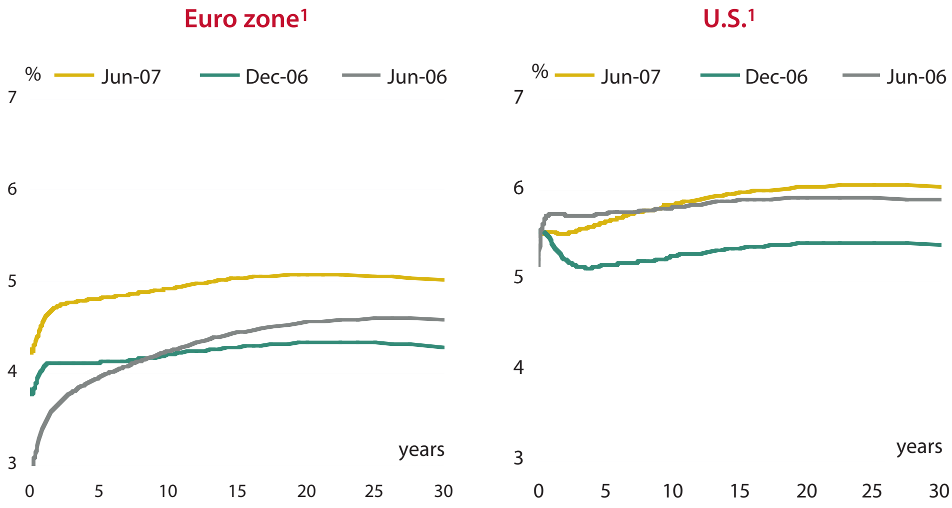
	Dec 04	Dec 05	Dec 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun-07[2]
Euro zone								
3 year	2.51	2.86	3.75	3.56	3.60	3.75	3.92	4.43
5 year	2.92	3.06	3.77	3.73	3.63	3.77	3.90	4.45
10 year	3.65	3.37	3.80	3.99	3.76	3.80	3.95	4.49
U.S.								
3 year	3.20	4.39	4.59	5.09	4.69	4.59	4.51	4.94
5 year	3.60	4.39	4.54	5.06	4.67	4.54	4.48	4.95
10 year	4.23	4.46	4.57	5.11	4.72	4.57	4.56	5.02
Japan								
3 year	0.24	0.46	0.93	0.99	0.81	0.93	0.90	1.14
5 year	0.57	0.86	1.22	1.36	1.15	1.22	1.18	1.43
10 year	1.40	1.53	1.64	1.86	1.66	1.64	1.62	1.82

Source: Reuters.
1 Average daily data.
2 Average data from 21 May to 20 June.

The zero coupon curves of figure 3 track the aforementioned movement in yields. We can see that the euro-zone curve shifted upwards between December 2006 and June 2007 by 45-55 basis points at the short end (to 1.5 years) and 60-70 basis points across remaining maturity bands. In the United States, the dominant feature was curve steepening between the two- and ten-year maturities, to 30-35 basis points in June from the 5 basis points of December 2006.

Zero coupon curve

FIGURE 3



Source: Reuters.
1 June data corresponding to day 20.

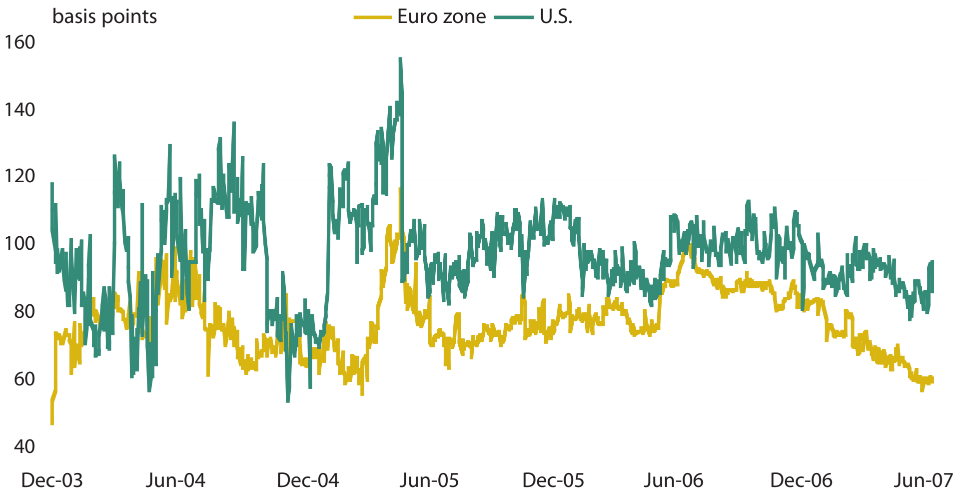
In euro-zone private fixed income, credit risk premiums prolonged the downtrend initiated in mid 2006 as far as their lowest levels in all maturities since December 2004. The long-term BBB-AAA spread stood at 60 basis points, 25 basis points lower than at end 2006 (see table 5). In the United States, credit risk premiums remained more volatile in time (see figure 4) with divergences by term. Hence despite year-long narrowing in the ten-year term, premiums moved consistently higher than their euro-zone equivalents.

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

basis points	Dec 04	Dec 05	Dec 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun-07[2]
Euro zone								
3 year	49	43	37	38	41	37	32	28
5 year	61	53	53	57	56	53	45	42
10 year	68	77	84	95	89	84	71	61
U.S.								
3 year	63	37	54	51	54	54	70	63
5 year	71	63	68	68	71	68	80	70
10 year	81	108	96	104	103	96	98	87

Source: Reuters.
1 Average daily data.
2 Average from 21 May to 20 June.

Credit risk premiums: 10-year BBB-AAA spread[1] FIGURE 4



Source: Reuters.
1 Data to 20 June.

2.4 International stock markets

Main international stock markets rallied in the second quarter of 2007 after their late February corrections (see figure 5). Markets by and large improved on their first-quarter performance (see table 6) despite earnings taking in early June. This correction traced to the revise-up of interest rate expectations in both the euro zone and the United States; however it failed to cause any upsurge in volatility, which held near historic lows (see figure 6 and table 7). The Spanish market was the exception to this overall pattern, in that the Ibex 35 fell short of its first quarter gains and volatility picked up slightly (see section 4).

In the euro zone, the German bourse was again the best performer with the Dax 30 recording a hefty gain of 17% to 20 June. The Euro Stoxx 50, Euronext 100 and France's Cac 40 all recorded gains in the 7.5%-8.5% range, while the Italian Mib 20 index was again the tail ender with a quarterly rise (to June 20) of just 2.8%. In the United States, gains of over 9% made up the ground lost in the first quarter. Japan, finally, underperformed the international stock market average.

Main world markets also looked an attractive investment in year-on-year terms. Best in class was again the Dax 30, with 47.3%, followed by the Ibex 35 with 35.4%.

Leading indices have recorded a solid advance since the start of the current bull run in April 2003: 153% the Ibex 35, 128% the Nikkei, 120% the Euro Stoxx 50 and 67% the Dow Jones. However this pales in comparison with the previous bull market from May 1995 to March 2000 in all major indices with the exception of the Nikkei: 337% the Ibex 35, 29% the Nikkei, 321% the EuroStoxx 50 and 144% the Dow Jones.

Performance of main stock market indices

TABLE 6

annual % unless otherwise indicated

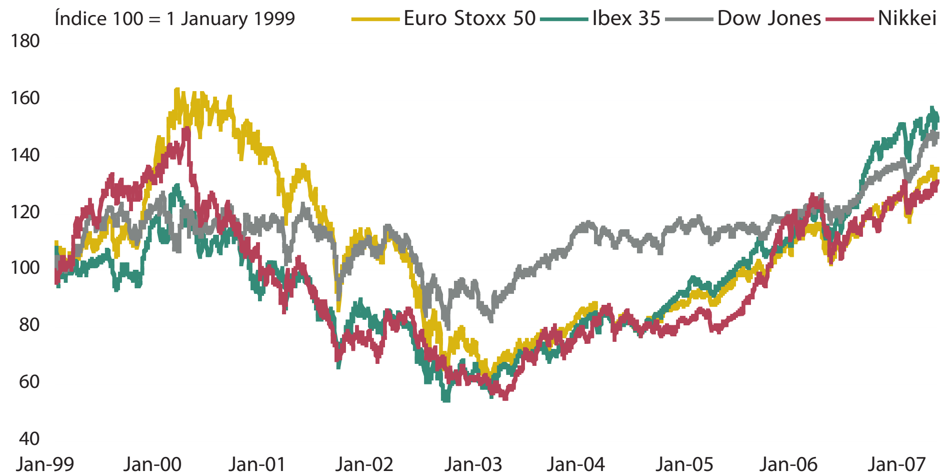
	Index	2005	2006	Q1 07	2007 – Jun[1] % Q	2007 – Jun[1] % change on Dec 06	2007 – Jun[1] % annual
World							
	MSCI World	7.6	18.0	2.1	6.4	8.6	26.8
Euro zone							
	Euro Stoxx 50	21.3	15.1	1.5	8.7	10.3	29.3
	Euronext 100	23.2	18.8	3.1	7.7	11.0	31.2
Germany	Dax 30	27.1	22.0	4.9	17.0	22.6	47.3
France	Cac 40	23.4	17.5	1.7	8.1	10.0	27.7
Italy	Mib 30	13.3	17.5	0.3	2.8	3.2	21.9
Spain	Ibex 35	18.2	31.8	3.5	2.7	6.3	35.4
United Kingdom							
	FTSE 100	16.7	10.7	1.4	5.4	6.9	17.5
United States							
	Dow Jones	-0.6	16.3	-0.9	9.2	8.2	22.9
	S&P 500	3.0	13.6	0.2	6.5	6.7	22.0
	Nasdaq-Cpte	1.4	9.5	0.3	7.4	7.6	23.4
Japan							
	Nikkei 225	40.2	6.9	0.4	5.3	5.7	24.3
	Topix	43.5	1.9	1.9	4.1	6.1	18.1

Source: Thomson Datastream.

1 Data to 20 June. The quarterly change (% Q) corresponds to the period between 20 June and 30 March.

Main stock market indices 1999-2007[1]

FIGURE 5

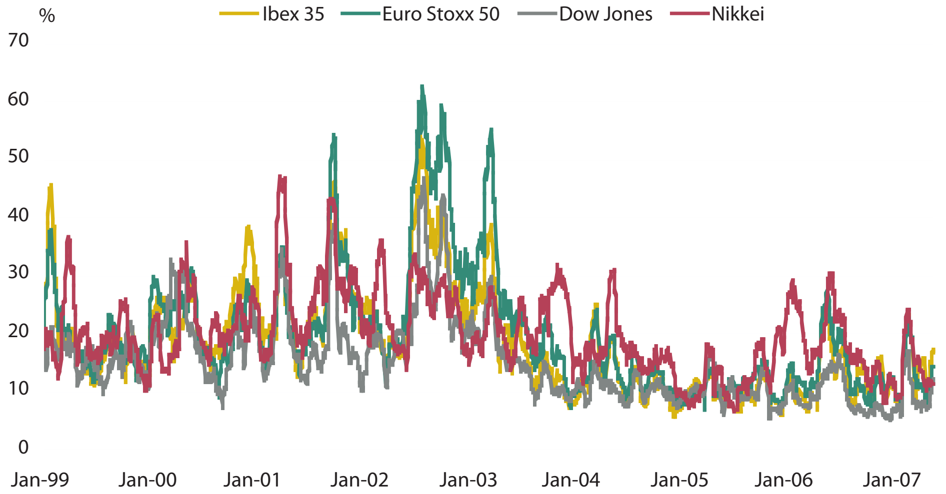


Source: Thomson Datastream.

1 Data to 20 June.

In emerging country markets, the second-quarter story was similar to that of other leading world bourses, that is, a quickening advance with respect to the preceding three months. However, a closer look shows wide disparities. The Venezuelan market continued reversing the progress made in 2006 and closed the period 19.2% down. Conversely, China and Peru succeeded in adding further to their already spectacular stock of gains (see table 8). Other markets marking up strong annual rises were Croatia, Philippines, Mexico and Poland.

Historical volatility of main stock indices[1] FIGURE 6



Source: Thomson Datastream.
1 Data to 20 June.

Historical volatility of major stock indices[1] TABLE 7

%	1999-2003	2004-2006	2004	2005	2006	Q1 07	Q2 07[2]
Euro Stoxx 50	25.08	12.57	13.36	10.73	13.61	13.27	12.11
Dow Jones	18.83	9.95	10.52	9.95	9.40	9.39	8.62
Nikkei	22.95	16.17	17.29	12.14	19.08	14.24	13.65
Ibex 35	23.09	11.48	12.15	9.86	12.43	13.00	13.86

Source: Thomson Datastream.
1 Average daily data.
2 Last available data for 20 June.

Performance of other international stock indices

TABLE 8

	Index	2005	2006	QI 07	2007 – Jun[1] % Q	2007 – Jun[1] % change on Dec 06	2007 – Jun[1] % annual
Latin America							
Argentina	Merval	12.2	35.5	0.6	5.9	6.5	43.6
Brazil	Bovespa	27.7	32.9	3.0	18.0	21.5	60.6
Chile	IGPA	2.7	34.4	7.6	10.2	18.5	53.0
Mexico	IPC	37.8	48.6	8.7	9.8	19.3	77.4
Peru	IGRA	29.4	168.3	33.2	29.1	71.9	184.4
Venezuela	IBC	-31.9	156.1	-6.3	-19.2	-24.3	29.8
Asia							
China	Shangai Comp	-8.3	130.4	19.0	31.3	56.3	162.6
India	BSE	38.3	41.0	-5.7	13.0	6.6	48.8
South Korea	Korea Cmp Ex	54.0	4.0	1.3	22.8	24.4	45.5
Philippines	Manila Comp	15.0	42.3	7.4	16.1	24.7	79.8
Hong Kong	Hang Seng	4.5	34.2	-0.8	9.5	8.6	38.9
Indonesia	Yakarta Comp	16.2	55.3	1.4	18.0	19.7	66.9
Malaysia	Kuala Lumpur Comp	-0.8	21.8	13.7	11.2	26.5	55.8
Singapore	SES All-S'Pore	13.6	27.2	8.2	12.3	21.5	55.9
Thailand	Bangkok SET	6.8	-4.7	-0.9	15.3	14.3	20.1
Taiwan	Taiwan Weighted Pr.	6.7	19.5	0.8	11.1	11.9	37.6
Eastern Europe							
Russia	Russian RTS Index	83.3	70.7	0.7	-1.0	-0.3	40.7
Poland	Warsaw G. Index	33.7	41.6	14.1	12.9	28.8	74.6
Rumania	Romania BET	50.9	22.2	6.2	7.3	13.9	37.0
Bulgaria	Sofix	32.0	48.3	4.4	6.6	11.3	54.5
Hungary	BUX	41.0	19.5	-5.7	14.3	7.7	42.1
Croatia	CROBEX	26.4	62.2	32.0	13.2	49.4	93.1

Source: Thomson Datastream.
1 Data to 20 June. Quarterly change (% Q) corresponds to the period between 20 June and 30 March.

Aside from investor returns by way of price movements, we must also consider dividend payments. In the euro zone, dividend yield contracted in the second quarter, though only in the Italian Mib 30 and the Ibex 35 did it drop below the closing level of 2006. As of 20 June, all euro-zone stock indices except Germany ' s Dax 30 and the Ibex 35 were yielding over 3% by the dividend route. In the United States too dividends yields moved down a little in the second quarter, to approximately 2%. Japan was again in the rear, albeit with an uptick in the second quarter to 1.2% (see table 9).

Dividend yield of main stock indices

TABLE 9

%	2004	2005	2006	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07[1]
S&P 500	1.84	1.94	1.91	2.10	1.98	1.91	2.13	2.02
Topix	1.11	0.95	1.11	1.16	1.17	1.11	1.11	1.21
Euro Stoxx 50	3.17	3.28	3.52	3.91	3.60	3.52	3.92	3.64
Euronext 100	3.22	3.23	3.32	3.86	3.52	3.32	3.63	3.55
FTSE 100	3.61	3.59	3.77	3.91	3.94	3.77	3.88	3.82
Dax 30	1.96	2.17	2.29	2.70	2.47	2.29	2.77	2.56
Cac 40	3.32	3.43	3.79	4.26	3.91	3.79	4.26	4.12
Mib 30	3.17	3.53	3.67	4.12	4.00	3.67	3.88	3.47
Ibex 35	2.77	3.08	3.02	3.33	2.94	3.02	3.19	2.98

Source: Thomson Datastream.
1 Data as of 20 June.

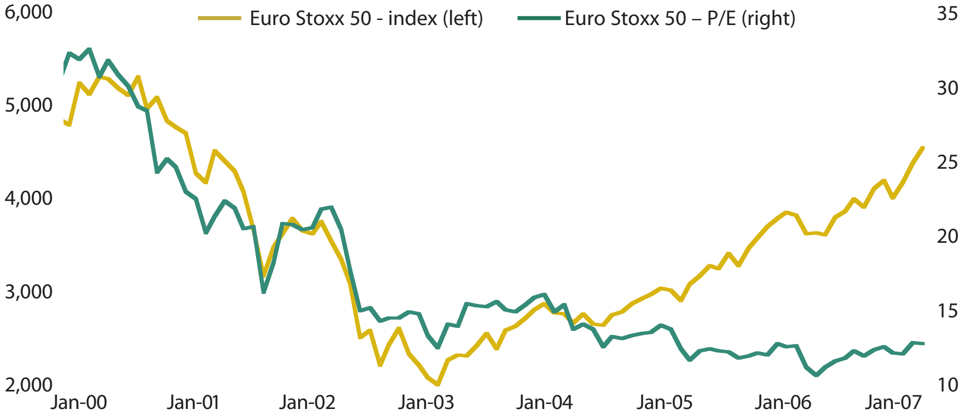
Stock prices have been rising faster than corporate earnings. In the second quarter of 2007, the price-earnings ratios (P/E) of euro-zone indices and the U.S.'s S&P 500 continued to trend higher as far as a June reading 1.5 points higher than one year before (see table 10). That said, P/Es continued moving lower than the historical average of 1999 to 2006 (see figure 7 and 7.1). The Topix P/E continued in the lead though losing some ground against the rest.

P/E of main stock indices TABLE 10

	2004	2005	2006	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07[1]
S&P 500	16.36	14.85	15.07	13.60	14.25	15.07	14.66	15.18
Topix	15.68	19.52	17.80	17.27	16.70	17.80	17.59	17.91
Euro Stoxx 50	13.00	12.03	12.15	10.82	11.73	12.15	11.94	12.21
Euronext 100	13.06	12.46	12.93	11.53	12.47	12.93	13.00	13.47
FTSE 100	16.63	12.45	12.41	11.52	11.75	12.41	12.48	12.64
Dax 30	12.96	12.62	12.78	11.19	12.08	12.78	12.66	13.06
Cac 40	12.93	12.14	12.68	11.41	12.19	12.68	12.55	12.99
Mib 30	15.57	13.38	13.07	11.63	12.36	13.07	12.85	12.85
Ibex 35	13.78	12.88	14.29	12.30	13.35	14.29	14.04	13.91

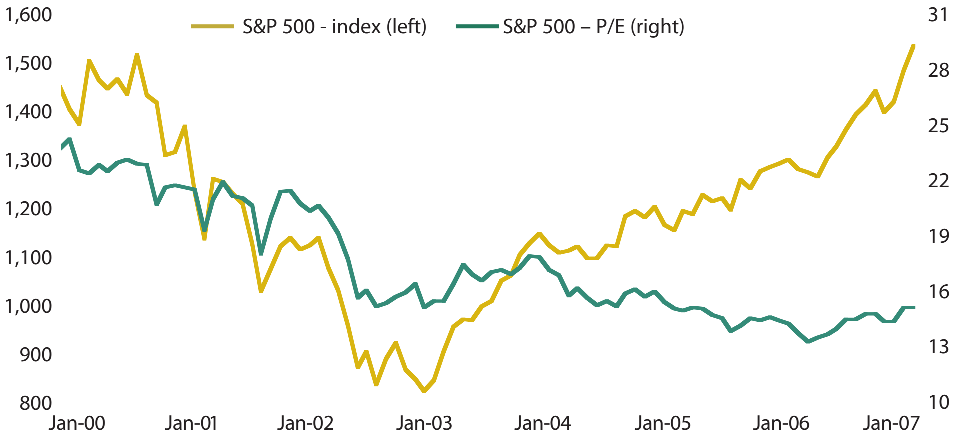
Source: Thomson Datastream.
1 Data as of 20 June.

Stock indices and P/E: Euro Stoxx 50 FIGURE 7



Source: Thomson Datastream.

Stock indices and P/E: S&P 500 FIGURE 7.1



Source: Thomson Datastream.

The latest available data on the turnover of main world markets, corresponding to the first quarter of 2007, shows that trading volumes expanded strongly. This was especially true of the euro zone, where first-quarter trading was a full 35% higher than the quarterly average for 2006. The New York and Tokyo markets both reported a more moderate increase of just over 10% (see table 11).

Trading volumes of main international stock markets TABLE 11

Billion euros

Exchange	2004	2005	2006	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07
U.S.[1]	16,813	20,042	27,044	7,179	7,128	6,091	6,646	7,439
New York	9,317	11,410	17,222	4,429	4,603	3,958	4,232	4,814
Tokyo	2,591	3,603	4,617	1,358	1,224	986	1,049	1,272
London	4,149	4,583	5,991	1,581	1,443	1,340	1,626	2,035
Euronext	1,986	2,345	3,006	762	891	617	736	948
Deutsche Börse	1,238	1,546	2,165	555	608	457	545	801
Borsa Italiana	778	1,051	1,258	293	377	231	357	388
BME[2]	646	859	1,154	272	263	265	354	419

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

3 Spanish fixed-income markets

Short-term rates prolonged the steady ascent that has characterised these last few years (see table 12). The increase in the quarter was likewise a gradual one, as markets adjusted their expectations about the ECB's stance on monetary policy.

Specifically, the interest rates of commercial paper and interbank deposits rose by 25-30 basis points in the second quarter of 2007. The exception was the 12-month rate of commercial paper, which climbed 35-40 basis points to around 4.6%, widening the spread over deposits in this term to 30 basis points.

Short-term interest rates [1] TABLE 12

%	Dec 04	Dec 05	Dec 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Commercial paper[2]								
3 month	2.25	2.58	3.78	3.10	3.42	3.78	4.00	4.22
6 month	2.30	2.74	3.91	3.29	3.63	3.91	4.11	4.36
12 month	2.39	2.93	4.00	3.53	3.78	4.00	4.23	4.58
Interbank deposits								
3 month	2.16	2.45	3.55	2.92	2.98	3.55	3.72	4.00
6 month	2.20	2.58	3.69	3.10	3.16	3.69	3.85	4.12
12 month	2.29	2.77	3.86	3.34	3.39	3.86	4.02	4.30

Source: AIAF and Thomson Datastream.
1 Average daily data. June 2007 data correspond to the average between 20 June and 21 May.
2 Trading on private fixed-income market AIAF.

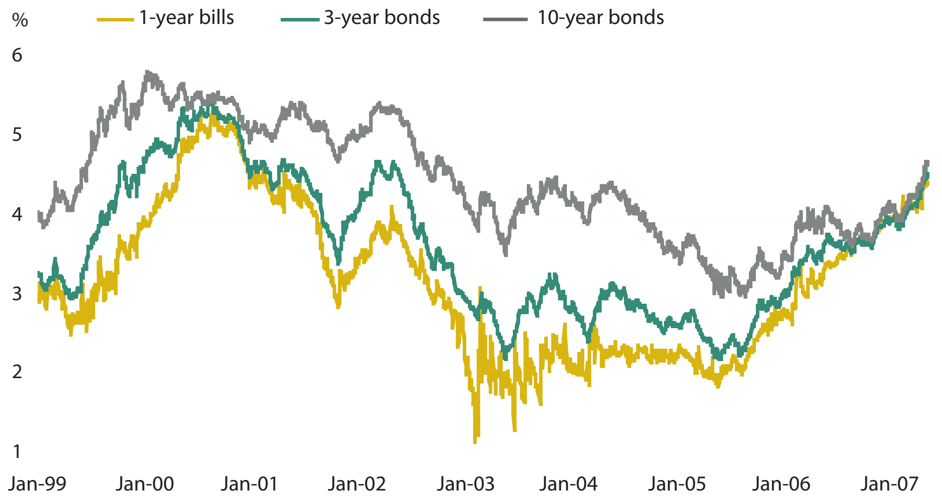
Spanish government bond yields moved up 50-55 basis points in the second quarter of 2007 (see table 13), with the spread between ten- and three-year terms holding at a low 10 basis points (see figure 8). Yields of medium- and long-term corporate bonds also increased 55 basis points in all maturities. As a result, corporate bond spreads over medium and long government bond yields repeated their end-March levels of 25-30 basis points in 3- and 5-year maturities and around -40 basis points in the ten-year term.

Yields of medium- and long-term government bonds and private fixed-income[1] TABLE 13

%	Dec 04	Dec 05	Dec 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Private fixed-income[2]								
3 year	2.81	3.15	4.04	3.86	3.91	4.04	4.17	4.69
5 year	3.38	3.48	4.14	4.12	4.02	4.14	4.21	4.77
10 year	4.15	3.89	4.26	4.48	4.24	4.26	4.39	4.93
Government bonds								
3 year	2.61	2.91	3.73	3.58	3.62	3.73	3.91	4.43
5 year	3.00	3.06	3.76	3.74	3.66	3.76	3.94	4.48
10 year	3.64	3.36	3.80	3.96	3.74	3.80	4.00	4.54
Spread[3]								
3 year	20	25	31	28	29	31	26	26
5 year	37	42	37	38	36	37	27	29
10 year	51	54	46	52	50	46	38	39

Source: Thomson Datastream and AIAF.
1 Average daily data. June 2007 data correspond to the average between 20 June and 21 May.
2 Medium- and long-term bonds and debentures in outright trades on the AIAF market.
3 Basis points.

Spanish government bond yields[1] FIGURE 8



Source: Thomson Datastream.
1 Data to 20 June.

Issues registered with the CNMV and trading on the AIAF fixed-income market exhibited a characteristic credit risk profile (see table 14). In the first quarter of 2007 a large percentage of covered bond issues conserved their "AAA" ratings, while plain bonds and debentures remained mainly bracketed in the "A" and " AA" categories and preference shares suffered some degree of downward revision, with 4.7% ending up below the investment grade cut-off "BBB".

Credit ratings of CNMV-registered issues trading on AIAF[1] TABLE 14

% total unless otherwise indicated	Mortgage-backed securities	Non mortgage asset-backed securities	Mortgage bonds	Territorial bonds	Matador bonds	Plain bonds	Plain debentures	Preference shares	Total
Rated									
Amount (million euros)	24,177.1	213,290.9	136,320.0	10,550.0	1,598.8	84,288.7	37,334.0	21,134.0	**528,693.7**
Percentage	99.7	93.1	97.9	84.6	100.0	91.5	80.9	90.2	**93.0**
Investment grade									
AAA	93.9	88.1	96.7	82.2	78.3	5.5	3.7	0.0	**66.5**
AA	1.2	0.9	1.1	0.0	16.0	48.8	28.5	5.0	**11.2**
A	3.5	2.3	0.0	2.4	3.8	37.2	42.7	44.7	**12.5**
BBB	0.7	1.3	0.0	0.0	0.0	0.0	6.0	35.8	**2.5**
Speculative grade									
<BBB	0.4	0.4	0.0	0.0	1.9	0.0	0.0	4.7	**0.4**
Unrated									
Amount (million euros)	64.0	15,846.4	2,940.0	1,925.0	0.0	7,865.3	8,794.1	2,283.6	**39,718.4**
Percentage	0.3	6.9	2.1	15.4	0.0	8.5	19.1	9.8	**7.0**

Source: CNMV.
1 Outstanding balance as of 30 March 2007.

4 Spanish equity markets

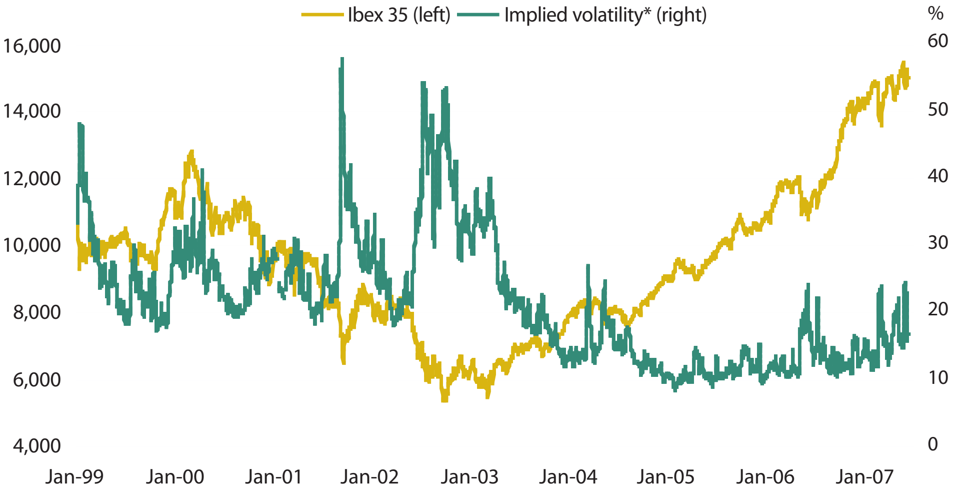
4.1 Prices

The Spanish stock market underperformed remaining euro-zone exchanges in the second quarter of 2007, with the Ibex 35 managing only a 2.7% gain to 20 June against the 8.9% average of the euro-zone markets. This result was heavily influenced by the 5% fall of June's opening week. Up to that point, the index had recorded a cumulative gain of 5.9%.

Remaining indices linked to Spanish corporates fared rather worse: the Madrid General Index (IGBM) rose 2.2% while the Ibex Nuevo Mercado (Ibex-NM) slipped back 6.4% (see table 15). The FTSE Latibex indices – linked to Latin American corporates – bucked the trend with a gain in the period of around 25%. This performance, however, was more reflective of stock market gains in the countries of origin of listed players (Brazil, Argentina, Mexico and Chile, principally).

Another distinguishing characteristic of the Spanish market in the second quarter of 2007 was the upturn in volatility. Implied at-the-money (ATM) volatility on the nearest expiry date of Ibex 35 options touched 23% on 11 June, though later corrected to 17% on 20 June. Compare this with end-March volatility of 14% (see figure 9).

Performance of the Ibex 35 and implied volatility FIGURE 9



Source: Thomson Datastream y MEFF.
* Implied ATM volatility on nearest expiry. Data to 20 June 2007.

A sectoral and bottom-up analysis of the Spanish market's second-quarter performance shows that "Financial and real estate services", or more specifically the "Real estate and others" subsector is being especially hard hit by interest rate rises and the shift in rate expectations. Companies in this sector remain immersed in a correction of the large gains accumulated in 2005 and 2006 (see table 16 and figure 10). One stock in particular, Astroc, which had begun losing heavily on 1 March, took another sharp tumble at the end of April, and eventually closed the period with a cumulative fall of 78.9%. Astroc thus completed a total 82.5% descent from its trading high, reached after a bull run of 972% in the first ninth months since it entered the IGBM. Another real estate operator, Urbas Proyectos Urbanísticos, saw its prices plunge by 48.1% after a 1,500% run-up between January 2001 and 2007 (see table 19).

These severe falls caused a general unease in the market, focusing especially on the real estate, and analysts have since been working out the likely effects of a contraction in housing demand on the earnings of the sector as a whole and each company in particular.

"Construction" is another subsector potentially affected by rising rates and the prospect of cooler demand for housing. Its prices, however, held up well in the second quarter, with a 2.6% gain to 20 June. The market seems to be giving a vote of confidence that contractors' international diversification will suffice to counter any downturn in Spanish construction activity.

Performance of Spanish stock indices

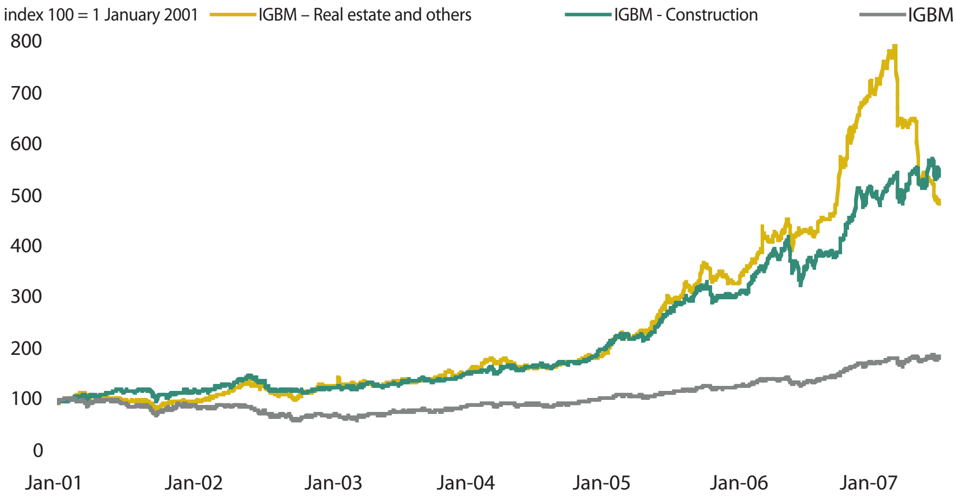
TABLE 15

annual % unless otherwise indicated	2005	2006	Q1 07	2007 – Jun[1] Index	% Q	% change on Dec 06	% annual
Ibex 35	18.2	31.8	3.5	15.036	2.7	6.3	35.4
IGBM[2]	20.6	34.5	4.3	1.657	2.2	6.6	37.4
Barcelona	12.7	29.3	3.5	1.172	1.0	3.2	32.3
Bilbao	17.7	34.1	3.5	2.707	1.3	5.0	33.8
Valencia	21.4	35.3	3.5	1.353	2.7	6.7	38.3
Ibex with dividends	22.0	36.0	14.1	24.174	5.6	10.0	39.4
Ibex-NM[3]	12.7	34.0	7.5	3.534	-6.4	0.6	26.6
Ibex Medium Cap[4]	37.1	42.1	13.1	22.584	1.7	14.9	50.2
Ibex Small Cap[5]	42.5	54.4	14.1	17.470	-0.8	13.1	58.5
BCN-Mid 50[6]	47.5	51.0	3.5	41.279	-2.3	11.7	50.1
FTSE Latibex All-share[7]	83.9	23.8	6.0	3.065	24.8	32.3	75.8
FTSE Latibex Top[8]	76.3 *	18.2	3.5	4.968	23.5	31.5	74.6
FTSE Latibex Brasil[9]	-	24.3 **	14.1	11.480	25.2	33.4	-

Source: Thomson Datastream, Reuters, Bolsa de Madrid and Sociedad de Bolsas.
1 Data to 20 June, except Ibex with dividends corresponding to 31 May. Quarterly change (% Q) refers to the period between 20 June (31 May in Ibex with dividends) and 30 March.
2 Madrid Stock Exchange General Index.
3 Ibex Nuevo Mercado, made up of TMTs (technology, media and telecoms).
4 Index of medium-cap shares made up of 20 companies.
5 Index of small-cap shares made up of 30 companies.
6 Index of the middle segment of the Spanish stock market drawn up by the Barcelona Exchange.
7 Index of all shares quoted on the Latin American market in euros (Latibex).
8 Index of main Latibex shares.
9 Index of main Brazilian shares quoted on Latibex.
* Since the index started on 3 January 2005.
**Since the index started on 26 September 2006.
na: data not available at the time of preparing this report.

Performance of Real estate and others and Construction[1]

FIGURE 10



Source: Bolsa de Madrid.
1 Data to 20 June.

The scant gain of the IGBM was largely about the falling prices of two bank shares (Banco Popular Español and Banco de Sabadell), although with upside support from "Oil and energy", especially the fast gaining Iberdrola, and to a lesser extent from SCH (see table 18).

Performance of the Madrid Stock Exchange by sector and leading shares [1]

TABLE 16

annual % unless otherwise indicated

	weighting[2]	2005	2006	Q1 07	2007 – Jun[3] % Q	% change on Dec 06	% anual
Financial and real estate services	41.84	22.7	34.9	0.2	-0.8	-0.5	29.1
Real estate and others	2.41	72.9	111.2	-8.5	-23.5	-30.1	12.6
BBVA	13.84	32.0	21.0	0.8	0.3	1.0	21.8
SCH	15.55	22.1	26.8	-5.5	4.1	-1.7	27.5
Oil and energy	21.19	28.0	33.3	7.1	10.5	18.4	51.3
Endesa	6.33	28.5	61.2	13.0	-0.8	12.0	52.3
Repsol YPF	4.34	23.9	28.8	-3.7	14.4	10.2	37.3
Iberdrola	5.73	23.5	43.4	6.8	24.0	32.5	71.2
Basic materials, industry and construction	10.14	43.4	61.9	8.0	4.2	12.6	56.1
Construction	5.89	54.0	61.0	5.2	2.6	8.0	52.9
Technology and telecommunications	16.41	-6.6	28.4	2.4	-0.6	1.8	29.6
Telefónica	15.45	-4.6	26.8	2.4	0.2	2.5	29.5
Consumer goods	5.58	24.2	31.9	17.0	1.1	18.3	46.9
Consumer services	4.84	21.2	8.6	11.8	-4.7	6.5	27.0

Source: Thomson Datastream and Bolsa de Madrid.
1 Shares capitalising at more than 4% of the IGBM.
2 Relative weight (%) in the IGBM as of 2 January 2007.
3 Data to 20 June. Quarterly change (% Q) corresponds to the period between 20 June and 30 March 2007.

A glance at table 17 reveals the adverse second-quarter showing of IGBM companies. Specifically, 56% of index members suffered losses in the period while only 5.7% posted significant gains, in excess of 25%. Among this last group were Service Point Solutions, Grifols and Técnicas Reunidas (see table 19).

Performance range of IGBM companies

TABLE 17

% of IGBM companies	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07[1]
≥ 25%	1.7	17.2	14.8	12.0	5.7
10% to 25%	2.6	3.4.4	27.9	37.6	8.2
0% to 10%	29.6	36.1	36.1	33.6	30.3
≤ 0%	66.1	12.3	21.3	16.8	55.7
Pro memoria: total no. of companies					
	115	122	122	125	122

Source: Thomson Datastream.
1 Data to 20 June.

Shares with greatest impact on IGBM change[1]

TABLE 18

Share	Sector	2007-Jun[2] Q2 07	Jan-Jun 07	last year
Rise				
Iberdrola	Oil and energy	1.38	1.86	4.07
BSCH	Financial and real estate services	0.63	-0.26	4.28
Repsol YPF	Oil and energy	0.63	0.44	1.62
Gas Natural	Oil and energy	0.31	0.58	1.18
Acciona	Basic materials. industry and construction	0.24	0.42	0.66
Fall				
Banco Popular Español	Financial and real estate services	-0.31	0.12	0.99
Astroc Mediterráneo	Financial and real estate services	-0.18	-0.17	-0.05
Banco de Sabadell	Financial and real estate services	-0.17	-0.07	0.44

Source: Thomson Datastream and Bolsa de Madrid.
1 The shares listed are those having most impact (equal to or more than 0.15 points) on the change in the IGBM.
2 Data to 20 June.

IGBM shares with biggest quarterly change

TABLE 19

Share	Sector	2007- Jun[1] % Q	% change on Dec 06	% annual
Rise				
Service Point Solutions	Consumer services	51.91	58.57	101.01
Grifols	Consumer goods	29.20	53.76	182.36
Técnicas Reunidas	Basic materials, industry and construction	27.81	63.50	-
Papeles y Cartones de Europa	Consumer goods	26.09	42.49	114.81
Acciona	Basic materials, industry and construction	25.81	44.58	71.21
Fall				
Astroc Mediterráneo	Financial and real estate services	-78.87	-75.51	-22.08
Urbas Proyectos Urbanísticos	Financial and real estate services	-48.10	-48.28	-26.83
Vueling Airlines	Consumer services	-42.73	-22.94	-
Montebalito	Financial and real estate services	-36.86	-1.25	6.90
Avanzit	Technology and Telecommunications	-24.90	-17.47	154.26

Source: Thomson Datastream and Bolsa de Madrid.
1 Data to 20 June. Quarterly change (% Q) between 20 June and 30 March 2007.

IGBM shares with biggest annual change

TABLE 20

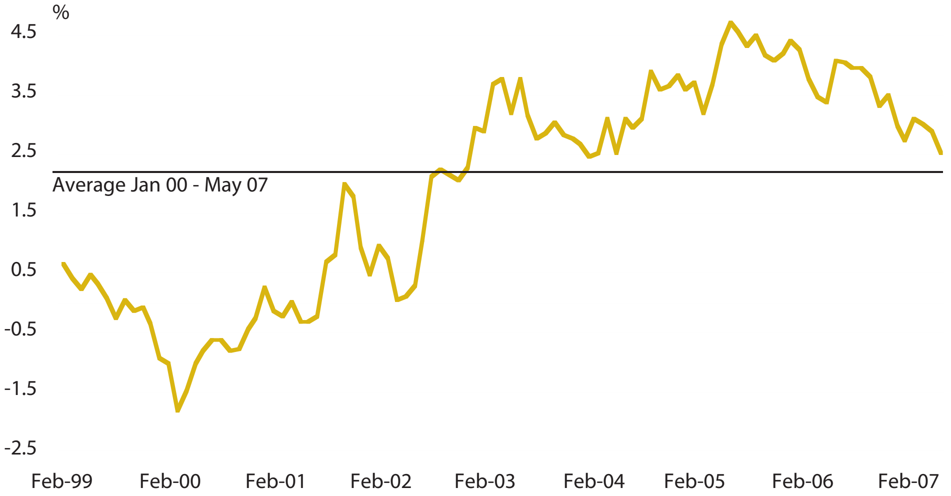
Share	Sector	2007- Jun[1] % annual	% Q
Rise			
Grifols	Consumer goods	182.36	29.20
General de Alquiler de Maquinaria (GAM)	Basic materials, industry and construction	168.10	21.51
Avanzit	Technology and telecommunications	154.26	-24.90
Cleop	Basic materials, industry and construction	142.80	-18.54
Duro Felguera	Basic materials, industry and construction	138.95	-10.07
Fall			
Urbas Proyectos Urbanísticos	Financial and real estate services	-26.83	-48.10
Astroc Mediterráneo	Financial and real estate services	-22.08	-78.87
Jazztel	Technology and telecommunications	-14.04	-20.97
Banco de Andalucía	Financial and real estate services	-10.64	-8.84
Banco de Galicia	Financial and real estate services	-10.56	-4.49

Source: Thomson Datastream and Bolsa de Madrid.
1 Data to 20 June. Quarterly change (% Q) between 20 June and 30 March 2007.

The price-earnings ratio (P/E) of the Ibex 35 moved down slightly in the second quarter to under 14% by 20 June (see table 9). This is a higher reading than the average multiple of the other main euro-zone indices (12.9) but still short of the averages posted between 1999 and December 2006 (16.3).

The sharp rise in long-term interest rates reduced the earnings yield gap between shares and bonds to 2.5% in the first week in June. This is slightly higher than the average recorded since January 2000 (see figure 11).

Earning yield gap[1] of the Ibex 35 FIGURE 11



Source: Thomson Datastream and authors.
1 Difference between stock market yield, taken as earnings/price, and ten-year bond yields. Data to 8 June.

4.2 Activity: trading and liquidity

Stock market trading activity continued intense through the months of April and May. Average daily trading on the continuous electronic market again topped six billion euros, though the figure was 2.5% short of the first-quarter outcome. These levels are well ahead of the 4.5 billion euros averaged in 2006 (see table 21).

Trading on the Spanish stock market TABLE 21

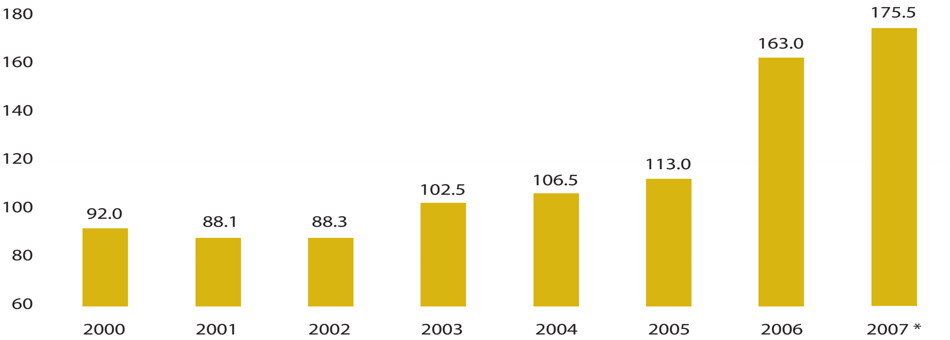
million euros	2004	2005	2006	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07[1]
All exchanges	**642,109**	**854,145**	**1,154,294**	**262,779**	**265,181**	**354,260**	**418,540**	**261,268**
Electronic market	636,527	847,664	1,146,390	261,344	263,943	351,020	415,857	259,831
Open outcry	5,194	5,899	5,318	1,207	974	1,358	574	157
of which SICAV[2]	4,541	4,864	3,980	1,146	867	1,091	258	34
MAB[3]	-	-	1,814	17	93	1,705	1,771	1,107
Second market	21	26	49	11	11	20	122	19
Latibex	366	557	723	200	160	158	217	155
Pro memoria: non resident trading (% all exchanges)								
	57.6	57.1	58.2	59.7	58.3	59.3	na	na

Source: CNMV and Directorate-General for Trade and Investment.
1 Cumulative data for April and May.
2 Open-ended investment companies.
3 Alternative investment market. Data since the start of trading on 29 May 2006.
na: data not available at the time of preparing this report.

The Spanish stock market again gained liquidity in the second quarter of 2007. On the data to May, the turnover velocity (ratio between trading volume and market cap) of the electronic market stood at 176, improving on the 2006 figure which itself was substantially up on the preceding year (see figure 12).

Turnover velocity[1] of the Spanish stock market

FIGURE 12



Source: CNMV and Sociedad de Bolsas.
1 Ratio of cumulative trading volume in the electronic market in the past twelve months and average monthly capitalisation in the same period.
* Data for May.

4.3 Listed company earnings

The strong earnings performance of Spanish companies is one of the main forces driving up share prices. The latest available data for the companies listed on the electronic market are still the full-year results for 2006 (see table 22). As we can see, gross operating income (EBITDA) moved up 23.3% in the year, a solid advance though slightly behind the 25.8% growth extrapolated from first-half figures.

All sectors contributed to EBITDA growth, but not to an equal degree. Basic materials, industry and construction and Consumer services were clearly in the lead, with 49.6% and 34.2% respectively, while growth was slowest in Consumer goods and Oil and energy (see table 22).

The outlook for 2007 is generally favourable to judge from the initial data, corresponding to the first-quarter performance of Ibex 35 members. Specifically, net profit growth in the period equated to an annual rate of 34.9%, with ten firms reporting growth ahead of 50% and only three cases of decline.

EBITDA[1] of companies listed on the electronic market

TABLE 22

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**	**25.4**	**24.8**
BBVA	10.6	27.0	26.1	-2.1	-12.9	11.7	20.4	28.7
SCH	18.6	32.6	24.0	-6.9	0.4	15.7	32.4	26.1
Oil and energy	**36.2**	**45.0**	**-2.6**	**-11.5**	**4.2**	**4.9**	**23.6**	**12.1**
Endesa	37.6	22.8	-3.6	1.8	-6.6	-6.1	33.2	18.6
Repsol YPF	63.5	110.7	-12.4	-28.0	4.8	12.7	22.6	6.9
Iberdrola	5.5	4.6	19.7	0.2	9.0	9.3	12.5	14.2
Basic materials, industry and construction	**26.0**	**37.3**	**8.1**	**13.5**	**16.2**	**14.7**	**12.2**	**49.6**
Technology and telecommunications	**13.4**	**9.1**	**33.9**	**-10.4**	**5.8**	**-6.3**	**22.5**	**27.2**
Telefónica	15.1	11.2	9.4	-10.5	5.3	-6.1	23.2	27.0
Consumer goods	**14.1**	**63.1**	**20.4**	**10.8**	**1.8**	**13.2**	**18.4**	**6.6**
Consumer services	**11.2**	**24.5**	**13.5**	**19.3**	**18.5**	**17.5**	**14.4**	**34.2**
Total electronic market	**21.0**	**30.0**	**14.9**	**-4.8**	**5.0**	**7.8**	**22.0**	**23.3**
Pro memoria: total EBITDA of the electronic market (million euros)								
	40,598	52,758	60,597	57,707	60,621	65,366	79,743	98,332

Source: Bolsa de Madrid.
1 Earning Before Interest, Taxes, Depreciation and Amortisation.

Corporate investment and its effects on listed company debt

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1 Introduction

In the last three years. Spain's listed companies have been investing heavily in order to grow their business and diversify their operations. They hope by this means to harness economies of scale and boost their competitiveness in today's increasingly globalised markets. This increase in size has come through the organic growth of traditional businesses and domestic mergers and acquisitions, and has significantly enlarged the presence of Spanish firms in international markets.

The sum total of the equity investments made by listed Spanish firms in the period 2004-2006 was approaching 150,000 million euros, of which 65% went on ownership interests in foreign companies. This international expansion is reflected in the changing geographical mix of their ordinary revenues, with the relative weight of non Spanish sales up by 11 percentage points to 43% of the total in the case of non-financial listed companies.

Low interest rates and the abundance of liquidity in the market have made it easier to find the finance to pay for these investments, leading to a sustained increase in companies' financial leverage which steepened significantly in 2006. Specifically, in this year the gross debt of non financial listed companies reached 266,198 million euros, double the equivalent figure for 2001.

The aim of this article is to analyse the nature and characteristics of the main corporate acquisitions and significant equity investments made by Spanish listed companies, and how leveraged they have become as a result of this effort.

Among other topics, we look at the origin and destination of investments by business sector and geographical market, their effects on the internationalisation of listed companies' operations, the structures most widely used to finance transactions and the impact they have had on a selection of leverage indicators. We supplement this information with a comparative study using aggregate data for U.S. and European corporates.

In preparing this article we have drawn on the disclosed materials of listed firms, including annual accounts, periodic reports, significant event notices and information on takeover bids.

2 Acquisitions by Spanish listed firms in the last three years and their effects on business internationalisation

2.1 Origin and destination of main acquisitions by business sector and geographical area

The table below provides aggregate data on the origin and destination of the main corporate acquisitions and significant equity investments made by Spanish companies in different sectors between the years 2004 and 2006, together with transactions announced or closed in the first quarter of 2007.

Acquisitions by listed companies TABLE 1

	Origin of investor				Investment destination	2007 (1st quarter)	
Million euros	2004	2005	2006	Total	2004-2006	Origin	Destination
Energy and Water	914	995	466	2,375	25,159	17,200	19,192
Construction and Real Estate	2,025	9,641	57,326	68,992	23,160	6,762	6,762
Industry, Trade and Services	1,406	3,691	3,146	8,243	12,778	1,433	2,226
Communications	3,982	6,144	26,135	36,261	36,411	---	---
Transport and Motorways	---	922	5,225	6,147	24,510	1,070	171
Financial and Insurance	18,734	1,473	7,587	27,794	27,794	9,888	8,002
Total	**27,061**	**22,866**	**99,885**	**149,812**	**149,812**	**36,353**	**36,353**

Source: CNMV.

The sums spent on corporate acquisitions and significant equity investments grew dramatically in 2006 to the extent that final investment is estimated to be double the combined amount of the two preceding years.

The most active firms on the buyer side belong to the Construction and Real Estate sectors, which together accounted for 46% of the sum spent on corporate takeovers. The least active in our reference period were those in Energy and Water, representing less than 2% of the total.

Regarding sector of destination, we can see that 60% of investments found their way to the Communications, Financial Institutions and Energy sectors.

Table 2 below provides aggregate information on the geographical destination of the main corporate acquisitions or significant equity investments made by listed Spanish firms between 2004 and 2006, along with deals announced or closed in the first quarter of 2007.

1 Aggregate information compiled from the financial data published by Spanish companies in the last three years regarding their main corporate transactions and significant investments in the capital of other entities. Totals also include takeover bids in the reference period launched by Spanish companies against listed firms, since some bidders intend to apply for their shares to be admitted to trading; the case for instance of Grupo Empresarial San José's bid for Parquesol or Construcciones Reyal's for Urbis. Not included are corporate transactions amounting to under 75 million euros and takeover bids by foreign companies.

Listed company acquisitions by geographical area

TABLE 2

	Investment destination				Investment destination
	2004	2005	2006	Total	2007 (1st quarter)
Energy and Water	**914**	**3,769**	**20,476**	**25,159**	**19,192**
- Spain	285	2,995	20,046	23,326	2,000
- Other countries	629	774	430	1,833	17,192
Construction and Real Estate	**1,560**	**4,482**	**17,118**	**23,160**	**6,762**
- Spain	---	4,303	13,010	17,313	5,498
- Other countries	1,560	179	4,108	5,847	1,264
Communications	**3,982**	**6,294**	**26,135**	**36,411**	**---**
- Spain	---	150	---	150	---
- Other countries	3,982	6,144	26,135	36,261	---
Financial and Insurance	**18,734**	**1,473**	**7,587**	**27,794**	**8,002**
- Spain	1,734	---	1,005	2,739	197
- Other countries	17,000	1,473	6,582	25,055	7,805
Other sectors	**1,871**	**6,847**	**28,569**	**37,288**	**2,397**
- Spain	645	3,179	4,284	8,108	672
- Other countries	1,226	3,669	24,285	29,180	1,725
Total	**27,061**	**22,866**	**99,885**	**149,812**	**36,353**
- Spain	2,664	10,628	38,345	51,636	8,367
- Other countries	24,397	12,238	61,540	98,175	27,986

Source: CNMV.

Acquisitions of foreign companies (98,175 million euros) made up 65% of the amount of the transactions computed in the reference period, which would seem to suggest that Spanish listed companies have found more attractive investment opportunities in international markets.

The expansion of construction firms into other geographical markets responds largely to a strategy of diversifying exposure ahead of a likely downturn in the general business cycle and, more particularly, in civil works and residential building, which have both been growing fast in recent years. These international investments have mainly favoured service concession holders in mature markets considered to hold out excellent potential for business development: the United Kingdom, Eastern European countries (next in line for structural funds from the European Union) and Latin America.

Spanish real estate operators have primarily targeted the French market, on the grounds of the good prospects mooted for the office sector and the tax breaks available for real estate investment trusts (Sociétés d'Investissements Immobiliers Coteés, SIIC). Since 2003, these companies have been exempt from both tax on rental income and capital gains tax on property sales, provided between 80% and 90% of the income raised is paid to shareholders as dividends[2].

Recent-year transactions by telecoms firms and financial institutions have succeeded in strengthening their market position and share in Latin American countries, while taking them into new European markets with strong growth potential.

2 In 2007 an amendment to the tax rules governing French REITs reduced a part of these tax benefits. The main changes were: (i) the majority shareholder may not own more than 60% of the company, (ii) the controlling shareholder will pay 20% tax on the net income and realised profits and (iii) the company must have a "free float" of at least 15%. The new law establishes a transition period of 2 years (to December 2008) for exchange-traded REITs.

The incentives introduced by Spain's Corporate Tax Law – deductions for reinvesting capital gains and the tax amortisation of financial goodwill arising from the acquisition of foreign companies – have also been a stimulus to international investment. However Law 35/2006 of 28 November has since amended the corporate tax rules to make these incentives non cumulative, meaning firms will lose out on part of the benefit.

2.2 Financing structures

Our next table sets out aggregate data on the main corporate transactions referred to above, indicating whether consideration was in cash or via the delivery of shares.

Most of the transactions examined to the first half of 2007 (86% of the total) were paid in cash using bank finance. However, a number of companies subsequently increased capital in order to rebalance their financial positions.

Acquisitions by listed companies, cash or delivery of shares TABLE 3

	Acquisitions (cash or delivery of shares)				Acquisitions
Million euros	2004	2005	2006	Total	2007 (1st quarter)
Cash or equivalent	13,295	21,516	98,796	133,607	27,091
Delivery of shares	13,766	1,350	1,089	16,205	9,262
Total	**27,061**	**22,866**	**99,885**	**149,812**	**36,353**

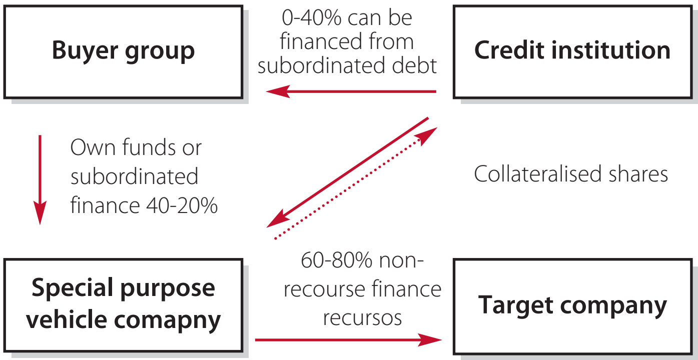
Source: CNMV.

Overall, transaction financing tended to involve two phases. In the first, a single financial entity provides the buyer with funds in the form of a "bridge loan". In the second, once the deal is confirmed, the debt is restructured through a syndicated loan in which the lead finance provider shares out the risk with other credit entities.

The financing structure common to most operations[3], in particular construction firm investments in Spanish electric utilities or other energy businesses, is shown diagrammatically in figure 1 below:

3 This pattern is derived from financing structures that have proved common to a number of transactions, although of course each corporate deal is a world unto itself. We have centred our attention on "project finance" as classified by companies themselves, though the same structure is extrapolable to other major acquisitions closed in 2006.

Financing structure of selected acquisitions FIGURE 1



Source: authors.

Financial institutions lend funds to a special-purpose vehicle owned 100% by the end buyer, which will hold the securities acquired. The financing, known as "non-recourse", usually extends to between 60% and 80% of the acquisition price. The buying company will fund the remainder of the deal out of equity or through other external borrowings. Normally, the interests receivable by the group parent on the funds loaned to the special-purpose vehicle are added to the principal until the non recourse loan is paid off.

This kind of finance is known as "non-recourse" because it is not secured on the assets of the acquiring company but only on the shares acquired. Hence contracts include a guarantee clause such that the market value of these shares must invariably exceed a stated percentage of the loan, round about 115%-120%. This clause provides banks with additional recovery assurance, because they can exercise this right when the shares are priced 15% or 20% above the loss-making threshold.

This kind of "non-recourse" arrangement is typical of project finance, since payment of the loan principal and interests is secured against the cashflow generated by the project itself rather than other assets of the borrower's. Listed companies usually present non-recourse debt separate from remaining debt when reporting to the market.

Finally, it bears mention that the financial requirements of these operations, especially outward equity investments, have led to foreign banking majors accompanying Spanish banks in the corresponding loan syndicates. This was the case of the syndicated loans taken out by Telefónica and Grupo Ferrovial to purchase control packages in the UK enterprises O2 and BAA respectively.

2.3 Leading corporate acquisitions

The following corporate transactions involving Spanish listed companies are among the largest of the last three years.

Construction companies

The diversification and internationalisation strategies pursued by Spanish construction companies have placed them at the forefront of the corporate acquisitions league.

We can distinguish two groups of listed companies according to the strategy adopted. Grupo Ferrovial, Fomento de Construcciones y Contratas and Obrascón Huarte Lain have concentrated on diversifying their business through investments in concessions and services, while Acciona, ACS Actividades de Construcciones y Servicios and Sacyr Vallehermoso have preferred to open up medium- and long-term earnings streams by investing in sectors such as energy; basically regulated industries with strong growth potential. What the big contractors are doing with these investments is creating similar- style conglomerates that will simultaneously allow them to ride out any downturn in construction business and lock into rising demand for energy and the upcoming regulatory changes in the sector.

Listed below are the main acquisitions that have gone through in the last three years:

- Acciona: Acquired 21.03% of Endesa in 2006 for 7,303 million euros. In the same year, the company spent a further 1,123 million euros on the purchase of 100% of wind-power group CESA and the company PRIDESA, engaging in water management and desalination, and shed its stake in Fomento de Construcción y Contratas (15.06%) for just over 1,500 million euros.

- Sacyr Vallehermoso: A string of purchases in 2006 gave it a 20% stake in Repsol Ypf at a combined cost of 6,525 million euros. Also in 2006, Sacyr Vallehermoso acquired 32% of French construction firm Eiffage for 1,750 million euros and 100% of Tesfran, of the same nationality, for 600 million euros. Finally, Sacyr Vallehermoso and Telekutxa launched a joint takeover bid against 58.8% of Europistas for a total outlay of 724 million euros, with the former putting up 616 million.

- ACS, Actividades de Construcción y Servicios: 2005–2006 purchases included 10% of Iberdrola and 40.5% of Unión Fenosa for 3,336 and 4,151 million euros respectively.

- Grupo Ferrovial: In 2006 the Spanish group acquired 61.06% of BAA, one of the world's largest airport authorities, for 15,600 million euros. The year before it had bought airport handler Swissport for 642 million euros.

- Fomento de Construcciones y Contratas (FCC): Acquired 100% of the UK' s Waste Recycling Group (WRG) in 2006 at a price of 1,963 million euros. DCC has also consolidated its lead in the cement sector through subsidiary Cementos Portland Valderrivas following its 234 million euros takeover of Cementos Lemona and purchase of 51% of Uniland for 1,097 million euros.

Real estate companies

Among the key factors driving the wave of transactions in Spanish real estate has been the abundant liquidity generated over its recent expansionary cycle as well as a series of mergers giving rise to larger and stronger companies. These circumstances paved the way for expansion into new, higher-growth markets, principally France, and investments in firms operating more on the rentals side, as a way to balance earnings and spread out risk.

Spanish real estate firms have been investing heavily in the French market: (i) Metrovacesa acquired 68.54% of Gecina in 2005 for 3,804 million euros; (ii) Inmobiliaria Colonial acquired 95% of Société Foncière Lyonnaise (SFL) in 2004 paying 1,560 million euros, though it disposed of 9.3% later that year for 157 million euros, and (iii) Realia (controlled by FCC and Caja de Ahorros y Monte de Piedad de Madrid) acquired 87% of SIIC de Paris for an outlay of 586 million euros.

These were joined by the following transactions in the domestic market:

- Grupo Inmocaral: Inmocaral[4] has been the most active buyer, with the 2006 purchase of Inmobiliaria Colonial for 3,513 million euros and its move into FCC through a 15% stake costing 1,534 million euros. It has also signed an irrevocable agreement with the main shareholder of Riofisa to tender an offer for 100% of the latter's capital. The deal, with an estimated price tag of 2,000 million euros, is still awaiting CNMV approval.

- Astroc Mediterraneo: Another active player, acquiring around 50% of the firms Landscape (real estate group of Banco de Sabadell) and Rayet for a combined 753 million euros.

Finally, to remark that three listed construction firms were the object of 2006 takeovers involving a total of 6,836 million euros:

(i) The largest operation was launched by Construcciones Reyal, which laid out 3,198 million euros for 96.4% of Inmobiliaria Urbis.

(ii) Metrovacesa was the target of two partial bids by significant shareholders: (i) Joaquin Rivero and Bautista Soler, acting together, gained a 24.0% stake for 1,954 million euros; and (ii) Román Sanhauja a 15.3% stake for 1,218 million euros.

(iii) Grupo Empresarial San José acquired 50.8% of Parquesol at a cost of 466 million euros.

Communications

Telefónica's keynote 2006 operation was the purchase of the UK's second mobile operator O2 at a cost of 26,135 million euros.

4 Following its merger with Inmobiliaria Colonial (April 2007), Grupo Inmocaral opted to take the name of its new acquisition.

In the 2004-2005 period, the Spanish multinational had purchased the Bellsouth Group's mobile subsidiaries in Latin America[5] for a combined 5,800 million euros, and laid out 3,660 million euros for Czech operator Cesky Telecom.

Financial institutions

Main acquisitions between the years 2004 and 2006 were:

- Banco Santander Central Hispano (BSCH): The sector's most headline-grabbing operation was BSCH's 2004 purchase of Abbey Bank for 12,696 million euros. In 2006, the bank spent a further 2,297 million on acquiring 24.89% of Sovereign Bank.

- Banco Bilbao Vizcaya Argentaria (BBVA): This group's more modest transactions include the acquisition in 2006 of Texas Regional Bancshares and State National Bancshares for 2,042 million euros, plus a stake in Chinese bank CITIC for 989 million euros. In 2004-2005 its main acquisitions were 100% of Laredo Bank at a cost of 666 million euros and 40.6% of BBVA Bancomer (Mexico) for 3,300 million euros.

- Banco Sabadell: Its 2004 purchase of Banco Atlántico cost the bank 1,480 million euros, of which 1,200 million euros were paid in shares. In 2006, Banco Sabadell acquired 99.74% of Banco Urquijo for the sum of 760 million euros.

Other sectors

- In transport and motorways, the consortium Holding d'Infraestructures de Transport SAS (HIT), led by Abertis Infraestructuras, purchased French motorway concession holder Sanef in 2006 for 5,324 million euros (Abertis having a consortium stake of 57.55%). The year before, Abertis Infraestructuras had acquired 100% of UK airports manager TBI for 790 million euros.

- The companies making up the industry, trade and services sector engaged in numerous operations over the same period, though generally on a smaller scale. Among them:

  (i) In 2006, Promotora de Informaciones (PRISA) launched a 1,000 million euro bid for 20% of Sogecable.

  (ii) Another 2006 transaction of note was Foodco Pastries' 542 million takeover of Telepizza. Foodco Pastries is jointly owned by Carbal, S.A. and private equity fund Permira Europe III.

  (iii) 2005 transactions included takeover bids for Recoletos and Aldeasa summing 856 million and 470 million euros respectively. The latter was presented by Retail Airport France, 50% owned by Altadis.

5 The acquisition of the Bellsouth Group's Latin American interests extends to its mobile subsidiaries in Chile, Ecuador, Guatemala, Panama, Venezuela, Colombia and Argentina. Also included is the 1,325 million euro purchase of CTC Chile (not belonging to Bellsouth).

Corporate acquisitions in the first quarter of 2007

Corporate transactions announced or closed in first quarter 2007 involved a combined amount of 36,000 million euros, higher than the full-year totals for 2004 and 2005.

Set out below are the most relevant transactions by amount and listed player:

- Iberdrola: Acquisition of Scottish Power for 17,200 million euros, of which 11,738 million were debt financed and the remaining 5,462 million through a capital increase[6].

- BBVA: Acquisition of Banco Compass for 7,385 million euros.

- Inmocaral: A 2,000 million euros takeover bid for Riofisa.

- ACS, Actividades de Construcción y Servicios: Acquisition of a 25% stake in Hotchtief, a construction and concession company headquartered in Germany, for the sum of 1,264 million euros.

- Abertis: Acquisition of 32% of Eutelstat for 1,070 million euros.

- Sociedad General de Aguas de Barcelona (Agbar): Hisusa, owned 49% by La Caixa and 51% by Suez, has tendered an offer for the 51% of Agbar outside the two firms' control. The ceiling set for the deal is 2,000 million euros.

- Fadesa Inmobiliaria (Fadesa): Martinsa and Huson Big paid 3,498 million euros for 86.5% of this real estate company in a takeover bid whose term for acceptance finalised 8 March 2007.

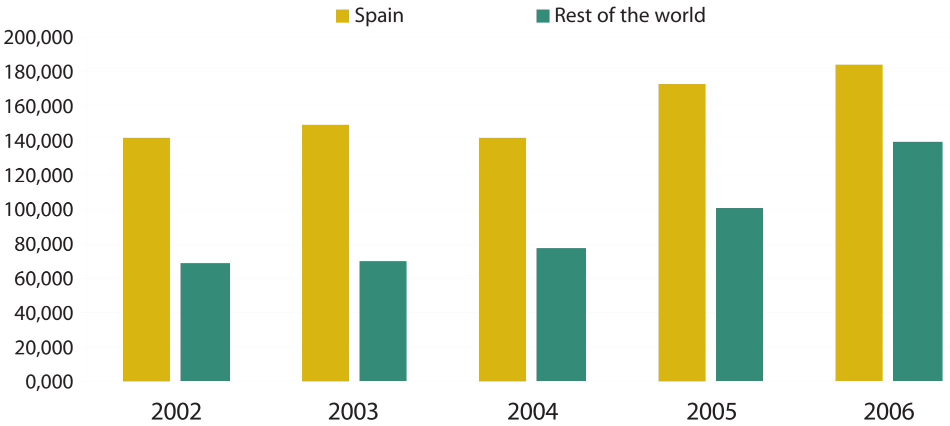
2.4. International expansion of Spanish listed companies

The investment strategy of Spanish companies has led to 65% of corporate transactions involving the buy-up of a foreign firm. This internationalisation effort is all about gaining the size needed to compete successfully in today's increasingly global markets. Figure 2 tracks the changing revenues mix of non financial listed companies by geographical market.

6 Information obtained from the annual accounts for 2006 referring to calculations drawn up on 27 November of that year.

Sales distribution of non financial sectors

FIGURE 2



Source: CNMV and authors.

In 2006, 43% of listed companies' sales revenues were generated outside Spain compared to just 32% in the year 2002. Also, these foreign sales recorded year-on-year growth of 20% in the 2002-2006 period, 13 percentage points more than sales in Spain.

Foreign business began to really take off in the year 2004 thanks to acquisitions of foreign firms and the start-up and growth of new operations abroad.

Traditionally, Spanish companies have maintained their largest investments in South America. Hence the dip in foreign revenues over 2002-2003 due to the Argentine crisis and its knock-on effect on other regional economies.

As of 2004, the recovery of Latin American markets and increased European investments pushed up the relative weight of foreign operations in Spanish groups' consolidated revenues.

Note that the inter-year figures in figure 2 are not entirely comparable. Firstly, the sample universe is not the same, in that aggregate data are drawn from Spanish issuers with their shares then admitted to trading. And secondly, the accounting rules used by listed firms in drawing up their consolidated annual accounts underwent a lasting change in 2005.

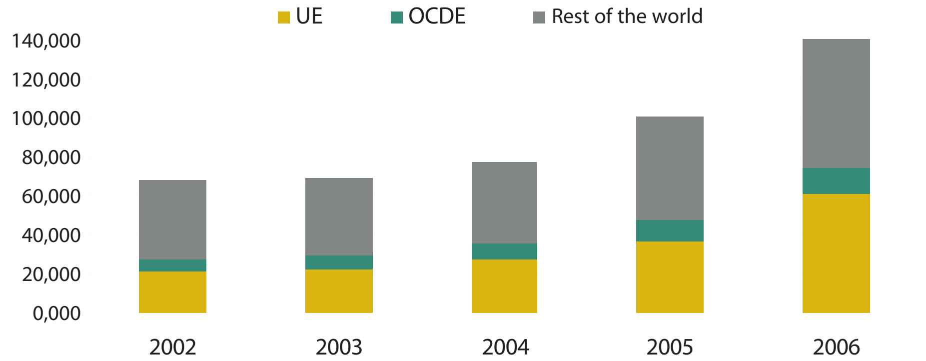
In consequence, the statistical information from consolidated statements for the years prior to 2004 is based on accounting principles generally accepted in Spain (Spanish GAAP), whereas later figures conform to the International Financial Reporting Standards whose application is governed by Regulation 1606/2002 of the European Parliament and of the Council (henceforth, adopted IFRS)[7].

This switch explains the lower revenues figuring for 2004 with respect to 2003. The main revenue impact of the changeover to adopted IFRS is the elimination of sales where the company acts as a commission agent, with the electric utilities most affected.

7 The first consolidated financial statements to be prepared under adopted IFRS corresponded to the year 2005. However the requirement that firms publish comparable figures for 2004 means our data go back one year further.

Figure 3 offers a breakdown of foreign sales by region of origin: the European Union, other OECD and the rest of the world.

Distribution of sales generated outside Spain FIGURE 3



Source: CNMV and authors.

The relative weight of revenues from the European Union climbed from 31% of foreign sales in 2002 to 43% in 2006. This change traces both to investments in consolidated economies like the UK and France, and to companies positioning themselves in the emerging Eastern European markets that recently joined the European Union.

The revenues generated in OECD countries excluding EU members have held flat at around 10% of total foreign sales. Of this group, the main interests of Spanish listed companies are located in the United States.

In contrast, the percentage of sales in the rest of the world, primarily Latin America, receded from 59% in 2002 to 47% in 2006.

Sales distribution by sector TABLE 4

Million euros		2002	2003	2004	2005	2006	AGR
Energy and Water	**Spain**	**65,199**	**66,452**	**59,024**	**78,475**	**78,308**	**4.7%**
	Rest of world	24,842	25,399	30,460	38,056	47,682	17.7%
Construction and Real Estate	**Spain**	**23,659**	**26,803**	**30,059**	**34,356**	**41,273**	**14.9%**
	Rest of world	4,880	5,892	7,867	10,342	16,804	36.2%
Industry, Trade and Services	**Spain**	**32,785**	**34,782**	**29,874**	**35,242**	**39,484**	**4.8%**
	Rest of world	23,444	23,889	24,194	30,544	36,835	12.0%
Communications	**Spain**	**16,743**	**17,498**	**18,578**	**19,676**	**20,039**	**4.6%**
	Rest of world	11,668	10,901	11,703	18,206	32,861	29.5%
Transport and Motorways	**Spain**	**3,599**	**3,687**	**4,195**	**4,669**	**4,800**	**7.5%**
	Rest of world	2,983	2,947	3,086	3,382	5,396	16.0%
Total	**Spain**	**141,985**	**149,222**	**141,730**	**172,418**	**183,904**	**6.7%**
	Rest of world	67,817	69,028	77,310	100,530	139,578	19.8%

Source: CNMV.

Table 4 tracks companies' sales figures in the years 2002-2006, with a breakdown by sector and geographical market:

- In Energy and Water, foreign sales near doubled in the period. Growth was concentrated in Latin America but with European Union countries coming up strongly, due mainly to Endesa's investments in Italy and France.

- In Construction and Real Estate, the growth in foreign sales owes to investments in French real estate companies (Metrovacesa's purchase of Gecina and Inmobiliaria Colonial's of SFL) plus Grupo Ferrovial's acquisition of BAA.

- In Communications, European Union sales moved up sharply on the heels of Telefónica's acquisition of O2 and operator Cesky Telecom. The result is that by 2006 only 38% of sales were drawn from Spain, against 27% from the European Union and 33% from Latin America.

- Finally, foreign sales in the Transport and Motorways sector were boosted by Abertis' 2006 acquisition of French motorway firm Sanef and its 2005 buy-up of UK airport manager TBI. The more moderate sales growth at home is because new concessions are still in the payback phase, and also because sector consolidation was largely complete by the year 2002.

3 The debt of listed companies

3.1 Changes in indebtedness

The growing investments committed by Spanish listed companies have had a significant impact on their debt levels.

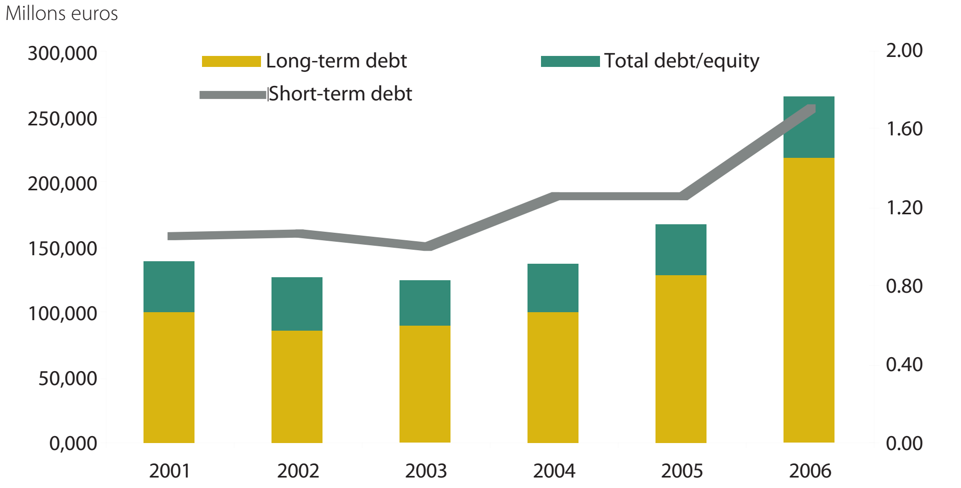
The analysis that follows draws on the financial statements published by listed companies for the years 2001-2006, and focuses on changes in their debt structure and selected ratios as shown in figures 4 and 5[8].

Figure 4 tracks companies' gross debt, distinguishing between amounts falling due in the short and long term, along with movements in their financial leverage (total debt to equity)[9].

8 Source financial information has been drawn up under two different accounting frameworks, so the value of the graph lies not in the absolute totals but in the trends depicted.
9 Gross debt is arrived at by summing short- and long-term bank loans with debentures and other marketable securities. Equity includes minority interests and losses on consolidation corresponding to the years 2001 and 2003.

Debt structure and leverage ratio

FIGURE 4



Source: CNMV and authors.

The gross debt of non financial listed companies as of year-end 2006 amounted to 266,198 million euros. This was 59% more than the sum recorded one year before and almost double the volume of 2001. Listed below are some observations on this and other trends:

- Debt levels have been moving relentlessly higher, with a sharp upturn in 2006 following the aforementioned corporate acquisitions. Factors driving this growth were the need to diversify and gain size in order to compete in globalised markets plus the supportive interest rate environment.

- The aggregate leverage of listed companies in debt-to-equity terms was as high as 1.71 times at the 2006 close, a marked deterioration versus the 1.06x of the year 2001.

  The growth of this indicator also owes to a sharp rise in dividend payments in the reference period – eating into retained earnings – and the adjustments arising from the first application of adopted IFRS, which reduced aggregate equity by 15% vs. the amount reported in 2004 under Spanish GAAP.

  Main adjustments with an equity impact in the changeover to adopted IFRS were: (i) reclassification of preference shares to financial liabilities, while Spanish GAAP had them recorded as minority interests; (ii) translation to euros of goodwill generated in foreign companies and stated in local currencies; (iii) adjustment of formation and capital increase expenses; and (iv) elimination of financial expenses capitalised among motorway concession firms.

  Other changes under adopted IFRS served to boost total equity and offset the negative impact of the above adjustments, primarily: (i) the revaluation of available-for-sale financial assets; and (ii) the elimination of general provisions.

- Short-term debt has reduced in relative terms because corporate transactions have been financed through syndicated loans with longer repayment periods, even though initial outlays are met through bridge loans maturing in less than one year.

- The debt increase shown in the figure does not coincide with the sum of the corporate transactions listed in the previous section. The reasons are several:

  (i) Table 1 confines itself to corporate investments on acquiring companies or significant shareholdings, so does not include either capital expenditure or working capital expense. Debt will increase (decrease) to the extent that the cash flow generated in operations – including changes in working capital – is lower (higher) than capital expenditure.

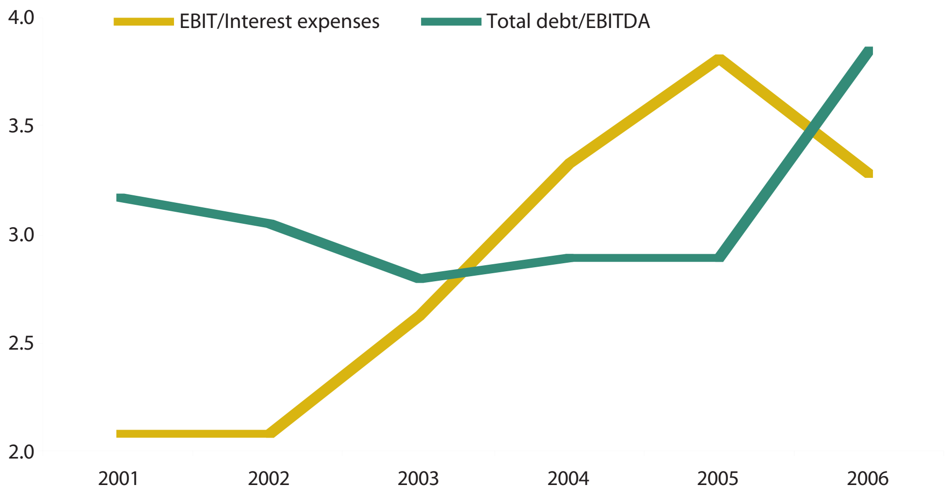
  Also, some of the transactions in table 1 were carried out by individuals, unlisted companies or associate companies of listed entities whose debt is not consolidated in the latters' financial statements.

  (ii) Another factor of weight is the debt brought on board by newly acquired companies. External borrowings to finance a purchase plus the leverage of the acquired firm can seriously inflate a company's debt burden.

Figure 5 tracks changes in companies' payback periods and interest coverage ratios over 2001-2006 by reference to EBITDA (earnings before interest, taxes, depreciation and amortisation) and EBIT (earnings before interest and taxes) respectively.

These two magnitudes are not subject to any standard definition and market practices differ in their regard. For the purposes of this article, EBIT (earnings before interest and taxes) is taken as equivalent to net operating income, and EBITDA as this same sum plus depreciation and amortisation.

Coverage ratios FIGURE 5



Source: CNMV and authors.

An analysis of these ratios permits the following conclusions:

- Up to 2005, sustained growth in operating income kept a reasonable lid on Total debt/EBITDA[10] (2.90 years). However the ratio deteriorated in 2006 (3.86 years EBITDA to pay back debt), despite the year's strong business performance, on a combination of at least two circumstances:

  (i) Some transactions went through in the closing quarter so there was no time for investee earnings to add meaningfully to the acquirer group's EBITDA, whereas all the associated borrowings and assumed debt would go straight to the consolidated balance sheet.

  (ii) Construction firms' investments in the energy sector, involving extremely large sums, could not be fully consolidated in the buyer's accounts as they did not confer a controlling interest. Hence they only show up in the income statement under equity-reported earnings, and this caption does not count towards calculating EBITDA.

- The curve of interest expense coverage through EBIT[11] shows considerable improvement to the year 2005 on the spur of corporate earnings growth and falling interest rates. This ratio too takes a turn for the worse in 2006, though less so than Total Debt/EBITDA because the costs of the new debt associated to the major deals of the year's last quarter had no time to cause a significant dent in companies' annual earnings.

A trend change in economic fundamentals could have adverse effects on the income statements of the most heavily indebted companies by way of possible interest rate rises and due to the procyclical nature of the new accounting framework. Adopted IFRS do not allow the establishment of general provisions, but impose a strict treatment on any signs of a decline in the value of investments and the associated goodwill.

As an example, the aggregate goodwill of non financial listed companies came to 62,691 million euros at end-2006 as against the 23,785 million euros carried in 2002, equating to 38% of aggregate equity compared to 16% four years before.

Under adopted IFRS, goodwill may not be amortised but must be assessed on an annual basis to check whether its carrying value is recoverable through the cash flow of the earning units to which it is assigned. Otherwise, impairment losses must be charged to the income statement for the year in question.

Analysis of debt by sector

Table 5 tracks gross debt by sector with Communications, Construction and Real Estate and Motorways clearly to the fore.

10 Total debt/EBITDA provides an intuitive handle on the years required to pay back debt principal with the cash raised from operations at a given date.

11 EBIT/Interest expenses measures the coverage of financial costs provided by a company's operating profit. A falling ratio indicates that interest payments on loans are eating up a larger share of these profits.

Gross debt by sector TABLE 5

Million euros		2001	2002	2003	2004	2005	2006
Energy and Water	**Debt**	**71,959**	**63,003**	**54,159**	**54,776**	**58,586**	**59,191**
	Debt/Equity	1.29	1.23	0.98	1.06	0.93	0.89
	Debt/EBITDA	3.64	3.52	2.92	2.78	2.41	2.17
	EBIT/Interest expenses	1.77	1.49	2.06	3.52	4.02	4.65
Construction and Real estate	**Debt**	**14,436**	**16,736**	**24,552**	**32,293**	**48,324**	**111,000**
	Debt/Equity	1.29	1.35	1.59	1.93	2.16	3.10
	Debt/EBITDA	4.63	5.11	5.91	5.71	6.51	11.52
	EBIT/Interest expenses	3.15	3.12	3.38	2.83	2.79	2.04
Industry, Trade and Services	**Debt**	**16,128**	**15,796**	**16,332**	**16,211**	**19,452**	**25,044**
	Debt/Equity	0.52	0.54	0.56	0.71	0.75	0.91
	Debt/EBITDA	2.33	2.06	2.05	1.93	2.02	2.37
	EBIT/Interest expenses	2.56	3.33	3.64	5.50	5.95	5.03
Communications	**Debt**	**31,697**	**26,701**	**23,305**	**27,703**	**34,403**	**58,700**
	Debt/Equity	0.95	1.18	1.10	2.24	2.13	2.93
	Debt/EBITDA	2.48	2.28	1.85	2.27	2.25	3.07
	EBIT/Interest expenses	2.18	2.82	3.25	2.51	3.58	2.45
Transport and Motorways	**Debt**	**5,496**	**5,561**	**5,826**	**10,988**	**14,615**	**23,462**
	Debt/Equity	0.81	0.86	0.95	1.48	1.87	2.63
	Debt/EBITDA	4.07	3.63	3.91	5.37	7.04	6.87
	EBIT/Interest expenses	2.85	2.95	3.07	2.30	1.67	1.79
Adjustments[1]	**Debt**	**(511)**	**(390)**	**(208)**	**(5,566)**	**(7,943)**	**(11,199)**
Total	**Debt**	**139,203**	**127,406**	**123,966**	**136,405**	**167,438**	**266,198**
	Debt/Equity	1.06	1.08	1.01	1.26	1.27	1.71
	Debt/EBITDA	3.18	3.05	2.80	2.90	2.90	3.86
	EBIT/Interest expenses	2.09	2.08	2.63	3.33	3.82	3.29

Source: CNMV and authors.

1 In drawing up this table we have eliminated the debt of listed companies that consolidate accounts with some other Spanish listed group. The adjustments row shows the eliminations corresponding to subsidiaries whose parent company belongs to another sector.

(i) Companies in Construction and Real Estate reported end-2006 debt eight times higher than in 2001 and doubling the level of the previous year. The sector alone accounted for 42% of the total debt of non financial listed companies compared to just 10% in 2001.

The jump in debt levels corresponds to the corporate transactions made by sector companies, principally the purchase of significant shareholdings in a number of energy sector players and the acquisition of the UK's largest airport manager. Also, real estate firms and businesses have been stepping up leveraged investment in land and rental properties and expanding in other geographical markets, particularly France.

(ii) The Communications sector practically doubled its debt over the reference period, following a string of acquisitions including UK mobile operator O2, the Latin American subsidiaries of the Bellsouth Group and Cesky Telecom.

(iii) In Transport and Motorways, the salient event was Abertis' buy-up of French motorway operator Sanef. In this case, debt was added by the dual route of transaction financing and the assumption of the debt carried on Sanef's balance sheet which is now consolidated in Abertis' accounts.

(iv) In general, energy firms' strategies in the period centred on the organic growth of core businesses. Some companies – Endesa and Unión Fenosa – took the step of selling off interests in other sectors like telecommunications, netting them substantial capital gains.

The result is that the Energy and Water sector reduced its share of aggregate debt from 52% in 2001 to 22% in 2006.

In 2007, Iberdrola closed its acquisition of a controlling interest in electric utility Scottish Power. The deal will push up the company's debt by around 11,738 million euros, or 82% in relative terms, and raise financial leverage after its planned capital increase (5,462 million euros) from 1.36 to 1.63[12].

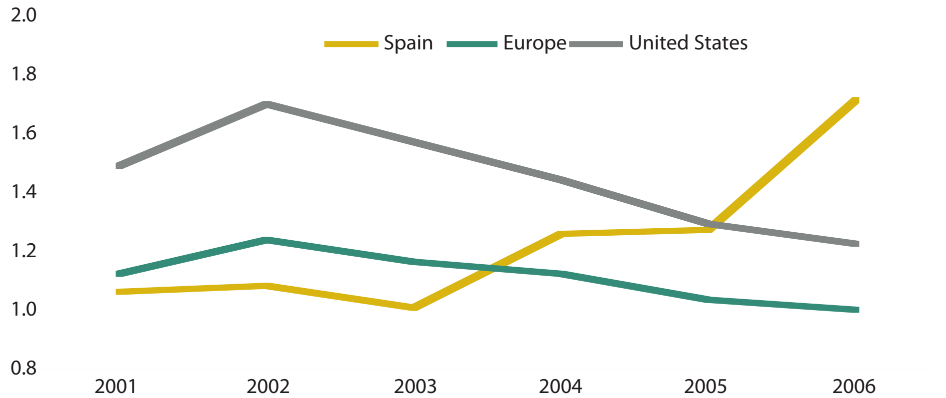
Finally, to remark that the Repsol Ypf group has managed its debt down by 60% to 8,317 million euros since the 1999 purchase of Ypf, accompanied by a significant improvement in its leverage (debt-to-equity).

3.2 International comparison of financial ratiosas

In order to check whether these indicators are in step with the dominant international trends we have calculated the equivalent ratios of the non financial companies figuring as of 31 December 2006 on the stock indices Standard&Poors 500 and FTSEurofirst 300. We thus have an international sample comprising 500 large cap American companies and another 300 in Europe.

Figure 6 traces the leverage of these indices, taken as debt to equity, against that of Spanish non-financial listed companies[13].

Leverage (Debt/Equity) FIGURE 6



Source: Reuters and authors.

12 Information based on the data published by the company in its 2006 annual accounts with reference to calculations made on 27 November 2006.
13 Companies missing any variable needed for the calculation of financial ratios were excluded from the sample. Note that the data may have biases impairing comparability, because the information available on foreign companies was not homogeneous in every case.

The first conclusion we can draw is that U.S. companies are more highly leveraged than their European counterparts, although with the gap closing somewhat as the years advance.

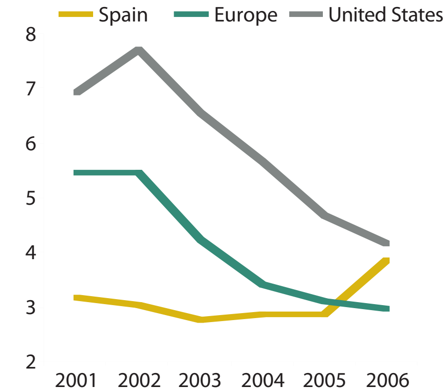
We can also see that leverage ratios have trended lower in both the European and U.S. sample. This decrease, it should be said, owes to the equity side of the equation because debt volumes have not varied significantly.

In 2006 the reduction in leverage began to visibly level off, reflecting an upswing in debt with its origin, possibly, in the reactivation of the international corporate control market after several years' decline.

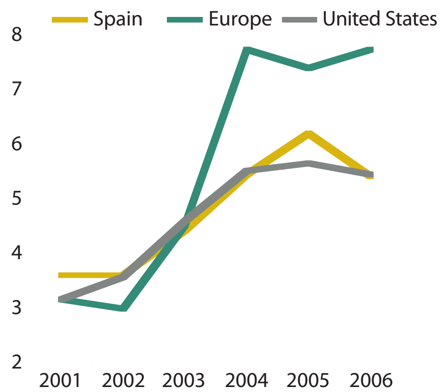
Historically the leverage ratios of Spanish corporates have moved below the European average. However, the last three years have brought a reversal of the trend.

Their recourse to external borrowing to fund the international expansion of recent years has sent the leverage ratios of Spanish listed firms moving in the opposite direction to those of European peers, most markedly in 2006.

Debt/EBITDA FIGURE 7



EBIT/Interest expenses FIGURE 8



Source: Reuters and authors.

As evidenced by the above figures 7 and 8, Debt/EBITDA and interest coverage ratios have improved at both European and U.S. firms, though the trends are dissimilar.

Debt/EBITDA has fallen off most sharply among U.S. corporates due to the operating performance of the 2001-2002 period. In these years 14% of firms reported a negative EBITDA, while in 2003-2006 the same percentage was a significantly lower 6%.

The EBIT/interest expenses of U.S. companies began to turn downwards as of 2004, possibly due to the rates up cycle initiated by the Federal Reserve in June that year, which took the reference rate to 5.25% at the 2006 close after a cumulative year-and-a-half run-up of 400 basis points.

In the euro zone, the European Central Bank hiked its official rates at the end of November 2005, initiating a tightening movement that took rates 150 basis points higher to 3.5% at the 2006 close. UK interest rates have charted a similar course, with a cumulative increase of 125 basis points between May 2004 and December 2005.

In any event, the 2005 trend change in EBIT/interest expenses among the European sample seems to be less about the above variables and more about the first-time application of adopted IFRS.

The pattern among Spanish listed companies is broadly similar until 2006, when the upsurge in corporate transactions did not find a replica either in Europe or the United States.

4 Conclusions

Spanish listed companies have grown in size over the last few years, particularly through external acquisitions. The result has been to broaden their business diversification while giving them a larger presence in international markets.

This internationalisation has pushed up the business generated in Europe and increased firms' positioning in consolidated and emerging markets, thereby reducing their exposure to a potential downturn in the domestic cycle or a possible economic crisis in Latin America.

The large investments involved are also reflected in the debt carried by Spanish listed companies, whose aggregate leverage has deteriorated in the period. However the returns made on these investments allied with interest rates at historic lows have kept interest coverage and payback periods moving in the right direction.

At least this was the case until 2006 when both indicators worsened sharply. Reasons were: (i) a sizeable percentage of corporate acquisitions gave the buyers a significant interest but not outright control, precluding any positive impact in operating income as calculated in this analysis; and (ii) interest rates have started heading higher.

This higher leverage has left companies exposed to new potential risks, primarily in Construction and Real Estate where investment strategies have been most aggressive.

A downturn in economic fundamentals or further rate rises could significantly impair the earnings prospects of the most indebted firms, or provoke a liquidity shortage that could prevent them taking up new investment opportunities as they arise.

Finally, in the case of equity investments in listed companies using loans secured on the shares acquired, a falling stock market might force some investors to offer additional guarantees or, in the last instance, to make early repayment.

Considerations regarding the Investors' Office

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1 Introduction

The Spanish Securities Market Act entrusts the National Securities Market Commission (CNMV) with the responsibility of ensuring the transparency of the securities markets, the correct establishment of pricing and the protection of investors in Spain, promoting the dissemination of the information that may be necessary to ensure the achievement of these aims.

Although all the Divisions of the CNMV contribute to the goal of ensuring the protection of investors reflected in the Securities Market Act, the Investors Division is in charge of dealing directly with the needs of minority or non-professional investors[1]. Hence, this Division plays a fundamental role as the interlocutor for those investors resorting to the supervisory body to present a complaint, query or other circumstance they may wish to communicate. In addition, the complaints submitted to the CNMV by investors constitute a valuable element to take into account for the supervisory and inspection tasks conducted by the CNMV. Furthermore, this Division makes sure that investors have available the information they need to take decisions with as much knowledge as possible and is in charge of providing training and improving the financial awareness of investors so that they are able to interpret the information that exists.

In order to maximize the scope of the information it can provide, the CNMV has devoted an area of its web page specifically to investors, known as Investor's Corner, explaining in simple terms the characteristics of financial products, legislative changes, indicating the mechanisms for submitting enquiries, suggestions or complaints and it recently includes tools to facilitate investment decisions such as the funds finder/comparer, already operational, or the forthcoming brokerage commissions comparison tool.

The Investors' Office (OAI in its Spanish acronym) is the channel available to investors to submit enquiries to the CNMV or lodge complaints. The Investors' Office can be reached by phone, fax or e-mail, as well as by traditional mail or in person at the offices of the CNMV.

This article deals with the activities of the Investors' Office. The first section shows how this Office has taken over the role of the Commissioner for the Defence of Investors. The second part explains how the FIN NET network set up by the European Union for the out-of-court settlement of disputes between clients and financial institutions. Headings three and four deal with the non-binding nature of the Office's resolutions and the criteria and recommendations it makes are also included in two Annexes at the end. The article concludes with a section offering statistical information on the Office's activities and some conclusions.

1 Pursuant to the definition contained in article 4.12 of Directive 2004/39/EC by the European Parliament and the Council, dated April 21st, 2004, regarding the markets in financial instruments (MiFID).

2 The Investors' Office: adaptation to R.D. 303 dated February 20th, 2004, approving the Regulations for the Commissioners for the Defence of Clients of Financial Services

Chapter V of the Financial System (Reform Measures) Act (Law 44 dated November 22nd, 2002) and Royal Decree 303 dated February 20th, 2004, approving the Regulations on Commissioners for the Defence of Financial Services Clients, together with other legislative measures, strengthened the mechanisms protecting the clientele of financial services with the fundamental goal that the measures adopted to increase efficiency and competitiveness in Spain's financial system should not have as a side effect a lower degree of protection for the clients of financial services.

In summary, it could be said that the channels were defined so that the users of financial services could deliver their enquiries and complaints against intermediaries to the supervising authorities, as well as establishing the basic principles that should govern their actions when it comes to handling these enquiries and complaints promptly and effectively.

In the specific case of the securities markets, consideration was given to the creation of the figure of the Commissioner for the Defence of Investors with functions that have now been fully assumed by the Investors' Office (hereinafter OAI) pursuant to the provisions of article 93 of the Securities Market Act and in the Sole Transitional Provision of Royal Decree 303/2004[2].

The functions that this Royal Decree reserves for the Commissioner are divided into several different levels based on the nature of the appeal made by the investor and the activity stemming from it; this functional distribution structure has been incorporated into the activity of the OAI:

(i) Handling of all Enquiries and requests for information formulated through any means and relating to matters that are not directly concerned with specific incidents involving a particular institution.

(ii) Resolution of complaints presented by investors, in which the OAI investigates specific discrepancies of investors attempting to obtain the restitution of an economic interest or right as a result of delays, negligence,

2 Article 93 of the Securities Markets Act (Law 24 dated July 28th, 1988): "The Ministry of the Economy and the Exchequer shall, without prejudice to the powers in this area of the Regional Authorities, regulate the constitution, by the National Securities Market Commission and, where considered necessary, by the bodies governing the official secondary securities markets and by the Securities Compensation and Settlement Service, of services intended to deal with complaints raised by the general public on issues within its scope, as well as to advise the public on its rights and the legal channels that exist to exercise them."
The Sole Transitional Provision of R.D. 303 dated February 20th, 2004, approving the Regulations on Commissioners for the defence of financial services clients: "Any files containing complaints submitted to the complaints service of the Bank of Spain, the National Securities Market Commission and the Directorate-General for Insurance and Pension Funds that are being processed when this Royal Decree comes into force shall continue to be investigated in accordance with the complaints resolution procedure in place under the preceding regulations".

breaches of contract or the regulations on transparency and protection of the clientele or failure of financial institutions to comply with good practices and custom, where these may have represented a quantifiable economic loss for the person submitting the claim.

(iii) Referral to the supervisory services of those files showing indications of a breach of or failure to comply with the rules on transparency and protection of the clientele.

(iv) Proposal of amendments to the regulations as appropriate to safeguard the rights of the users of financial services with regard to transparency and the protection of the clientele.

(v) Acting as the organ for communication and contact with foreign and domestic institutions and bodies complying with purposes or exercising powers similar to those established in these regulations.

(vi) Promotion of actions aimed at facilitating awareness by users of financial services of the regulations on transparency and protection of the clientele, as well as good financial practices and customs.

(vii) Information about the adaptation of operating rules for customer service departments and client ombudsman to the legal regime established by the Ministry of Economy.

(viii) Execution of activities disseminating the criteria used as the basis for the resolution of the files processed within the scope of its powers.

Furthermore, article 4 on the Commissioner's Powers and Functions, in the aforesaid Royal Decree 303/2004, contains the obligation to draft an Annual Report reflecting the activities carried out.

The CNMV's OAI applies a series of principles to its actions with a view to ensuring that investors receive real and effective protection. A great many of these principles are expressly[3] reflected in Royal Decree 303/2004 or are implicitly present in Spanish administrative rules. Some may be considered as coming from the recommendations established by the FIN-NET network on cross-border resolution of complaints for its members. Table 1 sets out the said principles and also indicates their origin.

3 Art. 2 of the Regulations on Commissioners for the defence of clients of financial services.

Principles underlying the OAI's actions TABLE 1

Principle	Description	Source
Legality	All of the OAI's actions are carried out under the protection of general regulations on administrative procedures and the securities market regulations, as part of the powers legally attributed to it.	**FIN-NET**
Voluntary nature	Investors enjoy full freedom to resort to the OAI as the body to settle their disputes without this implying any impairment of their right to make use of other arbitration or judicial bodies.	**FIN-NET**
Equality	All investors resorting to the CNMV to lodge a query or complaint receive the same treatment and the considerations and conclusions are the same for the same circumstances. Any hypothetical alteration in this principle of equality would be based on sufficiently strong arguments clearly set out.	
Speed	Reasonable response times are stipulated, at the same time as the mandatory procedures are made as diligently as possible to ensure compliance.	**FIN-NET**
Transparency	Parties submitting complaints have all information available on the procedure and the results obtained can be objectively assessed.	**FIN-NET**
Adversarial principle	Those parties against which a complaint or claim is brought are given the possibility of examining the position of the party complaining, as well as the right to present any arguments considered pertinent within the proceedings undertaken.	**FIN-NET**
Confidentiality	The information provided in the context of enquiries or complaints lodged are subject to the protection set out in the current sectorial regulations.	**R.D**
Cost-free	Actions do not imply any charge or public price for investors as a prior condition for the claim to be considered, nor is there an obligatory requirement to use a legal representative.	**R.D** **FIN-NET**
Effectiveness	When acting, the OAI attempts to deal satisfactorily and comprehensively with all of the questions raised by investors, bearing in mind all the elements necessary to settle the dispute.	**R.D** **FIN-NET**
Co-ordination	With other departments of the CNMV and other supervisory bodies for the purposes of exchanging information in order to provide investors with the best attention for the matters raised, as well as when notifying possible actions that, after they have been identified, may be of significance for administrative purposes. Similarly, this co-ordination must be present with regard to criteria applicable to specific situations, which must in all cases stem from a shared interpretation of the regulations.	**R.D**
Autonomy	Autonomy to adopt decisions. In this sense, the recent amendment of the status of the Investor Division should be mentioned as it has changed to a horizontal department reporting directly to the Office of the President of the CNMV.	**R.D** **FIN-NET**
Independence	Impartiality in all its actions.	**R.D FIN-NET**
Sole Contact Point	The OAI may receive any kind of complaint presented by a user of financial services, regardless of whether the subject matter it refers to deals with banking or insurance. Subsequently, and making use of secure data transfer mechanisms, these are referred to the competent body for consideration and resolution. This principle is reciprocal vis-à-vis other supervisory agencies.	**R.D**

The OAI basically carries out two activities: reception of complaints and handling of enquiries.

2.1 Complaints

In connection with complaints, the OAI acts in full compliance with the provisions of Chapter III of R.D. 303/2004. Table 2 reflects the action procedures established in the aforesaid R.D., faithfully followed by the OAI.

Commissioners' action procedures as per R.D. 303/2004 TABLE 2

		R.D.
Channel for Presentation	In writing. Using authorized electronic means with a sufficient degree of protection (not standard e-mail).	**Art. 7.2**
Minimum contents	Place and date of the brief, as well as the identity of the party submitting the complaint: full name and address of the person concerned or of a duly accredited proxy, together with their ID card numbers. In addition, the facts of the matter in the complaint must be set out clearly together with copies of the pertinent documents supporting the same; and also an express statement that no formal notice has been received to the effect that the matter is under consideration at any administrative, arbitration or judicial instance.	**Art. 7.3**
Acceptance	The only complaints that will be dismissed out of hand are those which: - omit essential details that cannot be remedied for their processing. - do not allow a sufficiently clear determination of the specific reasons giving rise to the claim. - do not demonstrate that they have previously been submitted to the appropriate dispute resolution bodies of the party against which the complaint is brought. - are subject to examination by other administrative, arbitration or judicial bodies.	**Art. 10**
Consideration	Once the corresponding file has been opened in the wake of a complaint, the benchmark deadlines are: - 10 days in which to inform the person concerned and notify the party against which the complaint is brought. - 15 days for the latter to submit its arguments. If there is agreement, this circumstance will be notified to the party bringing the complaint and a term of 15 days will be given for a reply acknowledging acceptance or otherwise of the proposed solution. - In the absence of any reply from the party against which the complaint is brought, a report will be drawn up closing the file.	**Art. 11**
Termination	The maximum term for the resolution of the file is 4 months from the date of receipt of the complaint or claim by the OAI, unless there are special circumstances that must be duly explained in the final report and notified in advance to the interested parties. The report has to contain clear and precise conclusions regarding the behaviour of the institution in the case presented and it must give a sufficient explanation of its reasoning; the report is not considered an act by the administration and therefore cannot be appealed before the administrative or judicial authorities. In addition, it is a merely informative document and is not binding on the parties; it does not contain any economic assessment or proposals regarding the possible damages incurred by the users of the investment services.	**Art. 12**
Complementary actions	The party against which the complaint is brought must expressly state, within the term of one month from the notification of the report, its acceptance or otherwise of the conclusions and criteria it contains as well as accreditation that it has rectified the situation of the party bringing the complaint, if appropriate. In this case, the file for the complaint will be placed in the archive without any further measures being taken, without prejudice to any liabilities under administrative law that may derive from the remission of the files to the corresponding supervisory services if there is any indication of a regulatory breach.	**Art. 13**

With respect to the scope of the activity of the Commissioner for the Defence of Investors, it should be indicated that R.D. 303/2004 defined the Commissioner as an "*institution lacking any executive or executory functions*", without the subsequent actions and reports being considered as administrative acts subject to appeal. The actions of the Commissioner do not exclude recourse to arbitration or the courts and in no case is there any pronouncement on the damages caused or are economic appraisals provided.

These attributions are fully assumed by the OAI. In fact, all of the reports resolving complaints indicate that "*The resolution of generally private disputes and the handling of requests for compensation in particular are in no case within the scope of powers of the CNMV. In order to resolve these matters, where appropriate, they should be addressed to the courts of law*". In addition, it must be remembered that the results and conclusions reached by the CNMV in its reports need not fully coincide with the decisions of the Courts in the same or similar cases it can therefore never be considered as a replacement for judicial proceedings.

2.2 Handling of enquiries

The activity of providing advice or information to investors by the OAI exceeds the provisions of Chapter IV of R.D. 303/2004, insofar as it not only handles enquiries posed in writing or electronically, but also provides investors with a telephone service which considerably speeds up this segment of activity with a clear benefit for investors.

This telephone service handles all enquiries; those with a technical component are dealt with by the OAI's technical personnel as quickly as possible, whereas those that are purely informative, regarding the contents of public registers, web pages, etc., are handled immediately by a call centre.

2.3 Other activities of the OAI

The OAI is currently the interlocutor for other foreign and domestic institutions with similar purposes. In fact, it has fluid, co-ordinated contact with the Complaints Services of the other supervisory bodies in the Spanish financial system, the Bank of Spain and the Directorate-General for Insurance and Pension Funds, as well as with the competent authorities for the Defence of Consumers.

In the same way, the OAI participates as a guest on FIN-NET, the European cross-border network detailed more completely in the next section, thus enabling it to be in contact and co-ordinate criteria with bodies for the out-of-court settlement of disputes.

The OAI collaborates with other areas of the CNMV for the verification of adaptation of operating rules for customer service departments and client ombudsman to the legal regime established by the Ministry of Economy, as the first step for authorization and administrative registration.

For all of the above, it is evident that investors receive full protection vis-à-vis the provision of information and the resolution of their disputes with intermediaries and that the OAI's activities conform very faithfully to the principles and procedures foreseen in R.D. 303/2004. We might even speak of certain comparative advantages in the current model with respect to the proposals contained in the said R.D.: greater capacity for interaction with the CNMV's supervisory activities, greater coverage of investors' requests for information, through its telephone service for handling enquiries and dealing with complaints against issuers, etc.

Furthermore, the OAI's activity when receiving the concerns, criticisms and even complaints from investors may in some cases constitute a first step in the chain for supervising investment service firms or the quality of the information about listed companies. The fact that the OAI passes on the appropriate supervisory body any files in which there are indications of a breach of or failure to comply with the rules on transparency and protection of clientele implies the generation of economies of scale and greater efficiency in the resources destined by the supervisor for this purpose.

2.4 Rendering accounts on the OAI's actions

R.D. 303/2004 determined that Commissioners had to report on their activities through the publication of an annual report including a statistical summary of the files processed for enquiries and complaints, with express identification of the criteria applied and the types of resolution provided, and the institutions affected by the reports, specifying their name and type of file they were involved in.

Since 2003, and unlike the Complaints Services of the bank of Spain and the Directorate-General for Insurance, the OAI does not produce this annual report but rather has created a quarterly publication providing the statistical data and criteria applied in the most significant files from a qualitative or quantitative standpoint. In addition, information on enquiries and complaints has so far also been included in the CNMV' s Annual Report.

In compliance with this principle of transparency and its function as a means of publicizing the criteria used as the basis for the resolution of the files handled, the CNMV' s web page will shortly be able to provide all of the criteria and claims applied by the OAI in the form of a live database which will be extended and expanded as and when its components change.

3 The FIN-NET network: cross-border complaint resolution

The integration of the national financial markets with a view to the creation of a single financial services market in the European Union will be fully justified insofar as it brings about a series of tangible benefits for non-professional investors, as well as those benefiting the finance industry itself and professional investors: access to a wider variety of quality financial products at a lower price, greater confidence in the solvency and accreditation of the service providers, better information and advice on which to base the investment decisions taken, etc.

Nonetheless, this change in the conditions for free access to a financial service or product, which may now be more complex and may be rendered by a cross-border institution, entails the need to organize mechanisms for the defence and protection of investors and allowing the channelling and adequate resolution of claims and complaints in this new setting. It should be pointed out that the contractual relations with institutions residing abroad are subject to legal frameworks that investors are ignorant of or where they have difficulties to achieve an adequate level of protection for their rights in situations of dispute.

Directive 2004/39/EC by the European Parliament and the Council, dated April 21st, 2004, regarding the markets in financial instruments, includes within its recitals the consideration[4] that "*When implementing provisions on complaints and redress procedures for out-of-court settlements, Member States should be encouraged to use existing cross-border cooperation mechanisms, notably the Financial Services Complaints Network (FIN-NET)*".

In its articles, it also states that "*Member States shall ensure that these bodies [for the resolution of complaints] are not prevented by legal or regulatory provisions from co-operating effectively in the resolution of cross-border disputes*" [5].

As a result, and unavoidably, the Spanish statutory instrument used to transpose this Directive must incorporate this mandate.

The FIN-NET network was established following the recommendation of the European Commission on March 30th, 1998 (98/257/CE), to assist consumers when service providers are resident in another country. It is specifically aimed at the resolution of disputes between the users of investment services and the providers of these services through out-of-court settlements. This network started operating on February 1st, 2001.

Its basic goals can be summed up by the statement that cross-border disputes should be answered as quickly and effectively as possible and that the systems for out-of-court settlement of disputes in the various countries should operate in accordance with shared principles, despite the existence of differences in their nature and powers with regard to whether they are mandatory or their resolutions are binding.

FIN-NET allows users of investment services to contact the out-of-court settlement body in their own country even if their complaint is addressed to a foreign financial service provider.

Therefore it is a " closest system" mechanism, allowing consumers to be aware of the appropriate complaint system for their problem and providing the necessary information about the same and the procedure it applies.

4 Consideration nº 61 of Directive 2004/39/EC by the European Parliament and the Council, dated April 21st, 2004, regarding the markets in financial instruments.

5 Art. 53 of Directive 2004/39/EC by the European Parliament and the Council, dated April 21st, 2004, regarding the markets in financial instruments.

Once the consumer is aware of this information, the complaint may be submitted to the FIN-NET member body in his or her country of origin. If the FIN-NET member body in the consumer's country of origin does not deal with the complaint directly, it will be able to send it on to the pertinent system of the country of the service provider.

In general, out-of-court settlement systems are applicable to the service providers operating in the country and from the country in which these systems exist. In this way, if a complaint is made against a foreign financial services provider, the complaint would be handled by the body acting in the country where the firm is established, thus allowing a better application of the decisions adopted by the out-of-court settlement bodies.

As for the language used in the complaint, it may be submitted in at least the language of the financial contract or in the language that the consumer has normally used in his or her contacts with the financial institution, although in some cases it is also possible to use other languages.

The network currently comprises 48 out-of-court settlement bodies for conflicts in the financial arena from a total of 21 states. Only one Spanish Institution is a member of this network, namely the Bank of Spain's Complaints Service, implying a certain asymmetry in access to this protection mechanism for the users of investment services vis-à-vis users of banking services.

On the basis of the preceding circumstances, it is of the greatest interest for the CNMV to become a member of the FIN-NET through its acceptance of the Memorandum for Admission, comprising a declaration of intent with regard to non-legally binding co-operation that, in consequence, does not generate rights or legal obligations for the parties or third parties.

The CNMV meets all of the quality principles required of members of the FIN-NET in its processes for conflict resolution, therefore its incorporation in this network would not require any adaptation or modification of procedures: principles of independence, transparency, the right to be heard, efficacy, legality, freedom and representation, which have already been analyzed in section 1 (please refer to Table 1).

4 The non-binding nature of Investors' Office resolutions

One of the aspects of the OAI's activities that may generate a certain amount of frustration among investors is the fact that the findings issued in response to the complaints submitted may conclude that the institution against which the complaint was brought has indeed acted improperly but this does not imply the satisfaction of the petitions for compensation or redress for the harm or losses suffered as a result of such action.

The fact is, as has already been mentioned in this article, the OAI must be considered as an administrative instance, therefore the resolution of private disputes, in general, and the handling of requests for compensation, in particular, are not within its remit.

In other words, the status of the OAI must in no case be assimilated to that of an arbitration or judicial organ and in this respect it is of interest to compare the CNMV's OAI with the mechanisms in place in other European countries for the resolution of complaints by users of investment services.

In the United Kingdom, the *Financial Services Authority* (FSA) does not deal with complaints brought by investors against intermediaries as these have to be addressed to the *Financial Ombudsman Service* as an alternative to the Courts of Law and always after completing the customer service processes in place at the intermediary in question.

It is, therefore, a mediation and reconciliation body that is independent of the market watchdog and its resolutions are binding on the institution against which the complaint is brought, providing that the parties bringing the complaint accept the resolutions handed down. If they do not, they may seek justice before the courts[6].

In France, on the other hand, there is an *Ombudsman* institution within the *Autorité des Marchés Financiers* (AMF, Financial Markets Authority), although it operates independently and has been granted mediation powers to achieve out-of-court settlements that, in any case, are not binding on the parties[7].

In Portugal, the *Comissão do Mercado de Valores Mobiliários* (CMVM) has an Investor Support and Conflict Mediation Office that, in its functions, is very similar to the Spanish model. With its resolutions, this office attempts to highlight those behaviours that do not conform to the market rules and reconcile the interests of investors and intermediaries.

Nonetheless, only the Courts would be competent to assess and decide on any petitions for compensation and the submission of a complaint would not suspend or interrupt the legal terms for resorting to these[8].

In Italy, the *Commissione Nazionale per le Società e la Borsa* (CONSOB) does not resolve on the disagreements between the bodies it supervises and their clients. Any disputes in this sense must be brought before the judicial authorities[9].

As can be seen, the models for dealing with and resolving complaints are heterogeneous in Europe, in such a way that only those bodies that have no dependence on the regulators are able to provide resolutions that are binding on the parties. In line with the Spanish regulatory framework, these could be assimilated to our arbitration bodies.

6 Information taken from the www.fsa.gov.uk web site.
7 Information taken from the www.amf-france.org web site.
8 Information taken from the www.cmvm.pt web site.
9 Information taken from the www.consob.it web site.

Opinions have been openly expressed in favour of attributing an executive character to the body in charge of resolving complaints about investment services, as it is felt that this lack is a weakness.

Thus, the Spanish Ombudsman maintained in his Annual Activity Report corresponding to 2006 that "*the absence of any executive functions in the CNMV's Complaints Service means that the citizenry has to resort to judicial or arbitration proceedings to seek satisfaction for their claims, albeit with the aforesaid findings as additional evidence.*

This model does not achieve the protection desired (...) for investors, therefore the purpose for which it was created, namely to provide effective protection for the clientele and investors, is not attained".

This position collides head-on with the legal plans foreseen in article 5 of R.D. 303 dated February 20th, 2004, which stipulated that "*The Commissioners for the Defence of Financial Services Clients are institutions lacking any executive or executory functions. Their actions or the findings they hand down shall not be considered as administrative acts and they will therefore not be subject to any appeal*".

In addition, the Spanish legal system is clear in its description of the instances for the resolution of conflicts arising between the providers of goods or services and their clients, as well as the attributions of each one: arbitration tribunals, previously accepted by the parties and the ordinary courts of justice. Therefore, there is no room for any other intermediate formula, even as an exception[10].

The CNMV is legally obliged to ensure the adequate operation of the securities markets and the OAI contributes to this by verifying compliance with the rules of conduct for the relations between intermediaries and clients through the complaints presented and handling the requests for findings by the parties to the complaints regarding their specific cases.

It is possible, therefore, to speak of the dual character of the OAI's functions as an observer of the actions undertaken by the institutions rendering investment services and their conformance with the applicable rules of conduct and also as a contributor to the resolution of the institution-client dispute by procuring, where appropriate, that the claims by the party complaining are heeded if the institution has failed to comply with the rules of conduct and has caused the client economic harm. Thus, the OAI notifies the institutions against which complaints have been lodged of its considerations arising out of the analysis of the complaints, although its activity vis-à-vis the bodies supervised would not lie in handling requests for compensation, but in corrective actions that it is able to promote as a supervisory body and even inspection or penalty measures that might eventually derive from the same.

This way of acting, on the other hand, does not imply any situation constituting a legal inability to prepare a proper defence as the parties to the complaint retain, in all cases, their full rights to resort to the courts of law.

10 This statement is based on an extensive interpretation of art. 117.6 of the 1978 Spanish Constitution, the Arbitration Act (Law 60 dated December 23rd, 2003) and the Civil Procedure Act (Law 1 dated January 7th, 2000).

For the supervisory body to have some system for adopting enforceable decisions, even without going into the legal obstacles currently in place, would mean adding yet another level to the resolution of the conflict because, at the end of the day, if any of the parties did not accept the executive act of the administration deciding on the matter, its decision would be subject to appeal and the matter would end up before the courts.

In this sense, it should be noted that, since January 1st, 2007, whenever the findings following a complaint conclude that the institution against which the complaint was made has been guilty of improper action, the CNMV request clarifications from the institution concerned about the measures it plans to adopt to correct the behaviour in question, reserving the right to order subsequent administrative actions if it is not corrected or if the improper behaviour is repeated. Most of the institutions involved have responded to these requests for information, referring to their willingness to abide by the criteria set out in the findings, taking due note so that the incidents are not repeated in future and, where the damage can be quantified economically, giving consideration to compensation for the parties lodging the complaint.

5 Interpretation of the regulations for the Investors' Office: Criteria and recommendations

In the scope of its day-to-day activity, the CNMV's OAI resorts constantly to the consultation and interpretation of the regulations applicable to the different circumstances posed.

At the present time, and while awaiting the imminent transposition of the Markets in Financial Instruments Directive (MiFID) that will incorporate considerable innovations with regard to the marketing of products and the provision of financial services, the suite of rules most recurrently invoked to analyze the various aspects referring to the relations established between the institutions and their clients are Rules of Behaviour[11].

11 Part VII of the Securities Market Act (Law 24 dated July 28th, 1988); R.D. 629 dated May 3rd, 1993, on rules for behaviour in securities markets and obligatory registers; Ministerial Order dated October 25th, 1995, partially developing R.D. 629 dated May 3rd, 1993, on rules for behaviour in securities markets and obligatory registers; Ministerial Order dated October 7th, 1999, developing the General Code of Conduct and rules for behaviour in the management of investment portfolios; CNMV Circular 3 dated December 29th, 1993, on the recording of transactions and filing of orders received; CNMV Circular 1 dated March 27th, 1996, on rules for behaviour, transparency and identification of clients in securities markets transactions; CNMV Circular 2 dated May 30th, 2000, on uniform models for standard contracts for discretional and individualized management of investment portfolios and other developments of the Ministerial Order dated October 7th, 1999, developing the General Code of Conduct and rules for behaviour in the management of investment portfolios; Royal Decree 1,333 dated November 4th, 2005, developing the Securities Market Act (Law 24 dated July 28th, 1988), on matters of market abuse.
Together with this set of rules, we should also include, because of their significance, the specific regulations applicable to the subscription, reimbursement or transfer of collective investment undertakings, the exercise of associated rights, marketing of collective investment undertakings, etc. (Collective Investment Undertakings Act, Law 35 dated November 4th, 2003); Royal Decree 1,309 dated November 4th, 2005, approving the Regulations for the Collective Investment Undertakings Act (Law 35 dated November 4th, 2003) and adapting the tax regime of collective investment undertakings, as amended by Royal Decree 362 dated March 16th, 2007.

Overall, the Rules of Behaviour represent a compilation of a large part of the precepts and principles that must govern the relations between investors and the institutions carrying out their activities in the markets, including foreign and domestic investment firms acting in this country, credit associations, companies managing collective investment undertakings, etc. They contain general principles of behaviour or customary financial practices, such as the duty to act fairly, diligently and the best interest of clients, at the same time as they regulate such relevant aspects as mandatory information, delivery of documentation, applicable tariffs, standard contracts, etc.

In certain aspect, it is possible to speak more of implicit or generic principles rather than specified obligations. This is perhaps due to the fact that they stem, at least in part, from legal rules on contracting or consumer rights subsequently adapted to the reality of the securities markets, and that they must be applied together with the contractual clauses agreed between the parties. Thus, for instance, we will not find in them any precept expressly establishing the functions that must be taken on by the custodian in connection with the registered owner of the securities deposited, although we will find repeated references to the duty to act diligently, deliver or make available relevant information, etc. This is not the case in other circumstances, basically on technical questions such as the conservation and registration of orders, where the deadlines and technical requirements are clearly described.

In any case, and without any doubt, the rules for behaviour constitute an element of balance in the relations established between investors and institutions, and compliance with them implies a major commitment with the transparency of information and respect by institutions for the rights of investors.

Based on the typical application of these rules, the OAI has drawn up a series of interpretative criteria that, once compiled, may become a source to be consulted by all agents taking part or planning to take part in securities markets.

The ultimate goal of their dissemination is manifold, depending on the nature of their recipients:

- For institutions rendering investment services, these rules may serve as a benchmark allowing them to adopt appropriate measures for the improvement of their services and their customers' experience. The dissemination of the criteria and recommendations is an attempt to foster among these institutions the correction of the situation of the client(s) potentially affected by equivalent situations, in some cases even reaching the situation where the client does not even need to present the corresponding complaint.

- Furthermore, it is also an attempt to improve the efficacy of the institutions' own Customer Service Departments, encouraging the adoption and application of the best practices identified through the resolution of the complaints and the learning of the lessons to be derived from dissatisfied clients.

- On the part of the investors, the goal is to favour their greater awareness of the financial markets and of their rights and obligations. It is also an attempt to alert them to what may be classed as poor practices and improper behaviour so that, where they might be affected by similar situations, they can have the chance to channel their complaint and, where appropriate, obtain the corresponding correction or redress.

Inevitably, the breadth of incidents brought to our attention by investors is extremely wide-ranging, so any kind of summary requires, on the one hand, the limitation and identification of standard incidents and, on the other hand, a consensus about what the applicable precept should say and, furthermore, how it should be interpreted. In addition, it must be understood that reality is constantly changing, so any amendment to the regulations or even in their interpretation would require the updating of these criteria.

Annexes 1 and 2 list some of the criteria and recommendations selected out of those published in the quarterly reports on enquiries and complaints corresponding to 2005 and 2006 that have been considered most frequent and most interesting.

6 Activity of the OAI

Throughout 2005, 2006 and the first five months of 2007, the OAI has received 1,972 complaints and 26,639 enquiries from investors, with the breakdown shown in Table 3.

Activity of the OAI TABLE 3

	Enquiries	Complaints
2005	11,887	792
2006	99,985	823
January /May 2007	4,767	357
Total	26,639	1,972

These figures show that the OAI has consolidated its history as a reference for investors when it comes to obtaining information about different aspects referring to the securities markets and to complaining about incidents that have arisen with regard to intermediaries.

Focusing on the complaints activity and depending on the type of resolution throughout 2006, the last complete year available, we can see their classification by type of outcome (please refer to Table 4).

Distribution of complaints by type of resolution TABLE 4

	Number	%
Resolved	**586**	**71.2**
Favourable report	179	21.7
Unfavourable report	326	39.6
Undecided report	5	0.6
Agreement between the parties	66	8.0
Complaint withdrawn	10	1.2
Unresolved	**237**	**28.8**
Responsibility of other institutions	29	3.5
Lack of mandatory requirements	204	24.8
Pending resolution	4	0.5
Total	**823**	**100.0**

The proportion of complaint resolutions by the CNMV in which it detected improper actions by the institutions against which the complaints had been lodged and these had not been dealt with previously by the institution's Customer Service Department, or where the findings were contrary to the interests of the parties bringing the complaint, amounted to 30.5% in 2006.

To this we must add the figure for agreements reached by the parties involved, that is to say the institutions accepted the petitions of the persons submitting the complaint prior to the issue of the resolution report by the supervisor, namely 11.3%.

These percentages imply that almost 42 out of every 100 complaints handled by the OAI had not obtained an appropriate resolution at the time from the Customer Service Department of the institutions they were clients of.

This figure is less than the average of the four previous years; in fact, the sum of favourable reports and agreements in 2002 out of the total complaints resolved with a finding by the CNMV was 46.92%, in 2003 this figure was 47.93%, in 2004 it was 39.5% and in 2005, 46.5%.

With regard to the legal nature of the institutions against which complaints were brought in 2006, the absolute dominance of credit institutions continued: banks and savings banks were involved in complaints in 93.44% of occasions, versus 4.49% for investment services firms and 1.45% related to collective investment undertakings. This distribution of complaints by type of institution clearly reflects the enormous and increasing weight of credit institutions in the marketing of investment products and the rendering of investment services.

Finally, the complaints resolved by the OAI in 2006 can be classified by the subject matter in the complaint (please refer to Table 5).

Complaints resolved by subject matter

TABLE 5

Matter	Number	%
Provision of investment services	**335**	**57.2**
Marketing of financial instruments	2	0.3
Reception, handling and execution of orders	214	36.5
Portfolio management	10	1.7
Administration and Deposit of securities	106	18.1
Others	3	0.5
Investment funds / Other undertakings	**251**	**42.8**
Marketing	103	17.6
Subscription and reimbursement of participations	101	17.2
Transfer between CIUs	44	7.5
Obligations regarding information for participants	3	0.5
Total	**586**	**100.0**

It can be seen that the complaints referring to the reception, handling and execution of orders regarding securities with all their variants (discrepancies on the commissions charged, incidents in the transmission and/or execution, delays, etc.) were the most numerous, followed by complaints originating in discrepancies over the information supplied to clients by institutions providing a securities administration and deposit service (remission of information about transactions and corporate events, informative statements, etc.).

These were followed, within the group of incidents related with investment funds and other collective investment undertakings, by those relating to the delivery of information prior to the subscription of the products and those corresponding to the execution of orders for the subscription and reimbursement of stakes and actions (commissions, assigned settlement value, delays in execution, etc.).

As for its enquiries activity, the OAI handled in 2006 a total of 9,985 enquiries, with the telephone as the method most commonly used to contact the CNMV (please refer to Table 6).

Enquiries handled in 2006 by means of access to the CNMV

TABLE 6

Access to the CNMV	Number	%
Telephone	6,836	68.46
E-Mail	2,228	22,31
In writing	239	2,39
Personally	682	6,83
Total	**9,985**	**100,00**

With regard to the matters that have stirred up the greatest interest among investors, we find, firstly, enquiries about issuing companies (29.23%) and within this section, those corresponding to the various takeover bids that have taken place in the course of 2006 (11.8%).

There were also a great many enquiries regarding the CNMV (21.47%), on the contents of the different official registers held by the CNMV (19.69%), about unregistered institutions (7.52%), incidents with investment services firms (7.09%), legislation (6.19%) or incidents with collective investment undertakings (5.83%).

7 Conclusions

This article has discussed several different aspects of the CNMV's Investors' Office in an attempt to provide an overview of the principles and procedures on the basis of which it acts, the criteria it applies for the resolution of enquiries and complaints or the scope of its findings.

It has highlighted the high degree of compliance in its actions with the provisions of R.D. 303 dated February 20th, 2004, approving the Regulations on Commissioners for the Defence of Financial Services Clients, which without a doubt has led to greater guarantees for investors and high standards of protection, and it has dispelled any suspicion of uncertainty or impairment in the degree of protection that must be enjoyed by investors.

The non-binding nature of its resolutions has been analyzed from various standpoints, before concluding that the current legal system leaves scant margin for resolutory bodies that are not arbitration or judicial institutions.

It has also reflected the Office's vocation as an interpreter of the regulations applicable to the behaviour of the institutions taking part in securities markets within the framework of its relations with the clientele; its role as a generator of criteria, recommendations and customary financial practices or the suitability of its participation in international fora on the out-of-court settlement of disputes.

In short, it has given an overview of the Investors' Office as an element that must contribute to improving the efficiency of the securities markets, in co-ordination with other areas of the CNMV, but with the added value of its proximity to the citizenry and its high degree of awareness of their day-to-day problems.

Annexe 1
Criteria and Recommendations on the provision of investment services

1 Marketing of Securities and Financial Instruments

- *Investors must make sure they receive the information legally required for the marketing of each financial product.*

  Before purchasing investment funds, subscribing contracts for the sale or purchase of options (also known as CFA), the acquisition of subordinated obligations or preferred stock participations, among other examples, investors must be provided with the official documents registered with the CNMV and reflecting the characteristics and risks of these products. Due to their significance, it is recommended that investors consult the informative prospectuses, which must be delivered free of charge in the case of investment funds and, on request from the client, in subscriptions on the primary market.

2 Reception, transmission and execution of securities orders

- *The acceptance deadline in a public takeover bid is decided by the bidder, without any possibility of this being shortened by the custodians of the shares.*

  The acceptance deadline in a public takeover bid is set by the bidder and cannot be less than one month or more than two. Information on this period is included in the explanatory prospectus for the transaction and in the relevant event notification disseminated on the occasion of its announcement; it is not possible for this to be unilaterally shortened by the custodians of the shares. Therefore, the custodian institutions must accept mandates up until the last day when the acceptance period concludes.

- *The suggestion of extending requests in initial placement offers (IPOs) or public stock offerings (PSOs) is a practice that may harm the interests of investors.*

  Subscription applications must be formalized in the amount really desired in order to avoid, among other problems, situations where the final number of shares allocated is greater than desired, thus generating overdrafts in the associated current accounts, multiplying commission charges, or creating an upward pressure in the final placement price.

- *Investors must be informed at all times of the commissions applicable to their transactions.*

  Although the institutions are free to set the commissions that they apply for their services (both in terms of concepts and amounts), clients are entitled to be informed at all times of the tariffs and expenses that are applicable to their transactions. This means that the institution must not only deliver the tariff sheet when opening the securities account, but must also make sure, before each transaction, that the exact cost associated is known, as this will impact the ultimate yield.

This is a significant aspect in transactions involving transfers of securities to another institution and changes in the registered ownership of securities mortis causa, as these are less frequent transactions entailing a high cost. In these cases, the institution should inform clients in writing and in advance of the commissions and expenses associated with the kind of transaction in question. Following the realization of the transaction or the provision of the service, clients must receive a detailed settlement giving a clear breakdown of the expenses charged, so that a verification can be made that these coincide with those announced.

- *Notifications about changes in the tariffs need not be given by registered mail and may be incorporated into any regular information that must be supplied to clients.*

Any modification in the tariffs for commissions and expenses that may be applicable to the contractual relationship must be notified by the institution to its clients in writing, although it is not necessary for this to be delivered in a specific dispatch as it can by incorporated into any regular information that the institution has to supply to the client. The latter has a minimum term of two months from receipt of the notification in which to alter or cancel the contractual relationship, without the new tariffs being applicable, unless they are more beneficial, in which case they will be applied immediately.

- *The fragmented execution of an order on the market may multiply the commissions charged.*

Those circumstances in which, even through a single sales mandate, the order is executed piecemeal in the market may give rise to the collection of expenses and commissions for each partial execution, even though they are all the consequence of a single order. Clients face an increase in costs due to the market circumstances, without any difference in the nature of the service requested or effectively rendered. For the institutions to be able to pass on these commissions, it is sufficient for them to be included and reflected as such in their tariff sheets.

- *In certain circumstances, it may be possible to stop paying administration commissions for shares in companies that are excluded from stock listings through inactivity.*

After the exclusion of a company's shares from trading on the stock market, the shareholders continue to pay administration commissions for so long as the securities in question are represented by means of book entries. The reason is that this representation system requires an institution in charge of the accounting record. This would not be necessary if they were represented by physical certificates that the shareholders could keep in their own custody directly.

Nonetheless there is a solution, albeit only in certain circumstances. Investors may cease to pay administration commissions on shares in companies excluded from the stock market listings due to inactivity. To this end, a voluntary waiver procedure has been devised for the maintenance of the entry in the book entry register. Clients can request information from the custodian regarding how to initiate this procedure and submit a complaint if the institution does not facilitate this change, assuming it is feasible.

- *In takeover bids, the charges for contracting and settlement are normally borne by the bidder, along with the expenses derived from the obligatory participation of a market maker, provided this is designated by the bidder.*

Expenses and commissions charged for handling acceptances of takeover bids are contemplated in the informative prospectuses. It is common practice for the bidder institution to assume the charges for contracting and settling up the sales order as well as those derived from the obligatory participation of a market maker, provided that the transaction is effected through the one designated by the bidder. The bidder may occasionally also assume the commissions for processing the acceptance order, but only when this is channelled through certain institutions indicated in the prospectus for the transaction.

- *When information is grouped together in a single remittance to the client, postage expenses may be charged only once.*

Postage expenses, foreseen in the tariff sheet and originating from sending out information to clients about transactions or the composition of the securities portfolio, refer solely to the activity of postal distribution of these notifications.

For this reason, when information is grouped together in a single remittance to the client, this concept must be charged only once, since the cost of preparing and printing the documentation is included in the brokerage and custody commissions, as the obligation derives from the provision of these investment services.

- *In cases of doubt about the contents of the tariff sheet, the interpretation most favourable for the investors shall prevail.*

The tariff sheet must be easily intelligible, so that investors can calculate in advance and for themselves the cost associated with their transactions. To this end, it is necessary for it to contain an accurate description of the bases for the calculation, the accrual intervals and the concepts to which the commissions will be applied.

In the resolution of disputes regarding discrepancies in the application of commissions due the lack of definition in the tariff sheet, the interpretation favouring the investor shall prevail.

- *It shall be up to the institutions, by application of their own criteria, to request or not a provision of funds from their clients before processing any order to participate in a PSO.*

Institutions are obliged to deal with subscription orders that are accepted and not revoked within the deadline, unless a provision of funds requested from the client has not been provided. The procedure for placing securities on the primary market is detailed in the corresponding informative prospectus and the placement must abide strictly to the prospectus. Thus, institutions and investors are subject to compliance with these rules.

3 Administration and Custody of Securities

- *Investors must be informed in due time by the Custodian of the deadlines for corporate actions, so that they are able to give their instructions.*

Although the institutions are free to set the commissions that they apply for their services (both in terms of concepts and amounts), clients are entitled to be informed at all times of the tariffs and expenses that are applicable to their transactions. This means that the institution must not only deliver the tariff sheet when opening the securities account, but must also make sure, before each transaction, that the exact cost associated is known, as this will impact the ultimate yield.

This is a significant aspect in transactions involving transfers of securities to another institution and changes in the registered ownership of securities mortis causa, as these are less frequent transactions entailing a high cost. In these cases, the institution should inform clients in writing and in advance of the commissions and expenses associated with the kind of transaction in question. Following the realization of the transaction or the provision of the service, clients must receive a detailed settlement giving a clear breakdown of the expenses charged, so that a verification can be made that these coincide with those announced.

- *Custodians will continue to inform shareholders after the company is excluded from stock market listing.*

The obligations to provide shareholders with information do not cease due to the mere fact that the company has been de-listed. In this sense, the administrator of the securities continues to have an undertaking to notify the registered holder of any and all information that may be necessary for the exercise of the rights acknowledged in the Spanish Public Limited Liability Companies Act and the administration contract.

The custodians of the securities take on certain obligations for which they receive an economic consideration. Both their obligations and the commissions they receive are reflected in the administration and custody contract signed by the client and the institution. These obligations include carrying out any and all acts that may be necessary for the effects deposited to retain their value and the rights corresponding to them.

- *The term during which the contracts must be retained by the institutions rendering investment services is six years from their cancellation.*

The rule stipulates that the institutions must retain the copy signed by the client for six years, although it does not specify when this period begins to elapse.

The goal of this conservation obligation is for any incidents that may arise in the course of the relationship between the intermediary and the client can be resolved taking into account the rights and obligations that both parties acknowledge to each other when signing the contract. In addition, it is possible for various reasons that the client's dissatisfaction with the service rendered will be manifested after the conclusion of the commercial relationship. In any case, the contract is frequently the essential evidence to determine which of the disputing parties is in the right, as it contains all of the points of the relationship between the institution and the client.

Therefore, the only interpretation that is compatible with the purpose of the rule is for the institutions to be obliged to retain this documentation not only during the provision of the services stipulated in the contract, but for six years following its termination.

- *The compensation of debit balances and credit balances corresponding to the same registered holder requires prior notice to clients.*

Generally speaking, when transactions with securities generate overdrafts in the associated current account, the administration and securities custody contracts generally contemplate authorization for the compensation of debit balances and credit balances corresponding to the same registered holder, in which case prior notification to the client shall be required.

- *Investors must be informed at all times of the commissions applicable to their transactions.*

When information is grouped together in a single remittance to the client, postage expenses may be charged only once. Postage expenses, foreseen in the tariff sheet and originating from sending out information to clients about transactions or the composition of the securities portfolio, refer solely to the activity of postal distribution of these notifications. For this reason, when information is grouped together in a single remittance to the client, this concept must be charged only once, since the cost of preparing and printing the documentation is included in the brokerage and custody commissions, as the obligation derives from the provision of these investment services.

- *Shareholders are entitled to dispose of the shares acquired in the course of a capital increase on the same day that they are listed on the stock market.*

In capital increases affecting listed companies, the securities must be made available to investors from the same date that they are allocated. In order to exercise legal rights vis-à-vis a possible complaint, it is of fundamental importance that clients do not forget to demand that their sales order be stamped on the date that they tried to process it. As is logical, these complaints increase in number when the listed price for the new shares is below the minimum of the opening session, since economic impairment is suffered if this availability is delayed.

4 Others

- *In the resolution of complaints, consideration will be given to the institution's diligence when it comes to detecting and correcting incidents.*

The treatment given by the CNMV to incidents produced by errors at the institutions, generally speaking, varies when the institution detects the error promptly, informs the client and resolves the issue, restoring the situation to its initial moment and correcting the tax impacts, if any. Positive consideration will be given to diligence in the detection and correction of incidents by institutions providing investment services.

Annexe 2
Criteria and Recommendations on investment funds and other collective investment undertakings (CIUs)

1 Marketing

- *Investors in investment funds must adopt their investment decisions guided by the contents of the prospectus and other mandatory information that they must receive free of charge prior to effecting the subscription.*

This is because the commissions and expenses, the investment policy, the terms and conditions for the guarantee in the case of guaranteed funds, the minimum investment and, in general, all the characteristics of the investment fund are contained in these documents.

The fact that a channel other than face-to-face meeting is used for contracting (telephone, Internet or other remote electronic means) does not exempt the institution marketing the instrument from complying with the obligation to deliver to the investor in advance the prospectus and other legal documents. Specifically, if the subscription is going to be effected over the Internet, all these documents must be available on the marketing institution's web page, so that access to the same and the investor's declaration that this documentation was made available are a preliminary step in the contracting process.

2 Subscription and reimbursement of participations

- *The opening of current accounts in order to subscribe investment funds is not obligatory.*

  It is not necessary to have an account in order to buy participations in Spanish investment funds. Nonetheless, the marketing institution frequently demands that the client open a current account. This practice, which my be justified for operational or monitoring reasons, is acceptable providing that it does not imply the collection of any commission whatsoever for the client, assuming that the account has no other movements or purpose apart from the sale or purchase of participations.

- *The conclusion of the guarantee period in a fund does not automatically imply the reimbursement of the participations.*

  In guaranteed investment funds, it is the guarantee that matures, not the investment fund, and this is a circumstance that is not always clearly understood by participants. Investors must be informed about this point when they subscribe to the fund. Therefore, if the participant wishes to cancel the investment when the guarantee matures, a reimbursement order must be sent within the period established for the purpose. If this is not done, the participant's investment will be kept in the fund with any changes that may have been introduced, if any.

- *The heirs of a deceased participant in an investment fund must indicate their wish to receive a reimbursement if they do not agree with the changes to be introduced in the fund, even though the change of registered ownership has not yet been processed.*

  Whenever significant changes are made in an investment fund, the participants are given the possibility of requesting a reimbursement without any commissions or expenses within a specified period. It may happen that the death of the registered holder prevents the exercise of this right. In such cases, the institution must speedily change the registered ownership of the securities in favour of the heirs, once it has received all of the legal documentation required.

  However, should the change of registered ownership due to probate proceedings coincide with the term granted to participants in a fund to opt for their right to separation free of charge, then the heirs must submit an order expressly stating their wish to exercise this right in order to benefit from reimbursement free of commissions or expenses. The management company is obliged to process such requests regardless of the moment when the process of changing the registered ownership has concluded.

3 Transfers between CIUs

- *The deadline for the execution of a transfer between investment funds held by the same management company or the same marketing institution is, in general, shortened by three working days, so it should not exceed the maximum term of five working days.*

Transfers between investment funds, under normal circumstances, may be effected in up to eight working days. This includes one working day for the target institution (through which the transfer is requested) to submit the request to the originating institution, and two for the latter to verify the correctness of the details before effecting the reimbursement. Once this has been confirmed, the originating institution must effect the reimbursement in a maximum of three working days and order the bank transfer for the appropriate amount to the target institution, together with the participant's tax details; this step generally takes two additional working days. When the amount reimbursed reaches the target institution, the new fund is subscribed automatically.

Whenever the originating and target CIUs have the same management company or the same marketing institution, the maximum term for effecting the transfer should, in general, be shortened to the three workings days considered in the rule for the target institution to send the order to the originating one for verification of the details. In these cases, the date of the transfer order must be taken as the date of the reimbursement order.

- *Transfers between foreign CIUs denominated in foreign currencies do not require prior conversion to euros when both CIUs have the same marketing institution.*

In transfers between CIUs, the transmission of the transfer request, the transfer of cash and the transmission of information between the institutions involved are effected through the National Electronic Compensation System (SNCE in its Spanish acronym). The SNCE, managed and administered by the Bank of Spain, only allows transfers to be made in euros. Hence in transfers between CIUs denominated in other currencies and with a different marketing institution, transfers to the target are effected over the SNCE and it is not possible to do in any currency other than euros. Only when the original and the target marketing institution coincide is it not necessary to resort to the SNCE and, therefore, the double currency conversion is not necessary.

- *Whenever a fund's liquidity window falls during the periods imposed by the rule for transfers, the latter should be deemed exempt from reimbursement commission.*

Having regard for the general action principle requiring institutions to conduct the transactions according to the strict instructions of their clients or, if there are no such instructions, on the best terms for them, and always bearing in mind the regulations and customs appropriate for each market, it is considered to be a good practice for the management and marketing institutions of Collective Investment Undertakings to consider the transfers exempt from reimbursement commission, providing that the original fund's liquidity window falls during the periods considered by the regulations for transfers.

- *It is considered to be a good practice for institutions to warn of the existence of reimbursement commissions in the original fund when dealing with the transfer order.*

Participants frequently query the application of a commission on transfers between CIUs because they feel that it is an expense-free transaction. This mistaken idea is, to some extent, founded on the tax deferral regime introduced from 2002 on, and partly due to the fact that the funds' prospectuses shows no specific commission for the transfer of participations.

Nonetheless, investors must bear in mind that the tax benefit does not prevent managers from charging the commissions foreseen for the participation subscription and reimbursement transactions in general, as the transfer implies a reimbursement and a subsequent subscription of shares or participations in another CIU. That is why the CNMV considers it to be a good practice, in order to avoid misunderstandings in the application of commissions on transfers, for the institutions to warn participants, whenever possible, of the reimbursement commissions applied by the originating fund, before processing the transfer order.

II Studies

Are trading suspensions effective? Empirical evidence using data from the CNMV for 2000-2005

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1 Introduction

Regulators make extensive use of trading suspensions, but the measure is not without its critics[1]. Those who criticise the restrictions on the private use of non-public information generally oppose the idea of suspending trading in order to disseminate information, arguing that such suspensions delay the incorporation of the new information into prices in an efficient market. It is also argued that trading suspensions may impair market stability by increasing the perception of uncertainty about the possibility of abandoning it (Gerety & Mulherin (1992)) . In contrast, supporters of trading suspensions argue that they give time for all investors to evaluate the new information, without giving an advantage to any single group; this leads to a price that is based on better information and reduces uncertainty (Greenwald & Stein (1991)).

Another criticism levelled at trading suspensions is based on the illiquidity costs that they impose on investors who need to buy or sell while trading is suspended and, more generally, on the loss of trading opportunities that this entails. In the final instance, this criticism suggests that regulators need to face the dilemma of whether or not to suspend as a cost-benefit analysis, and to minimise the duration of the suspension.

Accepting that the purpose of trading suspensions is to allow key information to be disseminated, an effective suspension must fulfil at least two conditions: (i) the information that is disseminated should be reflected in the price fully and quickly once trading resumes, and (ii) the suspension must be decided in time, so as to avoid or reduce the use of price-sensitive information before it is disseminated. The first condition rests on market efficiency. According to Fama (1970), in an efficient market, prices reflect all available information and only surprises cause price variations. Therefore, no price reaction should be expected after suspensions which are not accompanied by the release of significant news to the market; where such information is released, the price should react upon resumption of trading, followed by a rapid return to normality. The second condition is desirable as a result of the regulator's assigned role of correcting information asymmetries and preventing the abuse of privileged information.

Empirical studies offer no conclusive evidence that trading suspensions are effective. Most such studies refer to North America (USA and Canada) and deal mainly with what are called "trading halts", whose goal is to protect the specialists and market-makers on whom trading depends, to enable order books to adjust. There are as yet few studies based on European or Asian markets, but some of them are of particular interest to Spain since they refer to markets with a central order book. López (2006) describes the main conclusions of studies of this type.

1 Cf., for example, Wu (1998) regarding the debate on trading suspensions in the Hong Kong stock exchange.

This article seeks to analyse the extent to which the aforementioned two conditions for trading suspension to be effective are met. The work focuses on temporary suspensions of trading in securities listed in Spain's electronic market (*Sistema de Interconexión Bursátil Español*) between 2000 and 2005. The methodology is based on event studies, which are widely used in finance. To this end, price performance of the suspended securities is measured in forty sessions around the session in which trading resumed. The goal is to determine whether returns were obtained that were abnormal with respect to those that could have been expected if trading had not been suspended. Condition (i) is met if there are extraordinary returns in the first session after trading is resumed, but none in subsequent sessions (rapid price adjustment after trading resumption). Condition (ii) is met if there were no abnormal changes prior to suspension. In line with previous work in the field, this study on abnormal returns is complemented by an examination to detect abnormal trading volumes. Both analyses are conducted on a number of subsamples selected depending on the reason for which trading was suspended.

2 Legal framework

Article 33 of Spain's Securities Market Law (SML)[2] gives the National Securities Market Commission (CNMV) the power to suspend trading when special circumstances may distort trading in the securities to be suspended or where this is advisable for the purposes of investor protection. The decision may be adopted by the CNMV on its own initiative or at the request of the issuer or the market governing body. Although the Law establishes that a maximum limit may be established for trading suspensions, no such limit exists at present. Since 2005, CNMV trading suspension orders state when trading will foreseeably be resumed (when this is possible).

The Securities Market Law gives the CNMV broad discretionary powers with regard to trading suspensions. The only exception is in the area of takeover bids, where trading in the securities involved must be suspended immediately upon receipt by the CNMV of a formal application to authorise the takeover bid[3]. Under the regulations, trading must resume once the takeover bid has been authorised, when the related announcements have been published, or when the CNMV decides. To avoid unnecessary delays, the CNMV generally lifts the suspension before those deadlines are reached.

The Ministerial Order that regulates the content of periodic disclosures by listed companies provides the possibility (but not the obligation) of suspending trading when the CNMV considers that failure to file the required information or, generally, breach of the rules may "perturb trading in certain securities"[4]. Therefore, where suspension of trading is concerned, this rule may be viewed as a special case of article 33 of the Securities Market Law.

2 Law 24/1988, of26 July, on the securities market.
3 Article 13 of Royal Decree 1197/1991, of 26 July, on takeover bids.
4 Article 12 of the Ministry of Economy and Finance Order, of 18 January 1991, on periodic disclosures by issuers of securities listed on the stock exchanges.

Although the CNMV has the power to suspend trading, the stock market management companies can also interrupt trading as a precautionary measure in urgent and particularly serious cases[5]. Such interruptions must be notified immediately to the CNMV and must cease when the Commission decides, or before the end of the second business day following the adoption of the measure if the Commission does not order suspension of trading. This precautionary measure has been used only rarely.

The discretionary powers granted to the CNMV are not exceptional in the international context. A report by OICV-IOSCO[6] (2002) revealed that regulators normally have broad room for manoeuvre in imposing and administering suspensions of trading. The discretionary powers are an acknowledgement of the difficulty of classifying market situations that may require a measure of this type, and they provide the supervisor with the necessary flexibility to analyse the advisability and duration of the measure in each case.

Some countries' regulations cap the duration of the suspension in certain cases. For example, in the USA and Australia, suspensions ordered directly by the public regulator may not last more than 10 or 21 days, respectively. As for suspensions ordered by the market itself, Australia limits them to one hour at most from the time of the announcement of a takeover bid, and 10 minutes in other cases, if suspension is at the request of the issuer; when the issuer requests that the information not be disseminated immediately, the market may order suspension until at most the beginning of the second trading day after receipt of the request.

The area where Spain's regulations differ most from the international norm is in the breakdown of powers between the public regulator and the markets. In Spain, the authority with powers to suspend trading is the CNMV, even though the markets have the power to take such measures in urgent and serious cases. In most of the countries analysed by OICV-IOSCO (2002), the markets are generally the ones that adopt and administer trading suspensions, as established in their regulations. Public supervisory agencies generally oversee the markets' actions and only step in to order suspension in particularly serious cases. Among the main countries, the USA, Japan, France, Germany, Italy and Switzerland follow this pattern, in which the markets take the lead, and only the UK has centralised powers in the public regulator in a way that is comparable to the Spanish case.

3 Sample selection and classification of suspensions

The analysis of the efficacy of suspensions proposed focuses on suspensions in Spain's electronic market (SIBE), excluding Latibex[7], ordered by the CNMV between 1 January 2000 and 19 October 2005 (hereafter, the "2000-2005" period).

5 Royal Decree 726/1989, of 23 June, on stock exchange management companies and members, Sociedad de Bolsa and the collective bond.

6 Organización Internacional de Comisiones de Valores-International Organization of Securities Commissions.

7 Latibex is an organised trading system for Latin American stocks that are traded, in the first instance, in regulated markets in that region.

However, to offer a broader picture of the CNMV's policy on suspensions, particularly their duration, a broader sample is used that runs from 1 January 1992 to the aforementioned date in 2005 (hereafter the 1992-2005 period).

The sample of suspensions was obtained from the CNMV's database of suspensions and delistings. Table 1 shows that the 1992-2005 sample contains 592 suspensions, of which 301 correspond to the 2000-2005 subsample. The number of companies affected was 207 and 110, respectively. Apart from correcting errors in the database, three filter criteria were applied when selecting the sample: (i) only ordinary shares were considered, excluding any other types of securities that were suspended; (ii) suspensions that led directly to delisting, without resumption of trading, were discarded; and (iii) only uninterrupted periods of suspension were considered, regardless of the existence of decisions ratifying suspension.

Number of suspensions in the database and in the sample TABLE 1

Period	No. of suspensions		No. of companies affected	
	CNMV database	Sample	CNMV database	Sample
1992-2005 (*)	833	593	225	207
2000-2005 (*)	374	301	112	110
2000	63	55	37	36
2001	51	39	28	26
2002	87	63	38	35
2003	70	58	37	32
2004	56	44	35	34
2005 (*)	47	42	29	26

(*) Through 19 October 2005.
Source: CNMV and author.

The methodology used for the empirical analysis of the effectiveness of suspensions made it necessary to use an additional filter solely for this purpose. Specifically, suspensions of the same security that overlap within the trading sessions analysed around the suspension period were discarded. Because of this additional filter, the corrected sample for the 2000-2005 period amounts to 208 data points (down from 301).

Reasons for suspension: information disclosed to the market TABLE 2

	1992-2005 (*)		2000-2005 (*)	
Number of suspensions	Number	%	Number	%
Trades in the company's shares	371	62.6	180	59.8
Takeover bids	289	48.7	137	45.5
Transactions in large blocks of shares (without a takeover bid)	71	12.0	42	14.0
Other	11	1.9	1	0.3
Trades in shares of the parent company	8	1.3	1	0.3
Investments	100	16.9	63	20.9
Divestments	13	2.2	8	2.7
Agreements or alliances with other companies or groups	11	1.9	6	2.0
Capital/debt transactions	18	3.0	15	5.0
Insolvency/liquidation situations	25	4.2	3	1.0
Breach of reporting obligations	3	0.5	3	1.0
Other	25	4.2	22	7.3
No data	19	3.2	0	0.0
Total	**593**	**100.0**	**301**	**100.0**

(*) Through 19 October 2005.
Source: CNMV and author.

The suspensions selected in the sample were classified in accordance with the economic content of the information disclosed to the market as a result of the suspension[8]. To assign suspensions to these categories, the comments on the reasons made by CNMV staff in the original database were used, as well as the regulatory disclosure made to the market by the company following the suspension. The largest single category referred to trades in the company's shares (59.8% of suspensions in the 2000-2005 sample). Most suspensions in this category arose from takeover bids for the suspended company, although there were also a significant number of suspensions deriving from trades in large blocks of shares. As for the other categories, investments by the issuer is the most important (20.9%); about a third of suspensions in this category were triggered by takeover bids for other companies.

Detail of reasons for takeover bid TABLE 3

	1992-2005 (*)		2000-2005 (*)	
Number of suspensions	Number	%	Number	%
By type of takeover bid				
Delisting	86	29.8	37	27.0
To acquire own shares	6	2.1	3	2.2
Other types	197	68.2	97	70.8
Total	**289**	**100.0**	**137**	**100.0**
By type of information				
Announcement	105	36.3	52	38.0
Filing of documentation	153	52.9	62	45.3
Other	31	10.7	23	16.8
Total	**289**	**100.0**	**137**	**100.0**

(*) Through 19 October 2005.
Source: CNMV and author.

The importance of takeover bids within the sample and the range of cases they cover made it advisable to break them down on the basis of two criteria: the purpose of the takeover bid (delisting, acquisition of own shares, or other reasons) and the type of information disclosed about it (launch announcement, filing of documentation, and other reasons). Table 3 shows that the "Other" category is the largest in number and, probably, the most interesting one, since it includes bids to attain or strengthen control over the company. Delisting bids also account for a significant proportion of the total, whereas there were very few takeover bids for own shares. As for the type of information released about the takeover bid, the bulk of suspensions were due to launch announcements or to filing of documentation. The latter category (which is made up of obligatory suspensions) may also include a launch announcement if no specific regulatory disclosure were made beforehand.

Price performance after suspensions were lifted suggest that good news predominated among the reasons for suspensions (i.e. the price rose). For example, in the sample corrected for overlaps that will be used in the empirical analysis,

8 The author also applied a legal classification based directly on the CNMV's database of trading suspensions. Cf. López (2006).

suspensions relating to good news accounted for approximately 59% of the total. As Table 4 shows, prices moved predominantly in the expected direction, in cases where such an expectation is reasonable (trades in shares of the company or the parent company, divestments, insolvency or liquidation, and breach of reporting obligations)[9]. As for the other categories, the result is evenly balanced for capital and debt transactions, and positive in the case of investments by companies (although there was a large number of price declines in this case).

Information disclosed during suspension: good and bad news TABLE 4

Corrected sample[1] for the period 2000-2005[2]	Initial sample	Corrected sample		
Number of suspensions	Total	Total	Positive[3]	Negative[4]
Trades in the company's shares	180	105	67	38
Takeover bids	137	77	55	22
Transactions in large blocks of shares (without a takeover bid)	42	27	11	16
Other	1	1	1	0
Trades in shares of the parent company	1	1	1	0
Investments	63	54	33	21
Divestments	8	6	6	0
Agreements or alliances with other companies or groups	6	6	3	3
Capital/debt transactions	15	15	7	8
Insolvency/liquidation situations	3	2	0	2
Breach of reporting obligations	3	2	0	2
Other	22	17	7	10
Total	**301**	**208**	**124**	**84**

1 Sample corrected for event window overlaps (see methodology section).
2 Through 19 October 2005.
3 The first closing price after trading resumes exceeds the last price prior to suspension.
4 The first closing price after trading resumes is less than the last price prior to suspension.
Source: CNMV and author.

4 Duration of suspension in the sample

The duration of the suspension is as important as the decision to suspend, if not more so. If the regulator lifts the suspension too soon, the price-sensitive information may not have had time to be disseminated, whereas if the suspension is lengthy, it may impose an unnecessary burden of illiquidity on investors. The law does not provide specific rules on this area, so policy is set by the regulator.

The average duration of suspensions in the sample for 2000-2005 was 1.29 trading sessions, and the median duration (not influenced by outliers) was 0.39 sessions (just over three and a half hours)[10]. The median duration in the largest two categories of

9 Nevertheless, price declines were numerous (though nevertheless a minority) in takeover bids, and represented a majority in cases of purchases and sales without a takeover bid.
10 To facilitate comparisons between periods when market session durations differed, the duration of suspensions is measured here not in units of time but in the number of trading session equivalents.

suspension was 0.39 sessions (purchase and sale of company shares) and 0.47 sessions (investments) – Table 5. Apart from suspensions due to breach of reporting obligations, the median is under 1.89 sessions in all cases.

If the duration statistics in table 5 do not reveal a situation that is especially negative, an examination of the distribution of suspensions by duration gives an even more positive picture. Table 6 shows that 63.2% of suspensions in the period lasted less than half a session, and 84.1% ended within one session. In the last year of the sample, 54.8% of suspensions were lifted within a quarter-session (two-and-a-half hours).

Duration of suspensions in the sample, broken down by reason TABLE 5

		Number of sessions in suspension			
Period 2000-2005[1]	**No. of suspensions**	Mean	Median	Max.	Min.
Trades in shares of the company	180	0.80	0.39	17.00	0.00
Trades in shares of the parent company	1	1.89	1.89	1.89	1.89
Investments	63	0.68	0.47	3.03	0.00
Divestments	8	0.36	0.29	0.73	0.13
Agreements or alliances with other companies or groups	6	0.34	0.21	1.25	0.03
Capital/debt transactions	15	0.39	0.28	1.21	0.05
Insolvency/liquidation situations	3	1.18	1.22	1.72	0.59
Breach of reporting obligations	3	49.63	7.00	139.00	2.89
Other	22	1.73	0.39	22.28	0.04
Total	**301**	**1.29**	**0.39**	**139.00**	**0.00**

1 Through 19 October 2005.
Source: CNMV and author.

Distribution (%) of suspensions in the sample, by duration (d) TABLE 6

Period 2000-2005[1]

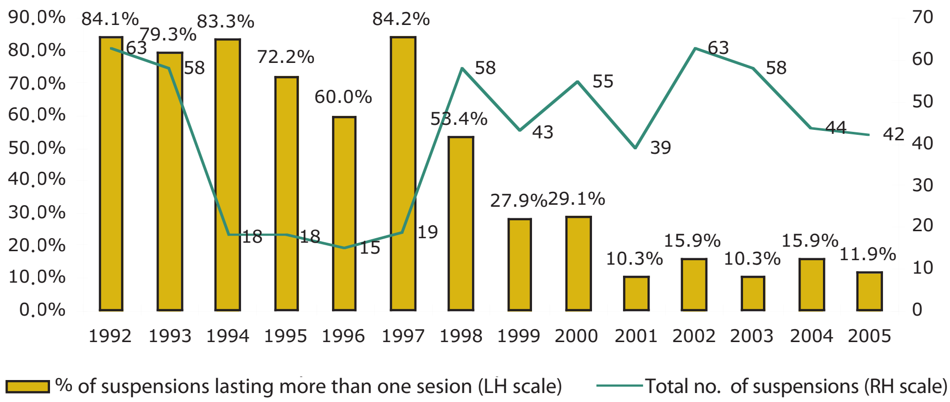
Year	**d≤0.25**	**0.25<d≤0.5**	**0.5<d≤1**	**1<d**	**Total**
2000	18.2	34.5	18.2	29.1	100.0
2001	38.5	30.8	20.5	10.3	100.0
2002	22.2	27.0	34.9	15.9	100.0
2003	32.8	36.2	20.7	10.3	100.0
2004	25.0	40.9	18.2	15.9	100.0
2005	54.8	26.2	7.1	11.9	100.0
2000-2005	**30.6**	**32.6**	**20.9**	**15.9**	**100.0**

1 Through 19 October 2005.
Source: CNMV and author.

A longer-term view reveals the efforts made by the CNMV to shorten trading suspensions. As Fig. 1 shows, the current situation contrasts with that existing until the late 1990s. In particular, during that period, suspensions lasting more than one session accounted for 60% of the total in all years between 1992 and 1997, and over 80% in some cases. The sharp reduction in suspension durations is linked mainly to the use of the internet to disseminate price-sensitive information produced by listed companies. The CNMV inaugurated its web site in 1997 and shortly afterwards began using the site to disseminate regulatory disclosures by listed companies[11], as well as decisions to suspend and resume trading.

It is not surprising that the use of the internet has enabled the CNMV to modify its approach and shorten the duration of suspensions. Since the information is presumably disseminated more quickly, there is now less justification for prolonging suspension after the information has been filed with the CNMV, except in cases where the regulator considers it necessary to demand more detail or more information. Moreover, the risk of information asymmetry is lower if the suspension is lifted during trading hours, since the internet ensures instant, extensive dissemination of that fact; if the information to be disseminated is available on the same day as suspension commences, then the sharp increase in the number of suspensions lasting less then one session is understandable.

Suspensions in the sample lasting more than one session FIGURE 1



Source: CNMV and author.

5 Methodology

The methodology falls within the field of event studies. In this case, the event whose impact is being studied is the suspension of trading. The basic idea is to ascertain whether, during a number of dates (event window) around the date when suspension was lifted (event date), the daily returns differed significantly from those observed in a time period prior to the event window (estimation window). The key variable in the analysis is what is termed "abnormal return", i.e. the deviation in the daily return from the value expected in the absence of the event. It also studies trading volume performance, focusing on detecting abnormally high volumes compared with the expected pattern. These analyses are conducted overall for the various categories of suspension.

11 Spanish law requires companies to file regulatory disclosures with the CNMV before publishing them directly. Listed companies are now required to disseminate regulatory disclosures via the internet.
12 Cf. McKinlay (1997) for an interesting summary of event studies.

The abnormal return on the security corresponding to the i-th suspension in the sample in trading session t, $AR_{i,t}$, is given by $AR_{i,t} = R_{i,t} - E(R_{i,t})$, where $R_{i,t}$[13] is the daily return and $E(R_{i,t})$ is the expected value of the daily return in the absence of suspension. $E(R_{i,t})$ is obtained here using the market model, which can be specified as

$$R_{i,t} = \alpha_i + \beta_i . R_{M,t} + \varepsilon_{i,t}$$

where $R_{M,t}$ is the return on a portfolio or index representing the market (in this case, the Ibex 35), and $\varepsilon_{i,t}$ is a random perturbation that is assumed to follow a normal distribution with mean of zero and a specific variance that is constant over time. The parameters α and β can be estimated consistently by least squares with the available observations in the estimation window.

López (2006) gives a detailed description of the various statistical tests used to ascertain whether or not the abnormal returns differ from zero in the session when suspension was lifted and in subsequent sessions. To summarise, two types of test are used: tests based on the assumption of a normal distribution of the error terms to the market model (parametric tests) and others not dependent on that assumption (the Cowan (1992) generalised sign test and the Corrado (1989) range test).

When analysing volume, the key variable is the deviation of daily turnover from the expected value. Turnover is defined as the ratio of the number of shares traded to the total number outstanding, i.e.

$$ROT_{i,t} = VOL_{i,t} \Big/ CAP_{i,t}$$

where $VOL_{i,t}$ is the number of shares of the security affected by the i-th suspension that were traded in session t and $CAP_{i,t}$ is the total number of shares of the company at that date. The deviation in turnover during the event window is calculated with respect to the mean of this variable during the estimation window. The tests used for abnormal returns are also applied in this case.

In this paper, the event window includes the first session in which a price is set after lifting of suspension (event date) and the 20 sessions immediately before and immediately after that date. When the index $t \in [\ldots,-20,\ldots,-1,0,1,\ldots,20,\ldots]$ is used to number the sessions in this window, t=0 identifies the event date, while t=-1 is the last full session prior to suspension. The estimation window includes a maximum of 180 trading sessions for each suspended security, the most recent of them being t=-21 and the earliest being t=-200.

The statistical tests that are used require that the sample observations be independent in time and transversely. For this reason, it is advisable to eliminate, from the sample, any suspensions of the same security that overlap within the event window. As indicated earlier, that approach reduces the sample for 2000-2005 from 301 to 208 suspensions.

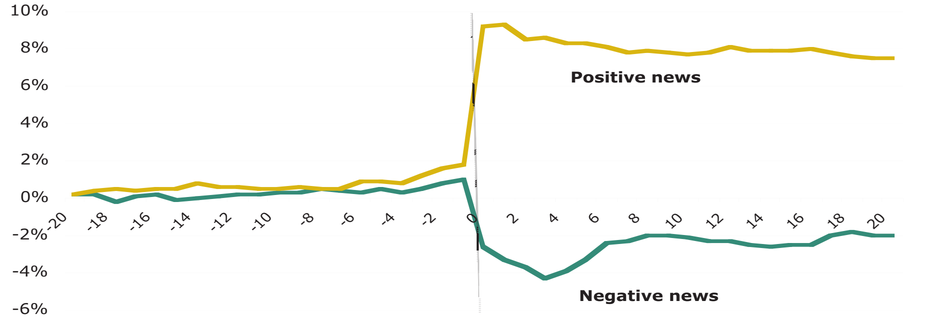
13 The daily return is approximated by the log of the quotient between the closing price in the session of reference and the closing price in the previous session.

6 Results

A first approximation of price performance in the event window can be obtained using charts of the mean accumulated abnormal returns for the various categories of suspension. Figure 2, which plots the overall sample, broken down into positive and negative news, shows that the sample means are relatively small in absolute terms for both types of news in the period prior to *t*=0, although, in the case of positive news, the means are systematically positive and rise as the suspension date approaches. At *t*=0, the mean rises sharply in both cases in absolute terms, the leap being clearly greater in the case of positive news. Thereafter, the two subsamples perform differently: whereas the effect of positive news appears to tail off rapidly, the abnormal returns accumulated in the case of negative news continue to rise, in absolute terms, to *t*=3.

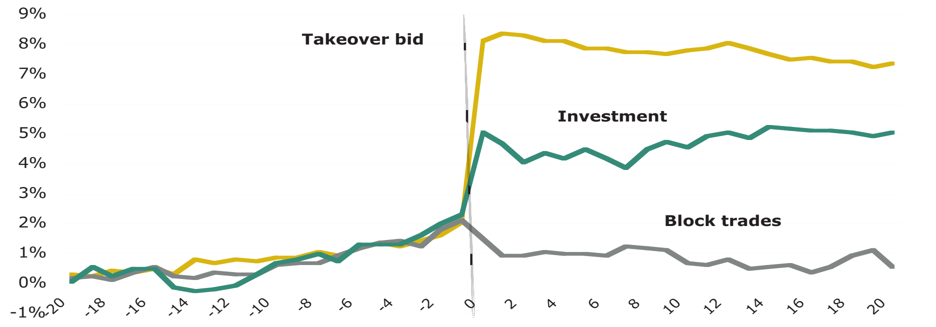
Figure 3 shows the mean accumulated abnormal returns for the three subsamples that are largest and most interesting, based on the information that is disclosed: takeover bid for the company, large block trade, and investment. All three cases exhibit positive rising means in the sessions prior to suspension. At *t*=0, a large leap is observed in the means for takeover bids and investments compared with purchases without a takeover bid, whereas no persisting adjustments are observed after the event in any of these three cases.

Accumulated abnormal returns: positive and negative news FIGURE 2



Source: CNMV and author.

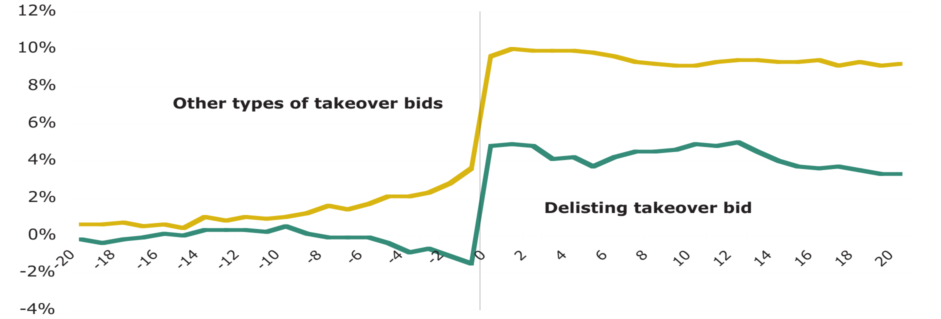
Accumulated abnormal returns: takeover bids, block trades in company's shares (without a takeover bid) and investments FIGURE 3



Source: CNMV and author.

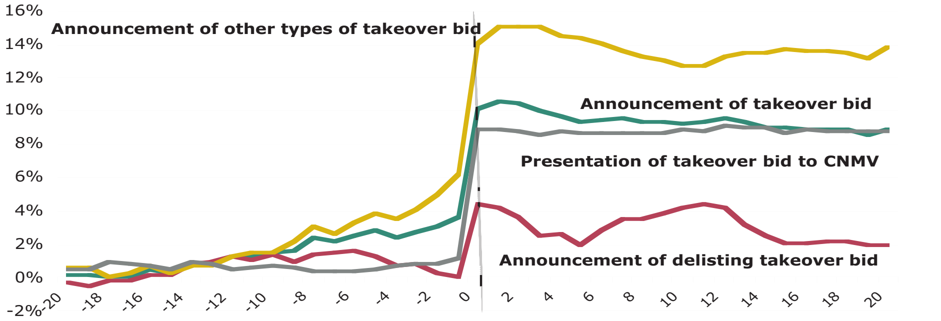
Figures 4 and 5 focus on takeover bids. Figure 4 shows that the price reaction at *t*=0 is similar in size for delisting takeover bids and other classes of takeover bid; however, only the later exhibit rising prices in the sessions prior to suspension. Figure 5 suggests that both announcements of takeover bids and the formal presentation of takeover documents have major information value for the market, but the anticipatory behaviour is stronger in the former case. That figure suggests also that there is more anticipation in announcements of other classes of takeover bids than in the case of delisting bids.

Accumulated abnormal returns: delisting takeover bids and other takeover bids FIGURE 4



Source: CNMV and author.

Accumulated abnormal returns: announcement and filing of takeover bid documentation FIGURE 5



Source: CNMV and author.

The figures offer interesting insights but they do not take account of estimation errors in the market model nor of prediction errors in obtaining the abnormal returns. A more accurate analysis requires formal statistical tests. Table 7 shows the result of parametric tests of the significance of the accumulated abnormal returns for a range of non-overlapping sections of the event window. For reasons of space, the other tests performed on abnormal returns and abnormal volumes are not discussed here and the reader is referred to López (2006). The results obtained from considering all of them are as follows:

(i) The empirical evidence obtained from this study suggests that the information released with trading suspensions is relevant to the market and is priced in rapidly. In the first session after the suspension is lifted, prices vary significantly in line with the sign of the news. The only exception is in a small group (19 observations) in the investments category, relating to suspensions because of takeover bids filed against other companies, where the existence of abnormal returns is rejected, though not the existence of abnormally high trading volumes. In subsequent trading sessions, prices rapidly return to their "normal" pattern. These results coincide with those of Hopewell and Schwartz (1978) for NYSE, De Ridder (1990) for the Stockholm Stock Exchange, Kabir (1992) for the Amsterdam Stock Exchange, Wu (1998) for the Hong Kong Stock Exchange, Kryzanowski and Nemiroff (1998) for the Canadian exchanges, and Engelen and Kabir (2001) for Euronext Brussels, but they differ from the conclusions obtained by, among others, Howe and Schlarbaum (1986) and Ferris et al. (1992) for suspensions ordered by the SEC, Lee et al. (1994) for NYSE, and Kabir (1994) for the London Stock Exchange.

Tests of accumulated abnormal returns in various sections of the event window[1] TABLE 7

		Sessions						
	Sample size	[-20,-11]	[-10,-6]	[-5,-1]	[0,0]	[+1,+5]	[+6,+10]	[+11,+20]
Subsamples based on the sign of the news								
Positive news	124	1.0	0.5	1.9*	40.4***	-2.6***	-1.3	0.0
Negative news	84	-0.7	0.7	0.5	-17.2***	-1.3	2.2**	0.3
Subsamples based on type of news disseminated								
Trades in the company's shares	105	1.4	1.8*	2.6***	22.9***	-0.7	-0.3	-0.7
Takeover bids	77	1.4	0.9	2.3**	28.0***	-0.3	-0.4	-0.6
Delisting	23	0.3	-0.1	-1.5	14.4***	-1.0	1.2	-1.2
Other types of takeover bid	53	1.4	1.1	3.8***	24.2***	0.3	-1.2	0.1
Announcements	32	1.3	1.7	1.9*	19.0***	-0.8	-0.2	-0.5
Delisting takeover bid	13	0.6	0.9	-1.4	6.5***	-1.8*	1.8	-1.3
Other types of takeover bid	19	1.2	1.5	3.5***	19.2***	0.5	-1.7	0.4
Formal application	35	0.9	-0.2	1.6	24.6***	-0.3	0.0	0.0
Block trade (without a takeover bid)	27	0.4	1.6	1.3	-2.7**	-0.5	0.0	-0.5
Investment	54	0.0	1.5	0.5	6.9***	-1.4	0.9	1.4
Via takeover bid	19	-0.5	1.0	-0.7	-0.5	-0.2	0.5	1.6
Other investments	35	0.4	1.1	1.2	9.0***	-1.6	0.7	0.6
Divestments	6	1.1	-0.4	-0.6	3.3**	-9.8***	0.1	0.3
Capital/debt transactions	15	-0.5	-1.7	-0.3	-1.8*	-1.1	0.1	-1.3
Subsamples based on administrative classification								
Art. 33 SML[2]: positive news	96	0.6	0.7	1.3	32.1***	-2.4**	-1.3	-0.1
Art. 33 SML[2]: negative news	72	-0.8	0.5	0.2	-17.8***	-1.1	2.3**	0.3
Art. 13 Takeover decree[3]	35	0.5	-0.3	1.5	21.0***	-0.5	-0.1	-0.1

Note: * indicates significant to 10%, ** to 5% and *** to 1%.
1 Values of the statistic used in the test.
2 Because of circumstances that might perturb normal trading in the securities (Securities Markets Law).
3 Filing of takeover bid documentation with the CNMV.
Source: CNMV and author.

(ii) In contrast with the rapid adjustment by prices in the sessions after suspension is lifted, abnormally high trading volumes are observed to persist in certain subsamples, including the largest ones (takeover bid, block trade without takeover bid, and investments by the company). This finding is in line with those of Ferris et al. (1992), Lee et al. (1994) and Christie et al. (2002), all relating to the US markets, Kabir (1992) for Amsterdam, Wu (1998) for Hong Kong, Kryzanowski and Nemiroff (1998) for Canada, and Engelen and Kabir (2001) for the Belgian market.

(iii) Regarding the sessions prior to suspension, there are only signs that the news was anticipated in the cases of the announcement of takeover bids for reasons other than delisting ("Other types of takeover bid"). Those signs were concentrated in the two sessions prior to suspension. It is interesting that there are no signs of anticipation in the case of obligatory suspensions under article 13 of the Takeover Decree (presentation of takeover bid documentation to the CNMV) even though the information released by such suspensions is also the first official news that the market receives about the operation. Abnormal returns prior to suspension were also detected by such studies as Hopewell and Schwartz (1978) and Ferris et al. (1992) for the US markets, Kryzanwski (1979) for the Canadian market, Kabir (1994) for the London Stock Exchange, and Wu (1998) for the Hong Kong bourse, whereas others such as Howe and Schlarbaum (1986) studying the US, De Ridder (1990) for the Stockholm exchange, Kabir (1992) for the Amsterdam exchange, and Engelen and Kabir (2001) for Euronext Brussels, found no such anticipatory behaviour.

(iv) An analysis of the sessions prior to suspension reveals abnormally high trading volumes in a larger number of subsamples. In the case of takeover bids, the abnormal volumes focus also, fundamentally, on announcements of other takeover bids, although they appear earlier. Similar results were reported by Ferris et al. (1992) for suspensions ordered by the SEC, Kabir (1992) for the Amsterdam exchange, and Kryzanowski and Nemiroff (1998) for the Canadian markets.

7 Conclusions

Overall, these results show that trading suspensions during the period analysed were effective. Empirical evidence suggests that the CNMV's decisions to suspend trading were based on the existence of undisclosed information of value to the market and that prices adjusted rapidly to the information that was released, while trading volumes adjusted more slowly. Meanwhile, suspensions have been shortened steadily: in 2000-2005, 84% of suspensions were lifted within no more than one session (88% in 2005). Although there are signs of anticipatory behaviour in prices, this is confined to one type of information (announcements of other takeover bids).

This overall positive conclusion is not to ignore that the CNMV's performance with regard to suspensions could be improved in certain aspects. The delay observed in suspension resulting from the launch of takeover bids suggests that timing is one priority area for improvement. It does not appear reasonable that suspension should be delayed by up to two sessions after the first signs of market anticipation. Although there may be a variety of reasons for the delay, it is necessary to have appropriate statistical tools to detect unusual prices or movements in trading in order to take action quickly. It is possible that event studies methodology might be used to design tools to monitor the market and enhance the efficacy of the battery of alarms currently used by the CNMV.

Another potential area for improvement is in implementing article 33 of the Securities Market Law as regards setting limits on the duration of suspension. Some countries' regulations do establish time limits for specific cases. The CNMV itself has been announcing projected durations when it orders suspensions in certain cases. Setting time limits by statute would impose greater discipline on the regulator and reduce the current uncertainty. This measure could be adopted with few disadvantages in suspensions where the CNMV had rapid access to the information to be disseminated, as occurs in suspensions requested by the issuer, regulatory disclosures made to the CNMV before the suspension, and suspensions due to reporting breaches or deficiencies.

The limits referred to in the preceding paragraph could also be considered as a specific case of a more general commitment: to establish a uniform, open criterion regarding the duration of suspensions once the related information has been released. In this case, the only reasonable justification for maintaining the suspension is to enable the information to be disseminated properly in the market. The efficacy of the current means of dissemination suggests that not much time is required for this purpose. In any event, since price-sensitive information is also disclosed in the market without trading suspensions, it will always be possible to obtain empirical data about the time the market requires to absorb news.

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Relationship between firm value and ownership structure

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1 Introduction

This paper analyses how a listed company's ownership structure can affect its value. The ownership structure is defined on the basis of percentages of significant ownership, distinguishing whether or not a shareholder has representation on the Board.

This paper makes two basic assumptions: (i) there is an agency problem in corporations that can be reduced by certain mechanisms related to the ownership structure, and (ii) the effect of these mechanisms is, to an extent, similar in all companies. Moreover, it is assumed that a company's ownership structure is, in turn, caused by the company's value; therefore, estimating this relationship presents endogeneity problems which this paper will try to control.

If there were an institutional system that controlled the agency problem perfectly, the ownership structure should be expected to have no effect on the company's value. Applying this reasoning, the results from two sample periods will be compared to ascertain whether the ownership structure's contribution to the value has declined.

Finally, it could be postulated that the identity of a significant shareholder (savings bank, private financial institution, listed company, government agency or natural person) might affect their attitude and aptitude with respect to managing the company and supervising its managers. To that end, the analysis was extended to ascertain whether the enterprise value is sensitive to the category of shareholder.

2 Relationship between firm value and the ownership structure

2.1 Economic theory

The agency problem posed by managers of a corporation has been widely analysed in economic terms; Jensen and Meckling (1976) was one of the first papers in this field. This problem arises because of two circumstances:

- Managers and shareholders have different incentives, since the former do not see maximising the share's value as their only priority.

- It is costly, not to say impossible, to enter into comprehensive contracts governing management actions or to supervise actions that have been taken.

Although this problem reduces the share value, rational shareholders will not be impaired since they will reduce their payments to buy shares, thus anticipating the problem. It is in the primary market that the company's founder-owner will receive a lower payment than if the agency problem did not exist.

This agency problem entails a loss of efficiency for the economy as it imposes certain costs, including notably:

- More expensive finance, with the result that certain projects that might be profitable in the absence of the agency problem are not implemented.

- If, because of this problem, managers with limited wealth are obliged to maintain a high stake in the company, this restricts the company's potential size. In some cases, companies may fail to attain technically-optimum scales of production.

- A high percentage of managers' assets invested in the company represents a loss of welfare as they cannot diversify their portfolio.

- Concealment actions by management are costly. Any effort to alter the provisions governing this problem is also costly.

- Private supervision by shareholders is costly. This will only be done by significant shareholders, who will likewise be unable to diversify their portfolio.

The principal standard methods for imposing discipline on managers are as follows:

i) Managers must own a stake in the company: By increasing their stake in the company, their interests are aligned with those of the other shareholders and the problem declines.

ii) Institutional system: A stringent system of oversight and punishment on the company's governing bodies facilitates oversight of management and encourages managers to behave in accordance with the shareholders' interests. The institutional is composed not just of regulators, supervisors and the legal system but also of other social factors such as morals and the financial culture.

iii) Market for corporate control: The likelihood of a hostile takeover bid increases if shareholder value is not maximised; this disciplines management as they will not wish to lose their control rents.

iv) Private supervision by shareholders: Supervision increases the likelihood of detecting management behaviour that is not aligned to shareholder interests. However, the results of supervision are a non-rival good, since there is no rivalry in their consumption, and it is also difficult to deprive other shareholders of the results. Consequently, private supervision will never be efficient except where the company has only one shareholder[1].

1 The institutional system seeks to mitigate this market failure by requiring an independent external audit of the company, paid for by the shareholders in proportion to their ownership interest.

These mechanisms are aimed at performing the same function and they entail costs for the participants. Consequently, if one of them is strengthened, the need for the others can be expected to decline. Under this assumption, the academic literature performs two types of analysis to examine the degree to which an economy's institutional system reduces the agency problem:

- Indirect approach: If the institutional system is weak, it will be replaced by ownership of a larger percentage of shares by managers or significant shareholders.

- Direct approach: The more the manager's performance[2] depends on the ownership structure, the less able the institutional system will be to reduce the agency problem.

This paper uses the direct approach. Market capitalisation will be used as the metric of management performance, since it reflects the immediate impact of management performance and future expectations with respect to it.

Two types of variable are used to describe the ownership structure: (i) shares represented on the board, and (ii) shares held by significant shareholders. The two variables have opposing effects on firm value:

- Insider ownership:

  - Positive effect: An increase in this variable aligns management interests with those of the other shareholders.

  - Negative effect: Above a certain level, an ownership interest enables insiders to *entrench* themselves and fend off hostile takeover bids, thus reducing this mechanism's impact as a means of mitigating the agency problem.

- Shares held by significant shareholders:

  - Positive effect: An increase in significant shareholdings increases the incentive to private supervision of the company and, therefore, discipline of management.

  - Negative effect: Based on empirical studies in the past, it is postulated that large shareholdings increase the majority shareholders' ability to expropriate from the minority shareholders.

Both the shares represented on the board and the significant holdings may be concentrated in one person or dispersed among several. Such dispersion can be expected to reduce these variables' impact on the firm value. For example, greater dispersion of the shares represented on the board reduces the degree of alignment of individual interests but also makes it more difficult for management to become entrenched.

2 A proxy of management performance, such as earnings or market capitalisation, is measured in connection with the company's ownership structure.

Following from Demsetz's (1983) argument, it is reasonable to presume that, while affecting the firm value, the ownership structure is, in turn, affected by that value[3]. As a result, when considering the relationship between that structure and the firm value, it is necessary to consider that the first variable may be endogenous

Moreover, Demsetz stated that an ownership structure is determined by considering all its costs and benefits and maximising the firm value; therefore, the structure cannot be expected to have the same effect on all companies—rather, the effect will depend on the company's own characteristics.

2.2 Studies of the relationship between firm value and ownership structure

The earliest work on this area includes Demsetz and Lehn (1985), who ascertained that the ownership structure is endogenous and found that the ownership structure does not have an effect on corporate earnings. More recently, Demsetz and Villalonga (2001) developed an equation for each of the two variables of interest and confirmed the results of the aforementioned study, their findings being robust with respect to the variations proposed commonly by other studies.

Other authors have defended the claim that the ownership structure has general effects on the firm value and have focused on specifying flexible functional forms in order to analyse the effects of insider ownership and significant shareholders:

- Morck, Shleifer and Vishny (1988) analysed the relationship between firm value and insider ownership, allowing changes in the linear function in order to determine threshold values, whereas Stutz (1988) specified a quadratic relationship. Short and Keasehy (1999) also used a cubic polynomial in which there were three segments with differing sign depending on the marginal effect that predominated: (i) an initial segment with positive slope, where alignment of interests has a greater impact than entrenchment; (ii) a second segment, with negative slope, due to insiders' greater ability to resist a hostile takeover; and (iii) a segment with a positive slope, as the marginal impact of entrenchment declines and alignment of interests continues.

- Other work seeks to analyse the effect of significant holdings on management performance and, therefore, on firm value. In theory, a greater percentage of significant holdings will lead to greater vigilance, therefore increasing the firm value. However, initial empirical studies using linear functions show major discrepancies with respect to the sign of this relationship. Agrawal and Mandelker (1990) and McConnell and Servaes (1995) found a positive relationship, others, such as McConnell and Servaes (1990), found no relationship, while others, including Mundabi and Nicosia (1998), a negative relationship. To overcome these problems, the functional relationship was made more flexible by using quadratic or cubic polynomials. Such studies revealed a concave curve in which firm value increased up to a

3 For example, if managers are better informed about the company's future prospects, and the valuation differs from the market price, they can be expected to modify their holding in line with their interests.

level of significant ownership, after which it declined. This led Shleifer and Vishny (1997) to postulate the expropriation hypothesis (majority shareholders taking from minority shareholders).

Others, such as Porta et al. (1999), who analysed a sample of 371 companies in 27 advanced economies, show that the influence of ownership concentration on firm value is lower in Common-law countries than in countries whose legal system is Napoleonic. For that comparison, they combine the significant ownership variable with a dummy variable for the type of legal system.

Managerial capacity and the capacity to oversee managers can also be expected to depend on the type of shareholder. Examining Norwegian companies, Bøhren and Ødergaard (2004) found differences in the impact on firm value depending on whether the majority shareholders were non-financial companies, financial companies, individual shareholders, governments or international investors.

In Spain, De Miguel, Pindado and De La Torre (2004) examined the relationship between value and ownership structure as a function of insider ownership and significant shareholders. They concluded that both ownership concentration and insider ownership affect firm value. This paper shows that an increase in ownership concentration up to 87% increases a company's value; above that, expropriation predominates. Plotting value against insider ownership reveals a chart in three segments, with a local maximum at 35% and a local minimum at 70%. To control for problems of endogeneity and unobservable heterogeneity in the ownership structure, those authors use panel data and instrumental variables.

This document shows the results of applying the methodology of the latter paper to a subsequent period. Moreover, an attempt will be made to: (i) ascertain whether the dispersion of significant ownership is significant, in addition to the percentage of significant ownership; (ii) analyse whether the relationship between ownership structure and firm value has varied over time; and (iii) analyse whether the type of shareholder influences the value.

3 Data sample

The sample consists of non-financial companies listed on Spain's electronic market. The period analysed is 1995-2004[4] by half-years. Most of the data are taken from the records of the CNMV, although data were also taken from Spain's National Statistics Institute and the Bank of Spain's Statistical Bulletin.

The following variables are calculated:

- Ownership concentration. Using the significant holdings disclosed to the CNMV at each analysis date and adjusting the data so that they represent

4 Only companies for which data is available for 8 consecutive half-year periods will be retained in the data base.

shareholders' economic rights in the company. The following variables are calculated:

- OC_{it}: The sum of the percentages of significant holdings.

- $OCHH_{it}$: Herfindahl-Hirschmann index of the significant holdings.

- $OCIIFFPR_{it}$ for ownership by investor-owned financial institution, $OCCAJA_{it}$ for ownership by savings banks, $OCSEPI_{it}$ for ownership by Spanish public administrations, $OCCOTIZ_{it}$ for ownership by other listed companies and $OCPF_{it}$ for other persons or companies owning the company in question.

- Ownership represented on the Board of Directors: Similar variables are calculated using the preceding data on significant ownership. The difference is that the holding is taken into account only if the shareholder is represented on the board[5] and no adjustment will be made for intermediate holders of shares[6].

  - IO_{it}: The sum of those percentages of significant ownership represented on the board.

  - $IOHH_{it}$: *Herfindahl-Hirschman* index.

  - The same variables as above, depending on the category of the insider ownership.

- Market value of the company's shares (V_{it}). Calculated from capitalisation at the end of each six-month period.

- Indebtedness ratio (D_{it}). Calculated as the market value of the company's long-term debt, divided by the sum of that same debt plus the market value of the company's shares. A more detailed description of this calculation is given in De Miguel and Pindado (2001).

- Intangible assets of the company (IFA_{it}). The accounting value of intangible assets.

- Asset replacement cost (K_{it}). Measures the value of the company's assets, and therefore its size[7]. The natural logarithm of this variable is used in calculations, $S_{it}=\ln(K_{it})$.

- Share price volatility in the half-year (σ_{it}).

5 The CNMV registers do not specify representation of shareholders in all cases. Consequently, it is necessary to seek additional information in order to ascertain whether a significant shareholder is represented on the board and to assess any family and professional relationships This entire process is discretionary, to an extent, and may lead to errors in some data.
6 Failure to perform this adjustment means that this variable is not a perfect representation of the impact of share price on the wealth of the shareholders represented on the board; however, it does provide a more accurate picture of their influence. Accordingly, this variable is of lower quality for measuring the effect of the alignment of interests, but it is superior when observing entrenchment by insider ownership.
7 The asset replacement cost is calculated using the companies' accounting data and a capital goods price index. The index serves to update the value of property, plant and equipment.

Descriptive statistics TABLE 1

Variable	Mean	Median	SD	Maximum	Minimum
V_{it}/K_{it}	1.327	0.861	1.623	22.190	0.081
$Ln(V_{it}/K_{it})$	-0.121	-0.149	0.870	3.100	-2.518
S_{it}	12.857	12.586	1.683	17.781	8.958
D_{it}	0.171	0.110	0.182	0.874	0.000
IFAit/Kit	0.024	0.005	0.055	0.590	0.000
σ_{it}	4.415	3.969	2.661	37.995	0.000
OC_{it}	0.480	0.474	0.233	1.000	0.000
IO_{it}	0.440	0.442	0.254	1.000	0.000
$OCHH_{it}$	0.174	0.104	0.198	1.000	0.000
$IOHH_{it}$	0.187	0.113	0.212	1.000	0.000
$OCPF_{it}$	0.288	0.250	0.260	0.982	0.000
$OCIIFFPR_{it}$	0.059	0.001	0.105	0.744	0.000
$OCCAJA_{it}$	0.041	0.000	0.093	0.505	0.000
$OCCOTIZ_{it}$	0.074	0.000	0.185	0.999	0.000
$OCSEPI_{it}$	0.017	0.000	0.082	0.671	0.000
$IOPF_{it}$	0.274	0.198	0.271	1.000	0.000
$IOIIFFPR_{it}$	0.037	0.000	0.106	0.773	0.000
$IOCAJA_{it}$	0.036	0.000	0.091	0.505	0.000
$IOCOTIZ_{it}$	0.076	0.000	0.193	1.000	0.000
$IOSEPI_{it}$	0.017	0.000	0.083	0.671	0.000

4 Empirical modelling and results

A panel format database makes it possible to make estimates while taking account of certain problems, such as unobservable heterogeneity (which would bias the results if it were correlated with the ownership structure). Accordingly, the models are estimated using the variables' orthogonal deviations.

The variable on the left-hand side of the equation, which measures the relative value of the company's shares, will be $\ln(V_{it}/K_{it})$. This variable expresses the share value as a function of the company's assets. Using the logarithm isolates the variable and may be interpreted as the percentage by which the company's shares are over- or undervalued. This variable does not include all of the company's financial liabilities as it does not include debt; therefore, it is not Tobin's q and does not offer complete information about the value of the company's liabilities. For that reason, it will be necessary to include, on the right-hand side of the equation, a control variable that contains information about the company's debt.

In addition to the variables that represent shareholder structure, control variables will be used such as the company's size, the indebtedness ratio, the percentage of intangible assets, and the share's volatility. Since the ownership structure variables may be endogenous, their -2 and -5 lags will be used as instrumental variables, except in the case of volatility and the ownership structure variables (-1 to -5). Since the instrumental variables are known at the time the share price is set, the error term is not correlated with them if market efficiency is assumed.

To check the aforementioned theories, a number of statistical models were developed which are described in Aparicio (2006). The annex to this document sets out the estimates for the "general models"; the remainder can be consulted in the latter paper.

4.1 General models

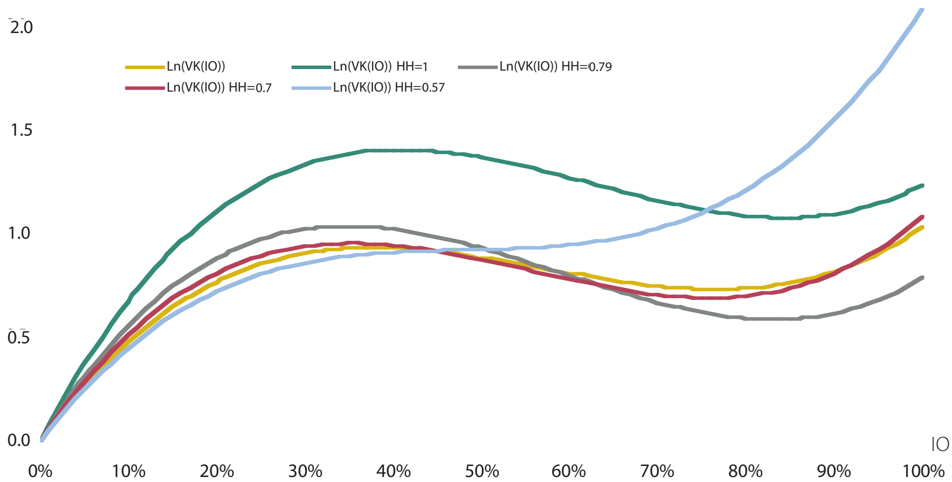
These models describe the relationship between the firm value and insider ownership or significant ownership as a cubic polynomial, thus making it possible to adopt a flexible functional relationship. Two models will be proposed for each descriptive variable of ownership structure: a simple model that considers only the percentage of insider ownership or significant ownership, and a broader model that includes the effect of dispersion of that ownership[8].

4.1.1 Insider ownership

Figure 1 shows the shape of the relationship between firm value and ownership represented on the board. The figure shows the simple model, (Ln(VK(IO)), and the more complex one, (Ln(VK(IO)) HH=X), which is sensitive to the dispersion of insider ownership.

The simple model has a first segment from 0% to 37.8% in which an increase in insider ownership increases the company's value; a second segment, from 37.8% to 76.7%, in which entrenchment predominates (hence the negative slope); and a third segment, from 76.7% to 100%, in which the marginal effect of entrenchment is lower than that of alignment of interests.

Relationship between value and insider ownership FIGURE 1



Ln(VK(IO)). Functional relationship in the model which does not consider dispersion.
Ln(VK(IO)) HH=X. Functional relationship in the model which does consider dispersion.
Ln(VK(IO)) HH=1, for one insider shareholder.
Ln(VK(IO)) HH=0.79, for two shareholders, one of whom owns 75% of the insider capital.
Ln(VK(IO)) HH=0.7, for two shareholders with the same percentage.
Ln(VK(IO)) HH=0.57, for three shareholders with the same percentage.
Source: CNMV and author.

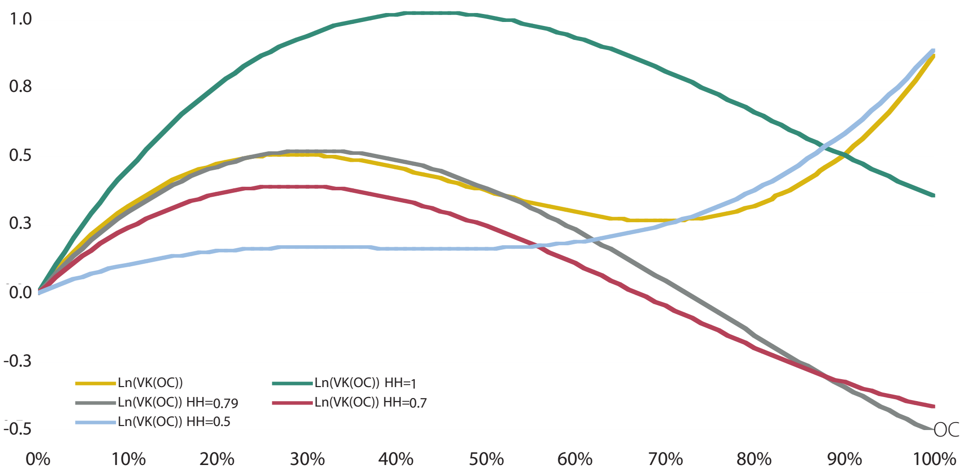
8 To that end, a transform of the Herfindahl-Hirschman index will be included on the right-hand side of the equation. In the case of insider ownership, for example, the following variables will be included: ($IO\text{-}IOHH^{0.5}$) and $(IO\text{-}IOHH^{0.5})^2$. Where there is only one insider owner or significant shareholder, these variables are zero.

The second model, which considers dispersion within insider ownership, reaches broadly the same conclusions as the previous model. Moreover, this new model is a refinement of its predecessor as it shows some of the impacts of such dispersion. When there are few managers (HH$\longrightarrow$ 1), the alignment-of-interests effect is stronger, so that the firm value increases, but the entrenchment effect is also stronger, which reduces the firm value. In the most dispersed case considered here (i.e. insider capital split evenly between three shareholders), there is no point at which the slope of the function is negative, since the entrenchment effect is reduced due to the fact that they cannot prevent one of their number from selling out to a hostile bidder.

4.1.2 Significant ownership

The figure below plots the function of the relationship between firm value and significant ownership. As in the previous case, two models were estimated: the first (Ln(VK(OC))) is a function nested within the second (Ln(VK(OC)) HH=X), which is sensitive to dispersion of ownership.

Relationship between value and significant ownership FIGURE 2



Ln(VK(OC)). Functional relationship in the model which does not consider dispersion.
Ln(VK(OC)) HH=X. Functional relationship in the model which does consider dispersion.
Ln(VK(OC)) HH=1, for only one insider shareholder.
Ln(VK(OC)) HH=0.79, for two shareholders, one owning 75% of the insider capital.
Ln(VK(OC)) HH=0.7, for two shareholders with the same percentage.
Ln(VK(OC)) HH=0.5, for 4 shareholders with the same percentage.
Source: CNMV and author.

The first model reveals three separate segments, depending on whether the monitoring or expropriation effect predominates. There is a local maximum at 28.4% and a local minimum at 69.4%, above which the marginal effect of the incentive to monitor over-rides that of expropriation.

Since supervision is a public good, the effect of dispersion of share ownership is very important, as evidenced in the results from the second estimate. As the figure reveals, the presence of a single significant shareholder has a very positive effect on the value for low percentages of ownership, but the expropriation effect tends to predominate above 43.8%. When ownership is very dispersed (in the line for four shareholders), the incentive to monitor is low but there are no segments with negative slope, perhaps because of the difficulty of coordinating the four insider shareholders to expropriate from the minority shareholders.

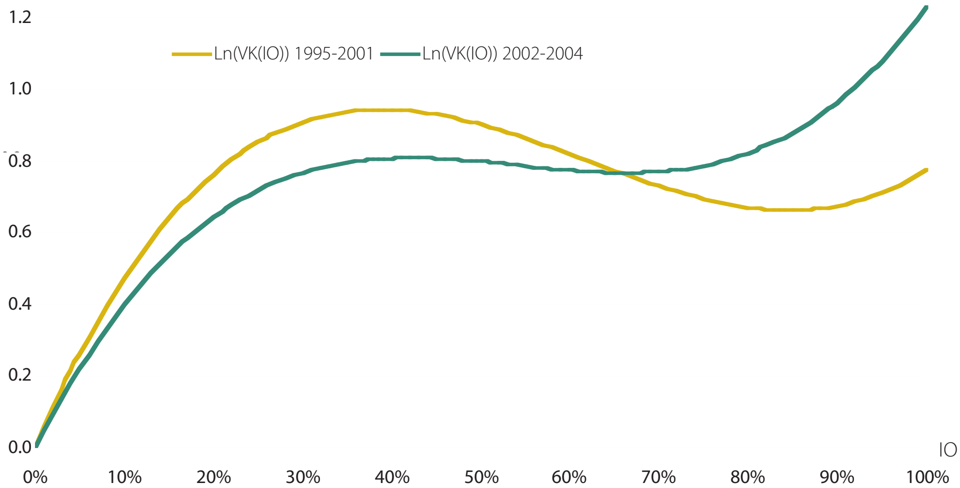
4.2 Repercussion of corporate governance measures

A dummy variable is added to the models of the preceding section, which is 1 for periods on or after June 2002, as La Porta et al. (1999) did to compare differences in regulatory models between countries. The variable is crossed with the variables that represent the company's ownership structure. If the institutional system improved in the previous period, one can expect that the influence of the ownership structure on firm value will have declined and that the segments where its marginal effect is negative will also have been reduced.

For simplicity, to analyse the effect of regulatory changes on the relationship between value and ownership structure, only the simple econometric models are used, i.e. those that do not use the *Herfindahl-Hirschman* index to control for dispersion of insider and significant ownership[9].

In the case of the function for ownership represented on the board (Fig. 3), this ownership structure variable is observed to have reduced its contribution to value throughout most of the analysis space. Moreover, the section where its marginal contribution is negative shrank from [38.8%,84.7%] to [42.1%,66.3%] in the final period.

Effects of corporate governance measures on the relationship between value and ownership represented on the board FIGURE 3

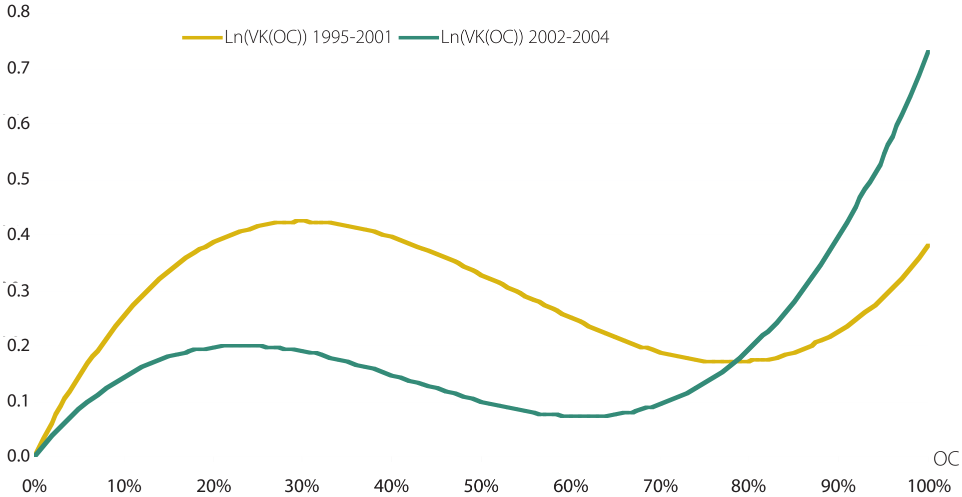


Ln(VK(IO)) 1995-2001. Functional relationship for the period 1995-2001.
Ln(VK(IO)) 2002-2004. Functional relationship for the period 2002-2004.
Source: CNMV and author.

9 The original document also contains more complex models of the relationship between ownership structure and changes in corporate governance rules.

The results for the significant ownership model are shown in figure 4. Here, too, a reduction is observed in the contribution by ownership to firm value, which supports the thesis that Spain's institutional system improved in that period. The segment where its contribution is negative (due to predominance of the expropriation effect) has also shrunk, from [30.0%,78.0%] to [23.2%,61.4%]. However, on the negative side, the negative marginal effect begins to predominate at lower percentages of ownership.

Effect of corporate governance measures on the relationship between value and significant ownership FIGURE 4



Ln(VK(OC)) 1995-2001. Functional relationship for the period 1995-2001
Ln(VK(OC)) 2002-2004. Functional relationship for the period 2002-2004.
Source: CNMV and author.

4.3 Analysis of the effects of shareholder identity

The shareholders were classified into the categories described in section 3. This section analyses whether the identity of insider shareholder or significant shareholder influences the firm value. The goal is to check some theoretical predictions about the differences in attitude and capacity of shareholders to manage or supervise a firm privately.

A first attempt uses a model containing all these variables, maintaining ownership as the control variable. However, this overloads the empirical model and leads to problems of statistical significance in the coefficients that are estimated.

To facilitate the analysis, simpler models are used that exclude the dispersion variables and are separate for each type of shareholder. These models provide partial results that are discussed below[10]:

- Significant ownership by savings banks seems to have a positive impact on firm value for levels of ownership under 37.5%.

10 The results of these estimates are shown in the original paper.

- Ownership represented on the board by financial institutions also has a positive effect for low percentages, but turns negative for higher percentages. Because of the sparse data set of companies where these institutions have a large ownership interest, this observation should be taken with caution.

- Listed companies: Significant or insider ownership by listed companies is not found to have any effect on firm value.

- Public administrations: No influence on value is observed. However, it should be noted that the "golden share" was still in force during the sample period, so that the public administrations' influence cannot be measured using only their percentage of ownership.

- Natural persons: Ownership by natural persons represented on the board has an influence on a listed company's valuation. Its effect varies depending on their percentage of ownership, and the function between firm value and significant ownership smooths as the percentage increases.

5 Conclusions

On the assumption that the effects of significant ownership and insider ownership are, to an extent, common to all companies, an attempt was made to estimate them for listed Spanish non-financial companies. To control for the problem of endogeneity of the ownership structure, lags of the variables were used as instrumental variables on the right-hand side of the equation.

The models confirm the theoretical assumptions, in principle. Insider ownership has a positive effect on share value due to the alignment of interests, but also a negative effect due to greater capacity for entrenchment. Significant ownership also has this mix of effects: it is positive due to encouraging private supervision, but negative because it facilitates expropriation from the minority shareholders.

The effect on the firm value of dispersion of the variables representing ownership structure was also measured. As expected, dispersion of ownership among several shareholders reduces the positive and negative effects for both types of variable.

The dependence of firm value on ownership structure reveals that Spain's institutional system is not capable of entirely eliminating the agency problem, as occurs in all the economies analysed by previous authors. However, efforts to improve corporate governance in recent years appear to have reduced the impact of ownership structure.

Finally, an attempt was made to examine the effect on firm value of the identity of shareholders represented on the board and those with significant holdings. It was not possible to combine all of them in a single model; accordingly, the results are partial.

This study faced three principal limitations. Firstly, the choice of the cut-off date for determining whether the relationship between share value and ownership structure has changed is somewhat arbitrary since the change in corporate governance regulations was implemented gradually over several years. Secondly, the variables representing the ownership structure are assumed to be endogenous and an attempt was made to eliminate this problem using instruments, but no attempt was made to model the behaviour of insider or significant ownership as a function of the available information, which Demsetz and Villalonga (2001) did. Thirdly, and most importantly, it was assumed that the ownership structure has the same effects in all companies in the sample, regardless of their individual characteristics; Demsetz would argue that this is meaningless since the ownership structure will adjust to maximise firm value. One possible extension of this analysis would be to estimate a model in which the marginal effects of ownership structure can vary with certain characteristics of the company, such as size, while also examining the change in that structure as a function of the variables used.

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Annex

Model of the relationship between value and insider ownership

TABLE A.1

	LN(VK(IO)			LN(VK(IO) HH		
	Coeff.	Statistic T		Coeff.	Statistic T	
S_{it}	-0.205	-5.738	***	-0.256	-6.897	***
D_{it}	-3.163	-26.112	***	-2.786	-20.918	***
IFA_{it}/K_{it}	1.957	5.027	***	1.389	2.941	***
σ_{it}	0.023	15.118	***	0.020	9.092	***
IO_{it}	5.934	5.512	***	8.234	5.950	***
IO_{it}^2	-11.717	-4.666	***	-14.967	-4.262	***
IO_{it3}	6.822	3.663	***	7.973	3.168	***
IO_{it}-$IOHH_{it}^{0,5}$				-6.204	-5.666	***
$(IO_{it}$-$IOHH_{it}^{0,5})2$				19.437	6.962	***
Timing TW		144.348	***		146.868	***
Structural TW		11.429	***		12.008	***

Where TW is the Wald statistic of nullity. Timing TW check the nullity of the dummy variables to control for timing effects that are common to the entire sample. Structural TW check the nullity of parameters related to the shareholder structure.
*** significantly different from zero at 1%, ** 5% and * 10%.

Model of the relationship between value and significant ownership

TABLE A.2

	LN(VK(OC)			LN(VK(OC) HH		
	Coeff.	Statistic T		Coeff.	Statistic T	
Sit	-0.142	-3.920	***	-0.331	-9.337	***
Dit	-3.188	-29.903	***	-3.044	-17.467	***
IFAit/Kit	1.883	3.851	***	1.923	4.342	***
σ_{it}	0.023	11.889	***	0.028	19.891	***
OC_{it}	4.147	4.204	***	5.333	4.490	***
OC_{it}^2	-10.302	-4.840	***	-8.230	-3.323	***
OC_{it3}	7.027	4.604	***	3.253	1.948	*
OC_{it}-$OCHH_{it}^{0,5}$				-7.878	-6.030	***
$(OC_{it}$-$OCHH_{it}^{0,5})2$				17.910	6.885	***
Timing TW		106.418	***		65.555	***
Structural TW		9.515	***		10.624	***

Where TW is the Wald statistic of nullity. Timing TW check the nullity of the dummy variables to control for timing effects that are common to the entire sample. Structural TW check the nullity of parameters related to the shareholder structure.
*** significantly different from zero at 1%, ** 5% and * 10%.

Realisable value of private fixed-income assets held by mutual funds

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1 Introduction

Mutual funds are obliged to mark their portfolios to market on a daily basis in order to have ongoing information about the actual value of their units. It is important that this valuation conform to the assets' actual realisable value to ensure that the price per unit quoted by fund managers is not greater (less) than the actual value of reimbursement (subscription).

In principle, assets that are regularly traded pose no major problems since the value is determined by the current or most recent market price. However, funds may also invest in illiquid or unlisted securities. In these cases, the non-existence of a market price forces fund managers to resort to alternative valuation methods. Growth in recent years in the volume of private fixed-income securities held by Spanish mutual funds highlights the need for proper valuation, since the trading characteristics of these assets can make it impossible to obtain a representative market price.

This paper discusses the main alternative methods for valuing private fixed-income securities. It is important to note that there is no single method for a given asset class; rather, there may be several reasonable alternatives. Two questions lie at the heart of the problem: estimating the zero coupon yield curve and determining the risk premium to be added to the zero coupon yield curve, which determine the asset's discounted cash flow function. A proper valuation must ensure that the asset price reflects interest rates and the issuer's credit risk at all times.

2 Fixed-income securities held by Spanish mutual funds

Spanish mutual funds' holdings of listed domestic private fixed-income securities have increased considerably in the last 3-4 years, in both absolute terms and as a percentage of their total assets. At 30 June 2006, the market value of the portfolios of FIM (securities funds) and FIAMM (money market funds) totalled 47.3 billion euro, up from 12.5 billion euro in August 2002. FIM holdings of listed Spanish private fixed-income securities amounted to 15% of total assets, up from 5% in April 2003. The percentage was higher in the case of FIAMM: 37%, compared with 11% in August 2002. Investment in unlisted securities has been practically non-existent to date.

Investments in foreign securities are concentrated in long-term fixed-income assets denominated in euro (Table 1). Although the data are not available to quantify the breakdown between public and private assets, it can be stated that the bulk of portfolios are in private assets.

Although holdings of listed Spanish private fixed-income securities have grown considerably, not many FIM have invested in this type of asset. At 30 June 2006, 36.1% of all Spanish funds, accounting for nearly half of all FIM assets, had invested in listed Spanish private fixed-income securities.

Mutual fund asset breakdown at market value(1) TABLE 1

Thousand euro

	FIAMM		FIM	
	Amount	% of assets	Amount	% of assets
Assets	34,898,926	100.0	234,878,984	100.0
Cash	1,163,773	3.3	8,481,745	3.6
Portfolio investments	33,792,145	96.8	226,405,727	96.4
Domestic securities, of which	24,635,395	70.6	101,754,849	43.3
Public money market assets	1,534,345	4.4	2,730,895	1.2
Other public fixed-income securities	284,214	0.8	9,151,914	3.9
Private money market assets	8,745,478	25.1	18,588,888	7.9
Other private fixed-income	4,122,810	11.8	15,791,137	6.7
Unlisted securities	0	0.0	331	0.0
Foreign securities, of which	9,156,750	26.2	124,650,878	53.1
Euro	9,153,908	26.2	111,252,081	47.4
Fixed-income	9,153,908	26.2	73,735,355	31.4
Short term	927,757	2.7	4,348,066	1.9
Long term	8,226,151	23.6	69,387,289	29.5
Unlisted securities	0	0.0	0	0.0
Other	2,842	0.0	13,398,797	5.7
Fixed-income	2,842	0.0	1,151,751	0.5
Short term		0.0	27,575	0.0
Long term	2,842	0.0	1,124,176	0.5
Unlisted securities	0	0.0	1,294	0.0

Source: CNMV.
1. Data at 30 June 2006.

3 Valuation standards for fixed-income securities held by mutual funds

3.1 Spanish standards

Spanish law[1] establishes that the realisable value of listed securities, both equities and fixed-income, must be determined using their market value, i.e. generally the official listed price on the balance sheet date (or, if there is none, in the immediately-preceding session) or the weighted average price of the day, if there is no official closing price.

1 CNMV Circular 7/1990, of 27 December, on accounting rules and confidential financial statements of collective investment institutions (amended by Circular 3/1998). A partial amendment of this Circular is being considered to adapt certain aspects of collective investment institution accounting to the new regulations on such institutions.

Under Spanish law, fixed-income securities must always be valued by discounting future cash flows at market interest rates. Market interest rates should be understood as the yields in the credit market and not just the risk-free market interest rate. To ensure proper interpretation, the legislation being drafted[2], which amends Circular 7/1990 on accounting rules and confidential financial statements of collective investment institutions, will explicitly set out the valuation adjustments for listed fixed-income securities, based on market interest rates and the issuer's credit risk.

Spanish law allows mutual funds to invest in unlisted securities[3] subject to a broad range of limitations and requirements.

General rules are provided for valuing unlisted assets. The first rule is the accounting principle of prudence, i.e. gains are only accounted for when realised, whereas risks are accounted for as soon as they become known. Unlisted securities must be valued by applying generally-accepted methods.

In addition to these general principles, specific valuation methods are given. These methods are not obligatory; other methods may be used with prior approval from the CNMV provided that they ensure the same degree of reliability in estimating the securities' realisable value. To obtain CNMV authorisation, the Boards of the fund manager and depository must first approve the change in method. In compliance with the principle of uniformity established in Circular 4/1997, once a valuation method is established, it must be used to value all assets of similar characteristics. Any change in method must be justified and requires CNMV approval.

In general, the price of a bond at a given time is calculated by discounting the cash flow (coupons plus amortisation) up to maturity:

$$P = \sum_{i=1}^{n} \frac{F_i}{\left[1 + h(0, m_i)\right]^{m_i}}$$

where:

F_i are the bond cash flows collected on "n" occasions

$h(0,m_i)$ are the spot zero coupon yields for each period mi expressed in years, converted to an annual percentage rate

If $D(m_i) = \dfrac{1}{\left[1 + h(0, m_i)\right]^{m_i}}$ is the discount function, then the price of the bond will be expressed as:

$$P = \sum_{i=1}^{n} F_i \cdot D(m_i)$$

2 Cf. section 7.b of the draft circular which was released for consultation late in 2006, at www.cnmv.es, in the section entitled "Publicaciones y otros documentos/ Documentos en fase de consulta".

3 Article 37 of Royal Decree 1309/2005, of 4 November, which approved the Regulation under Law 35/2003 on Collective investment institutions, and CNMV Circular 4/1997, of 26 November, on valuation standards and conditions governing mutual funds' investment in unlisted securities.

CNMV Circular 4/1997, of 26 November, on valuation standards and conditions for investment in unlisted securities, offers two options for estimating the realisable value of investments in fixed-income securities depending on the discount function used for the cash flow.

A first option is to use the market interest rate on government debt, incremented by a premium that represents the differences in the issuer's solvency, the issue's specific features, the liquidity, and the country risk (if any). The premium is calculated at the time of investment and remains constant except in the event of significant changes in the factors used to determine it.

As in the case of securities that are traded regularly in the securities markets, any securities whose maturity or residual life is six months or less are exempted from the general valuation method. These cases must be valued using the acquisition price plus accrued interest, which in this case may be calculated using the internal rate of return or a straight-line accrual method.

The second option allowed under Spanish regulations is discounting cash flow using the yield on other fixed-income securities that are sufficiently liquid and which are similar, in terms of financial characteristics, to the unlisted bonds to be valued. This election must be notified to the CNMV. In any case, these discount rates must also include a premium reflecting differences in the issuer's credit quality and the characteristics of the issue.

Market yields on private fixed-income securities can be obtained from financial information services[4]. This information is varied and heterogeneous: data aggregated according to a combination of criteria (rating, sector, maturity), as well as issuer-specific data.

3.2 International regulations

An analysis of international regulations reveals that Spain's rules on valuing fund assets are more elaborate, more specific and more transparent than those of other developed countries. The most frequent approach is to establish general valuation methods (fair value, prudence, recognised methods), while allowing fund manager to choose the specific method. The method must be approved by the boards of the fund manager and the depository. The regulator is charged with supervising the proper application of the chosen valuation methods. In Spain, Portugal and Ireland, the method, and any amendment to it, must be approved by the regulator. Changes in the valuation methods are allowed generally, provided that they are beneficial to investors' interests.

In line with IOSCO's general principles, most jurisdictions require that the general and specific valuation methods be disclosed, generally in the fund prospectus and occasionally also in the fund regulation. In Spain, they are also set out in the quarterly report to investors. Moreover, any change in valuation methods applied by the fund must be notified to investors.

4 Prestigious international financial information services that publish corporate bond yields include Bloomberg, Reuters and Thomson Datastream. There are also investment and research firms which produce indices of corporate bond yields, such as Lehman Brothers, MSCI and AFI (whose indices are available online at www.afi.es).

The Netherlands has the most detailed definition of fair value: the amount at which an asset may be traded between a knowledgeable seller and a knowledgeable buyer in a large transaction. The US and the UK do not specify criteria for valuing illiquid and unlisted fixed-income securities. Germany, Ireland, Portugal and Spain do specify such criteria. All these countries allow comparable bonds to be used as a benchmark, adjusted in each case on the basis of differences in issuer solvency, liquidity and taxation of the issue.

4 Alternative valuation methods

4.1 Estimating the zero coupon yield curve

In general, where there is no market price or where the market price has been set in illiquid conditions, the instrument's theoretical value is obtained by discounting the future cash flows using the zero coupon rates for the flows' terms, adjusted for the credit quality of the issuer or issue.

The zero coupon yield curve is not directly observable in the market since there not enough instruments issued at a discount in a broad range of terms with similar credit risk, liquidity and taxation. As a result, a "private fixed-income market yield curve" is estimated using a benchmark zero coupon yield plus a premium which, as far as possible, reflects specific information about the issue and issuer. Two curves are generally used as benchmarks: the zero coupon yield curve for government debt, and the interest rate swap (IRS) curve.

Another factor to consider is the methodology for estimating the zero coupon yield curve, i.e. the term structure of the interest rates, which reflects purely the relationship between the yield and the term. Yields observed in the market generally incorporate premiums for credit risk, liquidity, taxation effects and any special features of the financial instrument (intermediate payment structure). Consequently, it is necessary to estimate the term structure of the yields. There are a number of valid methods, each with its advantages and drawbacks. Two groups can be distinguished: econometric methods, and non-econometric (or recursive) methods.

In non-econometric methods, the yields are derived recursively from a set of "n" bonds and coupon dates, by solving a system of "n" equations in "n" unknowns. To apply these methods: (i) the bonds in question must have the same coupon payment dates, (ii) one of the bonds must have only one coupon outstanding, and (iii) the bonds' coupon payment dates must coincide with each of the bonds' maturity dates. This method is therefore difficult to apply to the Spanish government debt market, and even more difficult in the Spanish private sector fixed-income market. The problem is overcome with the IRS curve since the fixed part of the swap is equivalent to a bond issued at par on the trading date and with a term equal to the maturity, with an IRR (internal rate of return) and coupon equal to the swap rate. Therefore, the swaps at different terms that are traded in a session have identical coupon dates and this method can be applied if a set of consecutive terms is available. This class of method is discrete, making it necessary to interpolate intermediate zero-coupon terms.

Below we describe how the recursive method is used to obtain the zero coupon yield curve (the method is also called bootstrapping):

(1) The initial assumption in this method is that the zero coupon yield curve is composed of linear segments. The zero coupon yields are calculated recursively. Taking the price and coupon of the bond in time period 1 (P_1 and C_1 respectively), which has only one coupon payment outstanding before maturity, wet get the zero coupon yield for time period 1 (r_1).

$$P_1 = \frac{C_1 + 100}{1 + r_1} \longrightarrow r_1$$

(2) Then, taking the price of the bond in time period 2 (P_2), its two coupons (C_1, C_2)and the zero coupon yield from time period 1 (r_1), can be used to obtain the zero coupon yield for time period 2 by solving for r_2 in the following equation

$$P_2 = \frac{C_1}{1 + r_1} + \frac{C_2 + 100}{(1 + r_2)^2} \longrightarrow r_2$$

(3) The process is repeated for time periods 3, 4, etc. up to time period "n", where the price of the bond with maturity "n" with all the coupons through maturity, and the zero coupon yields obtained previously up to time period "n-1" give the zero coupon yield for time period "n" (r_n).

$$Pn = \frac{C_1}{1 + r_1} + \frac{C_2}{(1 + r_2)^2} + \ldots + \frac{C_n + 100}{(1 + r_n)^n} \longrightarrow r_n$$

The econometric methods directly estimate the discount function, d(t), using the Law of Uniqueness, i.e. that all of each bond's flows are discounted simultaneously by the market in accordance with a single yield curve that is positive, monotonously decreasing with d(0)=1 and d( )=0. The discount function is estimated using a regression model and is occasionally constrained to a given functional form. The literature includes the methods developed by McCulloch (1971 and 1975), Nelson & Siegel (1987) and Svensson (1994), and numerous variations on them. In this group of methods, the continuity of the discount function makes it possible to obtain the zero coupon yield directly for any term.

The specific choice of method should be based on the factors discussed below. The estimated term structure of the yields should ideally fulfil the following conditions:

i) continuity: broad terms, preferably continuous

ii) flexibility: capacity to capture the multiple forms that a term structure of yields can adopt

iii) smoothness: the curve should not undulate or oscillate, especially in the longer terms, since there is little justification for this from 10 years onwards and it would lead to instability in the forward rates for those terms.

It is also necessary to consider the difficulty of applying the method, the resources required, and the limitations involved in each one. All these factors are summarised in Table 2.

Comparison of alternative methods for estimating the term structure of yields TABLE 2

Method	Yield curve characteristics[1]			Complexity / Cost	Limitations
	Continuity	**Flexibility**	**Smoothness**		
Recursive methods:					
Public debt	no	yes		Low	Not enough bonds to enable it to be applied
Private bonds	no	yes		Low	Lack of bonds
IRS	no	yes	limited	Low	- Swaps are not quoted for all terms - Illiquid terms (including liquidity premiums)
Econometric methods:					
Direct estimation of the discount function (linear regression)	no	no	yes	medium	- Not enough observations (no. of bonds < no. of payment dates) - Multicollinearity problems
Estimation by imposing a functional form on the discount function Functional form:					
n-order polynomial	yes	yes	see limitations	medium-high	Excessively smooth fit in the short term and explosive in the long term if the polynomial order is not very high
Cubic splines[2] (McCulloch)	yes	yes	see limitations	High	Fit is not smooth at the long end of the estimated curve
Asymptotic convergence of forward rates[3] (Nelson & Siegel)	yes	yes		High	
Asymptotic convergence of forward rates[4] (Svensson)	yes	yes		High	

1 Conclusions taken from Soledad Nuñez: "Estimación de la estructura temporal de los tipos de interés en España: elección entre métodos alternativos" (Bank of Spain working paper no. 9522, May 1995).
2 Estimating via splines fits the discount function using n-order polynomials (normally quadratic or cubic). The polynomial coefficients vary in the various intervals into which the time period over which the discount period is to be estimated is divided. The McCulloch (1971 and 1975) approach uses cubic splines and is smoother than with quadratic splines. No constraint is imposed on the forward rates.
3 This method, applied by Nelson & Siegel (1987), assumes that the forward rates implicit in any term are asymptotic at some point, i.e. that the forward rates for long periods are similar (e.g. the implicit 6-month rate in 25 years' time is very similar to the implicit 6-month rate in 26 years' time).
4 This approach by Svensson (1994) includes not only the asymptotic convergence of implicit forward rates but also an additional assumption about the functional form of the instantaneous forward rate in order to make the yield structure more flexible.

The main conclusions with respect to the alternative methods of estimating the term structure of the yields are:

i) The McCulloch, Nelson & Siegel and Svensson methods comply acceptably with the continuity, flexibility and smoothness requirements. However, they are relatively complicated to apply. A priori, the McCulloch method is the most flexible one, while the Svensson method requires most computation time, particularly if the set of observations is small. From the application to Spain[5] it can be concluded that the Nelson & Siegel and Svensson methods provide best results in terms of the goodness of the fit and the ability to estimate smooth, flexible yield structures.

   However, the McCulloch cubic splines method[6] is widely used. It offers good results in terms of continuity and flexibility of the rate structure, which it estimates by linear regression. Many alternatives to McCulloch have been proposed, but they do not improve on its results since they occasionally entail a loss of flexibility, greater computational complexity and cost, or are based on non-falsifiable assumptions.

ii) The main advantage of recursive methods is their lower computational complexity and cost, but their results are poorer in terms of the desired characteristics of the term structure of the yields.

It is important to note that, regardless of the method that is used, the greater the similarity between the securities used (in terms of credit risk, liquidity and taxation), the better the fit of the estimated zero coupon yield curve. That is to say, for each type of identical securities, it is possible to estimate a specific zero coupon yield curve. Therefore, there are as many zero coupon yield curves as there are groups of securities with similar characteristics in terms of credit risk, liquidity and taxation. This explains, for example, why the zero coupon yield curves obtained from the IRS recursive method, using the euro interbank market credit risk, are higher than the curves found with the McCulloch econometric estimation, whose risk is lower as it is based on Spanish government bonds.

In any event, the zero coupon yield curve may be affected by estimation errors caused by such factors as: (i) inefficiencies in the IRS curve due to the existence of relatively illiquid terms, (ii) the impossibility of ensuring that the bonds used in the econometric estimate are totally homogeneous. Bond valuations may be distorted by an impending coupon, by being classified as benchmark or losing that classification, or by being the cheapest deliverable bond in future contracts on long-term interest rates.

4.2 Estimating the risk premium

Having derived the zero coupon yield curve, the next step is to determine the premiums to be applied to the discount function.

5 "Estimación de la estructura temporal de los tipos de interés en España: elección de métodos alternativos", Soledad Núñez Ramos, Working Document no. 9522, Bank of Spain, May 1995.

6 The spline approximation method consists of fitting the discount function using n-order polynomials. The polynomial coefficients vary in the various intervals into which the time period over which the discount period is to be estimated is divided.

One approach would be to derive the premiums from IRR data for comparable bonds published by prestigious financial information services. The choice needs to be made by taking account, as far as possible, of the issuer's credit risk, the term and duration of the issue, and the sector to which the issuer belongs.

Market IRR data published by those external sources are generally obtained from prices observed in a set of bonds that are homogeneous in terms of the type of instrument and the currency in which they are denominated. The publishers use different calculation methods, which may lead to considerable differences between their published IRRs. This situation is illustrated in Table 3.

Government debt yields and spreads in the euro area: comparison of data between publishers of financial information TABLE 3

	IRR (%)			Spread (basis points)		
	Bloomberg	Reuters	AFI	Bloomberg	Reuters	AFI
			1 year			
AAA	3.52	n.a.	3.63	14	n.a.	25
AA	3.55	n.a.	3.87	17	n.a.	49
A	3.59	n.a.	3.96	21	n.a.	58
BBB	3.67	n.a.	4.28	29	n.a.	90
			5 years			
AAA	4.08	3.94	3.97	23	9	12
AA	4.14	4.04	4.16	29	20	31
A	4.28	4.23	4.31	43	39	46
BBB	4.54	4.54	4.66	69	69	81
			10 years			
AAA	4.32	4.35	4.18	24	27	10
AA	4.45	4.48	4.40	37	40	32
A	4.69	4.80	4.68	62	72	60
BBB	5.11	5.35	5.16	104	127	108

Source: Bloomberg, Reuters and AFI.
1 Figures at 30 June 2006.

Another approach is to use a specific estimated premium for the issue, i.e. the difference between the theoretical IRR, calculated from the zero coupon yield curve, and the market IRR. This premium will be used to value the listed security where its last price was formed in insufficiently-liquid conditions or where there is no market price at the time of valuation, and to value similar bonds that are not listed. These premiums are not constant; they vary over time and, therefore, their historical series must be used, leaving the choice of determination method to the fund manager: simple or weighted mean of the last week, month, quarter, year, etc. or econometric models.

4.3 Other factors to consider

An analysis of methods for valuing private fixed-income securities would be incomplete without a discussion of some of the additional circumstances and factors that can potentially influence the final valuation.

i) Valuation of unrated securities: the CNMV does not require securities to be rated (only in the case of ABS). This raises the question of what credit category to use when determining the premium.

Out of prudence, securities should be classified directly as non-investment grade, or high yield (<BBB), although, given the high premiums applied to this category and the sizeable difference with respect to investment grade categories (Table 5 and Figure 3), that may excessively undervalue a fund's private fixed-income assets.

Another approach would be to allow the fund to adopt an internally-calculated rating that is reasonably justified. For example, this could be based on ratings of similar issues from the same issuer. This is similar to the Internal Ratings Based Approach (IRB) under the New Capital Accord (Basel II) released in November 2005. The IRB approach allows banks, in certain circumstances, to make their own estimates of credit risk for the purposes of determining their capital requirements.

Any justifications for the rating must be validated by the supervisor. Another option would be to oblige all issuers to obtain a rating, but the additional cost to the issuer would have to be taken into account.

ii) Adjusting the valuation on the basis of liquidity: it is difficult to determine an illiquidity premium for private fixed-income securities. Issues can be affected by a number of factors, which may be purely temporary, that make it difficult to isolate the liquidity component of the risk premium.

This difficulty declines with credit risk: the higher the credit rating, the higher will be the liquidity risk component in the difference between the bond's theoretical price at a given time and the market price (this difference is referred to as the "price bias"). The extreme case is that of government bonds: since the credit risk is zero, the spread reflects only liquidity and taxation factors.

Although it is not possible to specify an objective, specific, automatic method for estimating illiquidity premiums, there is published literature on testing and measuring the existence of liquidity premiums in the securities markets. However, most of them refer to equities and the few that deal with fixed-income refer exclusively to government debt (mainly in the US market).

A traditional approach to estimating the liquidity premium is based on calculating the spreads vs. government bonds between pre-benchmark and benchmark bonds. These spreads basically reflect the additional yield demanded of bonds not classified as benchmark in a specific term solely because of their lower liquidity with respect to benchmark bonds.

However, these methods are difficult to apply to private fixed-income securities, mainly because it is difficult to determine benchmark bonds for specific terms, given the diversity of instruments and issuers.

iii) interpolation method used for obtaining yields in undefined intermediate terms: linear or exponential. The differences between them are not significant, although the exponential method seems to be more appropriate for calculating the discount function, which fits an exponential function better than a linear one; moreover, using the exponential method does not make the calculation more complex.

iv) day count method: there are conventions which vary in terms of product and country (ACT/360, ACT/365, ACT/ACT, 30/360, etc.). Bond price and yield comparability is not guaranteed if the day count methods are not the same.

4.4 Summary of results from applying the valuation methodology

There are many reasonable ways of calculating the theoretical value of a private fixed-income asset that does not have a representative market price. For illustration, a mortgage covered bond, a fixed-coupon bond and a variable coupon bond were valued using the various methods[7]. The results are set out in Table 4. Clearly, there are many options, and notable differences in the results.

Results of valuation using alternative methods[1] TABLE 4

	Mortgage covered bond	Fixed-coupon bond	Variable coupon bond (Euribor 12m + 0.25)
Case	Prices not representative	Price not available	Unlisted
No. of valuations	7	3	2
Maximum price	100.855	107.269	104.859
Minimum price	100.162	106.810	103.725
Price range (%)	0.69	0.43	1.09
Standard deviation	0.23	0.21	--

Source: author.
1 Dirty prices.

5 Conclusions

Investment in Spanish private fixed-income securities is no longer a minority phenomenon among Spanish mutual funds. In mid-2006, more than one-third of FIM had domestic private fixed-income securities in portfolio, representing 15% of their total assets. They are all listed securities, since investment in unlisted securities is negligible.

There are many alternative ways of valuing private fixed-income securities, but they can be grouped on the basis of two issues: the method of estimating the zero coupon yield curve, and the form of determining the risk premium (which reflects the issue's solvency, liquidity and taxation). These two variables lead to the

7 For more details of the methodology applied in each case, cf. CNMV Monograph 17.

discount function to be applied to the asset's future cash flows in order to determine its net present value.

When estimating the zero coupon yield curve, the main advantage of recursive methods is their lower computation complexity and cost as compared with econometric methods. As a result, the standard valuation method uses zero coupon yields obtained from the depo-swap curve. The results obtained with econometric method are superior in terms of complying with the theoretically-desirable features of the term structure of the yields (continuity, flexibility, smoothness); however, computationally they are more costly and complex. The three main methods (McCulloch, Nelson & Siegel, and Svensson) provide satisfactory results in the Spanish market.

The credit risk premium can be derived from yields of assets that are similar to the ones to be valued. The difficulty in this approach lies in obtaining a proper match to the security's characteristics. Another approach is to use historical risk premiums estimated specifically for the issue in question. They are obtained from the difference between the theoretical IRR (obtained from the zero coupon yield curve) and the market IRR. A limitation of this method is that there must be representative market prices in a time period not very distant from the time of valuation. Adding an illiquidity component to the asset's risk premium is complex and there is no standard method.

Absent a single optimum valuation method, mutual funds holding private fixed-income securities for which no representative market price is available must estimate their value using one of the available alternative methods. The valuation can vary notably depending on the chosen method: the examples showed differences of 0.4%-1.1% between the maximum and minimum prices obtained. Accordingly, it is difficult to establish the exact realisable value and, therefore, it is more meaningful to speak of reasonable price bands.

International regulations on valuing collective investment institutions are normally based on setting general criteria, such as the fair value, the accounting principle of prudence, and the use of generally-accepted methods. The fund manager chooses the specific method, and the regulator is charged with supervising its application.

Spain's regulations are more specific than those of other countries with regard to unlisted securities since they provide two valuation methods (but they are not obligatory). For listed securities without a representative price, the regulations require the valuation to be adjusted to the term structure of interest rates and to changes in the issuer's solvency. Because of the great diversity of products to be valued and of valuation methods, it is meaningless to be more specific with regard to the method for valuing illiquid fixed-income assets. Therefore, regulatory oversight is essential to ensure that there are no mismatches between a fund's net asset value and realisable value.

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III International Reports

IOSCO Report on principles for the valuation of hedge fund portfolios

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1 Introduction

The International Organization of Securities Commissions (IOSCO), through its permanent Asset Management group, is as a matter of priority addressing issues related to hedge funds. In 1998 the *Long Term Capital Management* hedge fund underwent a collapse that jeopardized all of the world financial system, and since then IOSCO has expressed concern about the risks to which hedge funds may give rise on the financial markets. A year later it made a first analysis of hedge fund types in each of the IOSCO member jurisdictions. The latest comparative study concluded with a report published in November 2006 announcing the group's interest in exploring the sensitive and important point of valuation. The report entitled *Principles for the valuation of hedge fund portfolios* (the "Report") is the product of this initiative.

The Report on valuation is focussed on developing a set of flexible principles[1] that may be applied to hedge funds with widely differing but solid structures, with the aim of promoting good governance in the valuation process and mitigating the structural and operational conflicts of interest that may arise between the hedge fund manager and the hedge fund investors. The establishment of written and appropriately documented valuation policies and procedures is the fundamental principle put forward in the Report, without which the other principles cannot be applied. The Report also highlights the concepts of independence, transparency and consistency in the valuation process. In short, it lays down the principles that should guide the governing body and the managing company of any hedge fund by means of developing and implementing the fund's valuation policies and procedures.

The Report was written with the very active involvement of European and American representatives of the hedge fund industry, and IOSCO's purpose is that the valuation principles should constitute a practical tool to be used by managers, hedge fund governing bodies[2], investors and any other party involved in valuation. IOSCO also suggests that investors should, before making an investment, check compliance with these principles, without prejudice to the need to make a detailed analysis and appraisal of the valuation policies and procedures of the hedge fund to be invested in.

Finally, the Report discussed in this article is under public consultation up to 21 July 2007, so the final Report may include changes made in the light of the comments received.

1 The premise of one size does not fit all is the Report's starting point; hence it proposes flexible principles adaptable to all hedge funds, whatever their legal framework and organizational structure.

2 A governing body is defined for the purposes of the Report as the entity ultimately responsible for the hedge fund. This term may, according to the fund's jurisdiction and organizational structure, refer to the fund's board of directors, its manager, the majority shareholder of the limited partnership under which the fund is organized, etc.

Below we analyze the reasons that led IOSCO to draw up these principles and give a summary of what the principles involve. Then, stepping back from the Report, we study compliance with the IOSCO principles by hedge funds under Spanish legislation and remark on some points directly related to valuation that are not addressed in the Report. The article ends with some conclusions.

2 What drove IOSCO's focus on hedge fund portfolio valuation?

The interest of IOSCO and oversight bodies in hedge fund valuation is due chiefly to the following reasons:

- The increasing importance of hedge funds to global capital markets.

  With investor capital currently in the order of $1.5 trillion, and the use of leverage applied to that capital, hedge funds play an increasingly important role in capital markets and provide substantial liquidity. They are, moreover, a source of continuous product change and innovation, and also an important source of investment diversification for institutional and sophisticated individual investors. They also help to better distribute risk in financial systems worldwide.

- The complexity of certain hedge fund portfolio strategies and their underlying instruments.

  The growing influence of hedge funds in financial markets brings with it challenges and risks. Important among these is the difficulty in valuing the complex, illiquid financial instruments forming their portfolios. This complexity generally arises from a lack of reliable price information, or the lack of a liquid market, or the use of valuation models that rely on imperfect data or are dependent on the occurrence of a future event, the probability of which is difficult to estimate (e.g., distressed securities and over-the-counter structured notes).

- The central role of valuation to hedge funds.

  The valuation of the financial instruments employed by hedge funds is critical because it affects hedge fund net asset value. Hedge fund investors, which include registered collective investment schemes and registered funds of hedge funds, take investment decisions based on a hedge fund's performance, which is directly related to portfolio valuation. Valuation is also the basis for financial reporting on the market and for the calculation of collateral requirements by institutions providing funding. Moreover, the fees charged by these funds, generally performance based, depend directly on asset valuation.

- Conflicts of interest can exacerbate valuation difficulties.

  In addition to the inherent difficulties in valuing certain complex and illiquid financial instruments[3] held or employed by hedge funds, the structure and operation of hedge funds can exacerbate these difficulties because of attendant conflicts of interest, especially where a manager takes an active role in the valuation process.

When a hedge fund invests in financial instruments that are hard to value, the Manager may be the most reliable source of information about pricing for a particular financial instrument. But a manager's involvement in valuation may trigger serious conflicts of interest with the investors in the fund. The manager is likely to have both the incentive and the ability to manipulate the valuation made, as, on one hand, its remuneration is based on the value of the fund's portfolio, and on the other, it has an interest in meeting investor expectations, for if these are not met the investors might withdraw their capital. The use of leverage can also exacerbate the impact of valuation errors, whether intentional or not. When hedge funds invest in liquid and exchange-traded instruments, which are therefore easy to value, manipulation and conflicts of interest are less likely. The Report therefore focuses on conflicts that may arise with hard-to-value instruments.

3 The nine principles

Below we set out the principles that IOSCO recommends to all hedge funds in the valuation of their portfolios.

1 Comprehensive, documented policies and procedures[4] should be established for the valuation of financial instruments held or employed by a hedge fund.

The hedge fund governing body should ensure that written policies and procedures are established which seek to ensure integrity in the valuation process. In particular it should set out the obligations, roles and responsibilities of the various parties involved in the valuation process.

In establishing valuation policies and procedures, the following points should be addressed: (i) the competence and independence of personnel who are responsible for valuation, (ii) the specific investment strategies of the hedge fund and the financial instruments in the portfolio, (iii) the controls over the selection of valuation inputs, sources and methodologies, (iv) the escalation procedures for resolving differences in value for financial instruments, (v) the

3 The *Alternative Investment Management Association* (AIMA) concluded in a recent study that some 23% of the financial instruments employed by hedge funds are *hard-to-value instruments*.

4 The term "valuation policies and procedures" reoccurs throughout the Report. "Policies" refers to the high-level principles governing valuation, and "procedures" are all the detailed processes that lead to the valuation of assets forming a hedge fund's portfolio.

valuation adjustments related to the size and liquidity of positions, and (vi) the appropriate time for closing the books for valuation purposes.

2 The policies should identify the methodologies that will be used for valuing all of the financial instruments held or employed by the hedge fund.

The policies should set out the methodology to be used for each financial instrument, which include inputs, models and the selection criteria for pricing and market data sources. For example, the policies should consider what constitutes an acceptable input, acknowledging that prices should, whenever possible, be obtained from independent sources. As another example, the policies should address cut-off times when securities are traded in multiple time zones. The selection process for a particular methodology should include an assessment of the different relevant methodologies available.

If a model is used to value a financial instrument, the model and the variable inputs should be explained and justified in the valuation policy and procedures. The assumptions and rationale in model-based valuations should be appropriately documented to facilitate later review.

3 The financial instruments held or employed by hedge funds should be consistently valued according to the policies and procedures.

This principle requires that the policies, procedures and designated methodologies established be applied consistently, i.e. all financial instruments within a fund that share similar economic characteristics should be valued by the same criteria. Policies and procedures should also be applied consistently over time unless circumstances arise that suggest that the policy requires changing or updating. Finally, they should be applied consistently across all hedge funds that have the same manager. Two portfolios with similar instruments cannot therefore be valued with different criteria, inputs or models.

4 The policies and procedures should be reviewed periodically to seek to ensure their continued appropriateness.

The desirability of consistent application over time of the policies and procedures should be balanced with a periodic review of, and appropriate changes to, the policies and procedures. Recognizing that hedge funds operate within a dynamic and changing environment, the policies should allow for a review and change of methodologies periodically and after any event that calls into question their validity or utility.

The policies and procedures should be reviewed prior to the fund's engagement with a new investment strategy or financial instrument to determine whether the existing policies and procedures sufficiently address the new types of strategies or investments.

5 The governing body should seek to ensure that an appropriately high level of independence is brought to bear in the application of the policies and procedures and whenever they are reviewed.

One of the main challenges posed by valuation arises when the manager is the person who best knows the instrument being valued (due to its being illiquid, complex or unique), and therefore is the person best placed to provide an accurate value. If we consider only this, the manager should be the party in charge of valuation. But as mentioned above, the manager may have incentives to manipulate the valuation to its own benefit and to the detriment of investors. That is to say, the principles of independence and expertise in valuation are almost impossible to satisfy at once, as one is achieved at the cost of the other. Thus we must ask if it is more desirable to get an independent valuation (avoiding conflicts of interest) at the cost of being less accurate, or the reverse. Managing this trade-off is a task that IOSCO assigns to the hedge fund's governing body: this body must be able to provide a balanced solution marrying independence in valuation with appropriate experience and competence in those carrying out the process.

As one of the Report's aims is to mitigate conflicts of interest in valuation, and given that independence is the basic means of achieving this, the Report suggests various approaches, in no particular order of preference, given the great range of structures under which a hedge fund may be organized. The approaches put forward are as follows:

- Third-party pricing services. Outsourcing valuation to an independent third party can help to mitigate conflicts of interest, especially where valuation is influenced by the manager. The third party should have the necessary resources and capability to make the valuation.

- Independent reporting lines within the manager. If valuation is not outsourced to a third party and the manager itself values certain instruments, independence may be achieved through the bodies that oversee the managing company.

- Establishment of a valuation committee. The governing body could oversee the establishment of a valuation committee to review the valuation policy and procedures and oversee their application. Independence in this case can be strengthened by the appointment of persons who are not connected to the Manager to represent the interests of investors (such as a member of the governing body in the case of offshore hedge funds). The committee may choose to consult with external experts in the case of financial instruments that are hard to value.

Depending on the organizational structure of the hedge fund, either the board of directors, the majority partner of a limited partnership, the valuation committee or a third-party valuation agent to which the valuation is outsourced may be viewed as an independent party[5] for the purposes of valuation.

5 The term "independent party" also appears repeatedly in the Report. It is a general term referring to the entity, person or persons through which independence in valuation is achieved.

6 The policies should seek to ensure that an appropriate level of independent review is undertaken of the individual values that are generated by the policies and procedures and, in particular, of any valuation that is influenced by the manager.

There should be an independent review process for individual values generated so as to ensure their appropriateness, especially where the risk of inappropriate pricing may be greater, e.g. where prices are available only from a single counterparty, in the case of illiquid assets or in vendors influenced by the manager or by other entities that may have an interest in the hedge fund's performance.

As mentioned in the previous principle, it is recognized that the necessary experience and expertise to value complex and illiquid instruments in an appropriate manner may rest with a limited number of individuals. It may be more difficult or not possible to find an independent pricing service. For example, the counterparty of a derivative contract is often utilized as the primary or only pricing provider. Sourcing prices from such a provider may, however, present a conflict of interest for the price provider, as the price it furnishes may be influenced by its expectation of trading the instrument with the client or in the market place. The furnished price could lead to an overstated or understated price because the counterparty may hold either a position which is in the same or opposite direction to that of the hedge fund.

Thus the policies and procedures should include controls to ensure that an appropriate degree of objectivity is brought to bear in considering values that are obtained from counterparties. That objectivity may be achieved through the involvement of the independent party, which will be responsible for arbitrating and resolving disputes on the determination of an appropriate price, and balancing any undue influence of the manager. The independent party may conclude that the choices by those in charge of pricing are made with impartiality and based on merit alone.

7 A hedge fund's policies and procedures should describe the process for handling and documenting price overrides, including the review of price overrides by an independent party.

Hedge fund literature uses the term "price override" to mean the rejection or invalidation of a value for a financial instrument that was determined according to the hedge fund's policies and procedures, due to exceptional circumstances that mean that this value may not be appropriate. The manager, valuation agent or other party involved in the pricing process may therefore propose an override to that value and use another.

The procedures for price overrides should encompass a requirement for reporting to, and an appropriate level of review by, the independent party. The detail of, and reasons for, each override should be documented, including any evidence supporting the proposed override.

8 The hedge fund governing body should conduct initial and periodic due diligence on third parties that are appointed to perform valuation services.

The due diligence should check that the third party maintains appropriate systems and controls and a sufficient complement of personnel with an appropriate level of knowledge, experience and training. The governing body should apply Principles 1 and 2 from section III of the IOSCO 'Principles on outsourcing'[6].

9 The arrangements in place for the valuation of the hedge fund's investment portfolio should be transparent to investors.

This principle may take the form of making available to investors the following documentation, which should be handed over upon request:

- The valuation policies of a hedge fund and material changes to the policies, accompanied by, as appropriate, an explanation and quantification of the effect of such a change.

- A description of the roles, skills and experience of all of the parties that are involved in valuation.

- A description of the extent to which valuations have been provided by the manager.

- A description of any material conflicts of interest that may arise in the valuation.

- The hedge fund's responses to investor questionnaires.

- Information about the nature and degree of any contracted data and pricing services.

Some of the principles proposed by IOSCO had already been adopted by the hedge fund industry as a result of previous suggestions by some associations of hedge fund managers. In table 1[7] we see that, though a large percentage of hedge funds have documented valuation policies carried out by independent parties, there are still some managers that do not follow these two basic recommendations.

Valuation principles TABLE 1

	Hedge funds that comply with the principle
Net asset value calculated by an administrator or a third party	78%
Independent review of valuation	47%
Establishment of documented valuation policies and procedures	86%
Annual review of valuation policies and procedures	38%
Transparency of valuation policies	68%
Performance and updating of a due diligence on the entity to which the valuation is outsourced	25%

Source: CNMV and author.

6 "*Principles on outsourcing of financial services for market intermediaries*". These principles refer to the specific points to keep in mind when conducting a due diligence, and the characteristics and clauses that should be included in contracts regulating an outsourcing arrangement.
7 Data from the study "Precautions that pay off" conducted by Deloitte on a sample of 244 hedge funds managed by 60 managers.

4 Spanish legislation on hedge funds analyzed in the light of the IOSCO valuation principles

Hedge funds in Spain are regulated under the legal concept of collective investment schemes ("CIS"), and may be set up as funds or as variable capital investment companies. They are therefore a special form of CIS, with the same system of governance and benefiting from the same safeguards. However, the specific rules on hedge funds contained in article 43 of the Collective Investment Scheme Regulations ("RIIC"), in Instruction EHA/1199/2006 developing the provisions of RIIC relating to Free CIS, and in Circular 1/2006 on Free CIS ("Circular 1/2006"), provide specific requirements for seeking to mitigate conflicts of interest and other risks in such funds, especially operational risk. The term IIC de Inversión Libre (Free CIS) was chosen for identifying and regulating hedge funds in Spain.

Like other CIS, hedge funds are required to engage a depositary, always acting independently, not only to hold and safeguard the fund's portfolio but also to monitor its management and to oversee the criteria, formulas and procedures used by the manager for calculating net asset value.

Do the rules developed in Spain on hedge funds meet the principles drawn up by IOSCO? To answer this question, let us consider each principle:

- The first and second principles recommend that the hedge fund should have documented valuation policies, procedures and methodologies for each of the instruments in its portfolio.

  These principles are set out in articles 10.2 and 43.1(i) of the CIS act, and in articles 48 and 73 of RIIC. Circular 3/98 of the Spanish Securities Commission (CNMV) on derivatives provides rules for valuing these instruments in its seventh chapter and CNMV Circular 4/97 does the same for non-traded securities. That is, the Spanish rules require that funds should have a good administrative and accounting organization and sufficient human and technical resources for administering CIS and in particular for appropriate pricing, which is conducted largely according to regulated principles.

  Our valuation rules are so detailed that funds have very little room for establishing valuation criteria of their own. Only in respect of the valuation of derivative financial instruments and non-traded securities does the legislation leave a certain margin in which for companies to establish their own valuation criteria. Finally we should note that CNMV Circular 3/97, in chapter IV of its third annex, lays down detailed provisions on the need for funds to develop valuation procedures, including the models and external data sources used, and the performance of adjustments and reconciliation.

- The third principle, on consistency in the valuation process, is included in the CNMV's special rules on accounting and valuation. Thus CNMV Circular 7/90 provides that "once a criterion has been adopted in the application of accounting principles within the options permitted thereby, if any, it should be kept in place over time in so far as the assumptions forming the rationale for that choice of criterion remain unchanged". IOSCO also notes that in the case of hedge funds managed by a single manager, the principle of consistency must likewise be fulfilled. So if a manager uses the room for manoeuvre that it has for establishing valuation criteria for derivatives or non-traded instruments, it will do so in the same way for all of its funds.

- The fourth principle recommends the periodic review of the policies and procedures mentioned in the first principle. In this connection, chapter IV of CNMV Circular 3/97 reiteratively establishes the need to review the procedures established with the aim of detecting any inconsistencies or errors.

- The fifth principle on independence in valuation is one of the most notable principles and on which IOSCO puts most stress. As we noted when describing this principle, valuations must be made independently and by persons with appropriate expertise. These two requirements, hard to meet both at once, are a source of conflicts of interest. Spanish legislation – both the general CIS rules and the specific rules on hedge funds – makes a particular effort to suitably address these points, as analyzed below:

  - Independence: The seventh provision of Circular 1/2006 states that "managing companies must ensure that management, administration (valuation) and control functions are appropriately separated, both when they are kept within the company and when they are outsourced to external providers. Moreover, in the determination of the net asset value of the CIS managed, whether this function is outsourced or not, no persons performing management functions must be involved. However, in exceptional cases where some input from the managing division is required for the calculation of net asset value, a documented record must be left of the justification for that involvement, to be kept for five years".

  - *Expertise*: There are many references in general Spanish legislation on CIS, but as regards specific rules on hedge funds, both RIIC and the fourth provision of Circular 1/2006 state that managers must have the necessary human and material resources to allow for suitable control of risks as well as prior valuation and continuous monitoring of investments.

  We should note that both within IOSCO and in the hedge fund group set up in the CNMV to regulate such funds, there was considerable debate on the need to impose the obligation to outsource valuation to an administrator as a means of achieving independence. In both forums it was concluded that, though that was one of the possible options, the valuation could also be carried out within the manager itself provided that the various functions in the company were suitably separated. There are many fund of hedge fund managers, however, which, when conducting a due diligence, give a poor rating to hedge funds that have no independent administrator for pricing.

- The sixth principle refers to the independent review of valuations, especially if these are made or influenced by the manager. The general CIS rules provide not only for the separation of functions but also for the existence within the organization of a control unit responsible for reviewing the internal control procedures and systems established. This unit, directly dependent on the board of directors, will also be responsible for resolving any disputes that may arise in the valuation and, where appropriate, for submitting them to the board. In addition, as mentioned above, the depository must also supervise the calculation of net asset value, and the fund's accounts must be audited every year.

- The seventh principle recommends the establishment of a procedure for handling and documenting price overrides. This situation normally arises when a hedge fund manager disagrees with a certain valuation provided by an independent administrator or the manager's valuation department. This event is covered in Spanish legislation when it concedes, as mentioned in the previous section, that the manager may intervene in the valuation process in exceptional cases, provided that a documented record is left of the justification for that involvement. Moreover, as the manager must have established a procedure for reporting to the board and for reviews, frequency and flows of information, a price override would be kept under control.

- The eighth principle states that when a third party is appointed to perform valuation services, a due diligence must be conducted on that third party. Both article 68 of RIIC and the tenth provision of Circular 1/2006 specify that the third party should have personnel with sufficient experience and with appropriate material resources. The manager appointing the third party must also have made checks to ensure that the outsourced tasks are performed appropriately, and must establish suitable control procedures in respect of the third party's activity.

- The ninth principle recommends making the arrangements for the valuation of a hedge fund's portfolio transparent to investors, where investors so request. In this connection, the 21st provision of Circular 1/2006 states that hedge funds "shall be subject to the basic principles and general valuation criteria established for financial CIS, in accordance with the valuation criteria established in the institution's prospectus". As the CIS valuation rules in Spain are extensive and detailed, the prospectus may simply reference these rules, which are public and can be consulted by investors. Where the rules allow for a certain flexibility in valuation, the manager will establish the applicable valuation principles in the prospectus.

5 Other points related to valuation not covered in the IOSCO Report

IOSCO's interest in the valuation of hedge funds is shared by the *Alternative Investment Management Association* (AIMA), the European hedge fund industry association, which has also recently published some valuation principles[8].

IOSCO distilled its recommendations on valuation into nine principles, whereas AIMA has drawn up fifteen. Though more detailed, they are in essence so similar to those drawn up by IOSCO that a hedge fund manager applying either set to its organization would create a structure of a similar nature. AIMA, however, addresses an issue not covered by IOSCO, namely side pockets, which we shall discuss below.

Some points involved in the valuation of hedge funds, though not directly addressed by IOSCO in its principles, are worth a brief mention and analysis:

- *Fair Value*: In the Report's preparation the possibility was considered of including the concept of fair value in valuation as a principle. This option was finally ruled out given that the aim of the IOSCO principles is to create not valuation rules but principles for overseeing a hedge fund's governance system and allowing valuations to be determined so that the net asset value that investors purchase and redeem may be calculated. The valuation rules for preparing financial statements are already provided by the *International Financial Reporting Standards* (IFRS) or the *US Generally Accepted Accounting Principles* (*US GAAP*). Thus the valuation made to calculate net asset value may differ from that obtained from the application of the IFRS and the US GAAP. For example, the IFRS require the use of the bid quotation for long positions and the ask quotation for short positions. But many hedge funds use the last price at which a transaction was negotiated or the midpoint of the spread between bid and ask in the calculation of net asset value. The principle of fair value is expressly specified in Circular 1/2006 when it states that valuation criteria "shall be designed to reflect the value at which the assets could reasonably be sold to a third party that had no relationship with the CIS and that was appropriately informed at the time of valuation".

- *Side pockets*: Currently only a minority of hedge funds have side pockets, but such pockets are a growing trend. But what is a side pocket? They are defined as separate accounts within a hedge fund's portfolio containing hard-to-value illiquid assets of a similar nature to private equity or venture capital assets. Each of these side pockets normally involves a different share class (known as *side pocket share classes, special situation share classes or class S shares)*.

8 *AIMA's Guide to Sound Practices for Hedge Fund Valuation (March, 2007)*

Why do hedge funds create side pockets? Hedge funds are increasingly interested in investing in private or quasi-private equity assets, in a constant search for new sources of diversification, returns or even ways of taking control of companies. Private equity assets are characterized by illiquidity and indeterminate duration – normally several years – whereas a hedge fund provides periodic liquidity, usually quarterly. Also venture capital normally values its assets at cost price, whereas a hedge fund values them periodically and at market prices. Finally, whereas hedge funds charge quarterly performance fees, venture capital funds charge no such fees until the investment takes shape, i.e. until the asset is sold or realized. All these peculiarities mean that when a hedge fund invests in venture capital, it creates a special share class in which to put these assets. Thus a hedge fund may have two (or more) share classes, one that provides periodic liquidity and another that is indeterminately illiquid for several years and that can only be redeemed when the hedge fund sheds its private equity portfolio. If a hedge fund makes different investments in private equity, it would normally create a different share class for each investment.

Although side pockets allow the creation of hybrids between hedge funds and venture capital funds, their use raises concerns. A hedge fund manager may have the incentive to arbitrarily select its assets that perform worst or have poorer growth prospects and hive them off into a side pocket so as not to impair the fund's overall returns, or the performance fees charged. This practice, known as cherry picking, constitutes a form of manipulation. Another disadvantage of side pockets is their high administrative cost, especially if several share classes are created for not very significant private equity positions.

To seek to mitigate this kind of manipulation by a manager (hiving off the poorest assets so as not to value them), AIMA proposes in its principles that any decision to create side pockets should be taken by the hedge fund governing body after careful consideration, and that investors should be informed of the decision. The criteria applicable to side pockets should also be as consistent as possible. The criteria of consistency and transparency established by AIMA for dealing with side pockets are vital in order to ensure fair treatment of investors and to prevent arbitrary measures being taken by managers. The valuation policies and procedures should also establish the way in which such assets are valued – whether at cost price or if they should be updated to market price. There are moreover several ways of structuring side pockets. In some cases participation is obligatory and in others investors are allowed to decide whether to participate or not. Those entitled to participate are normally only investors participating in the hedge fund at the time when the side pocket is created. This aspect, along with mechanisms for ensuring the equal treatment of participants, must also be clearly defined in the hedge fund's policies and procedures.

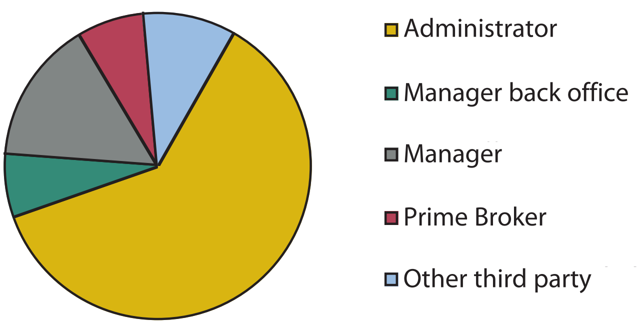
Under the Spanish rules, traditional investment funds may invest up to 10% of their capital in non-traded securities, the value of which is hard to calculate. Our investment funds, however, must value such assets at market value and in a regular manner, with no use of side pocketing.

- The role of prime brokers ("PBs") in valuation: PBs are general providers of financial services to hedge funds. They execute their transactions, clear and settle them and also offer finance and lending of securities. When a PB finances a hedge fund, the fund assigns securities from its portfolio in escrow to it, which the PB may later dispose of. The PB values the assets assigned to it in escrow by the fund and applies a haircut to them in order to calculate the cash that it can lend. Thus the PB plays an important role in valuation, as the finance granted to the hedge fund depends on it. But, as PBs argue, this valuation cannot be used in determining the hedge fund's net asset value, as the PB is not impartial and the valuations that it makes take account of the financial relationship linking it to the hedge fund, i.e. its valuations would not reflect the price for which the assets could reasonably be sold to a third party that had no special relationship with the CIS and that was appropriately informed at the time of valuation (fair value).

- Frequency of valuation: Neither the IOSCO Report nor the AIMA specifies the frequency at which assets should be valued. Hedge funds normally offer monthly net asset values, and the document on valuation policies and procedures should establish the specific dates for calculation and publication of net asset value. The fact that this is calculated monthly need not mean, for reasons of risk control, that asset valuation cannot be daily, if possible. This idea is expressed in Circular 1/2006 when it says that " assets and financial instruments must be valued daily, except in the case of positions that are not actively traded or whose valuation involves a considerable effort or is complex, in which case a lower frequency may be established".

- To end, figure 1[9] shows the disparity of valuation models in the hedge fund industry. We see that 14% of hedge funds are valued by the manager itself or by the PB, which would not in principle meet the recommendations either of IOSCO or of AIMA.

Who calculates net asset value in hedge funds FIGURE 1



Source: CNMV and author.

9 Ibid npp.7.

6 Conclusions

The recommendation that hedge funds should establish valuation policies and procedures for their asset portfolios stems from the need to mitigate the operational risk to which they are exposed. The typical operational risks faced by hedge funds are misappropriation and misrepresentation, which, in a word, constitute fraud. The former refers to the misappropriation of assets by the manager and the second to the manipulation of valuations. The initiative taken by IOSCO in proposing its recommendations is designed to reduce the likelihood of valuations being manipulated.

One of the key features of the proposed principles is their flexibility for adaptation to the multiplicity of structures under which hedge funds are organized worldwide. Though the principles may seem very general compared to regulations such as those enacted in Spain, compliance with them is in many cases not to be taken for granted. In fact some hedge funds are so small that separation of functions and independence are challenges remaining to be met.

Spain and other western European countries such as France, Germany, Italy, Portugal and Ireland have opted to regulate and oversee these funds by fitting them into a regulatory framework in which they will enjoy safeguards similar to those applying to other overseen and regulated institutions. Thus it may be said that hedge funds have been regulated in keeping with principles such as those proposed by IOSCO.

Regulated hedge funds are still in the minority, as the rules developed for the purpose are recent. Most such funds are domiciled offshore, are established as limited partnerships or private companies, and are not subject to oversight. These funds are governed solely by their articles of incorporation and the policies and procedures that they may develop internally. The IOSCO principles may therefore provide them with added value, helping to improve their organization and their valuation procedures, thereby mitigating the conflicts of interest and the operational risk referred to in the course of this article.

One of the IOSCO Report's aims is to encourage investors to check whether a hedge fund in which they intend to invest meets the proposed principles. Thus investors would apply pressure by choosing only those hedge funds that had a sound system of governance. If we consider that most hedge fund investors in recent years have been institutional, such as funds of funds, foundations and pension funds, at the expense of the large individual fortunes that were the major investors early on, it is natural that such institutions should succeed in creating a certain discipline in fund governance systems. With the growing pressure of institutional investors on hedge funds' governance systems, we may expect a shift by investors towards regulated funds and those that meet principles such as those of IOSCO and AIMA, with the other hedge funds following in their wake.

Regime of cross-border activities (passports) under the MiFID

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1 Introduction

Council Directive 93/22/EEC, of 10 May 1993, on investment services in the securities field (hereinafter the 'ISD') for the first time established a totally innovative regime of cross border activities for investment firms ('Ifs') which brought with it an unprecedented opening up of borders within the European Union (EU). As a first and principal consequence there was a large increase in competitiveness amongst this type of firm throughout the EU since the ISD, pursuant to mutual recognition, enabled IFs authorised in their Member State of origin to engage in all or part of the activities covered by their authorisation throughout the EU, either by establishing branches or under the freedom to provide services, without the need to apply for an additional authorisation from the competent authority of the Member State in which they wished to provide services or engage in the said activities. In other words, obtaining a licence as IF in any Member State provided them with the possibility of operating throughout the EU.

The focus adopted by the ISD was, however, aimed at bringing about only the basic degree of harmonisation which was necessary and sufficient to guarantee mutual recognition of authorisations and prudential supervision systems. The lack of success of the ISD derived precisely from the ambiguity of the terms 'necessary and sufficient'. The ISD was thus obliged to establish a distribution of competencies over firms which provided cross-border investment services in such a manner that the supervisor of the home Member State of origin was attributed with authorisation and supervision of prudential rules and the host State that of rules of conduct. The reason for this was that European harmonisation was achieved of the former and insufficient harmonisation of the latter.

With the opening up of borders involved in the ISD, as an importer of investment services[1] Spain always maintained a protectionist interpretation of what must be understood by rules of conduct, the supervision of which was attributed to the competent authority of the host Member State, with this concept including both rules relating to relations with clients as well as all rules regarding internal organisation of the IF; an interpretation which was allowed by the ISD, given its ambiguity, but which was not however shared by all Member States.

Indeed, experience showed that the scant, not to say lack of, harmonisation of both organisational requirements and rules of conduct gave rise to the limited success of the so-called 'passports', both under a regime of freedom of provision of services and through the establishment of branches. This weakness in the legislation led on

1 The proportion of registered national IFs is one compared with eight IFs from other EU Member States with a passport to operate in Spain.

some occasions to differences in interpretation between the supervisors of Member States which gave rise to supervisory lacunae, and cases of regulatory arbitrage[2].

The Markets in Financial Instruments Directive, 2004/39/EC ('MiFID') came about as the result of a need to improve the ISD in line with the evolution of markets and the activities of IFs. This evolution made it advisable to extend the Community legal framework in order to take in the whole of this investor service range of activities. For these purposes it was desirable to achieve the necessary degree of harmonisation to provide investors with a high degree of protection and permit IFs to provide services throughout the EU, since it is a single market, taking supervision of the home Member State as basis.

In this context it should be emphasised that the MiFID and its subsidiary regulations represent an important step at European scale in achieving reasonable levels of quality in respect of the Community passport granted to IFs. The foregoing with the idea of strengthening the protection of consumers of these services, particularly individuals. Thus the importance of harmonisation of the rules which ensure greater integrity in relations between IFs and their clients, and more uniform organisational requirements which limit the regulatory arbitrage which could result from scant or excessively generic harmonisation of requirements applicable to the Community passport (organisational requirements). These are the exclusive competence of the home Member State, being that which grants the authorisation.

The MiFID eventually managed to harmonise and delineate organisational requirements and rules of conduct. Furthermore, aware of the complexity and problems which had resulted from the distribution of supervisory powers and functions under the ISD, this error was corrected and home Member State were assigned full supervision of IFs which engage in cross-border activities under freedom of provision of services, and provides that in the case of branches the competent authority of the host Member State will be responsible for supervising that the services provided in its territory comply with the obligations laid down in Articles 19, 21, 22, 25, 27 and 28[3].

2 In Recital Four the ISD provides that the principles of mutual recognition and supervision by the home Member State require that the competent authorities of each Member State should not grant authorisation, or withdraw it, where factors such as the content of programmes of operations, the geographical distribution or activities actually carried out indicate clearly that the IF has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in the Member State in which it plans or effectively engages in the majority of its activities; that for the purposes of this Directive, any IF which is a legal person must be authorised in the Member State in which it has its registered office; that an IF which is not a legal entity must be authorised in the Member State in which it has its head office; that, furthermore, Member States must require that the head office of an IF is always in its home Member State and that it actually operates there.

3 In Recital 32, the MiFID provides: "By way of derogation from the principle of home country authorisation, supervision and enforcement of obligations in respect of the operation of branches, it is appropriate for the competent authority of the host Member State to assume responsibility for enforcing certain obligations specified in this Directive in relation to business conducted through a branch within the territory where the branch is located, since that authority is closest to the branch, and is better placed to detect and intervene in respect of infringements of rules governing the operations of the branch." For these purposes it assigns responsibility for supervising compliance with Articles 19, 21, 22, 25, 27 and 28 of the MiFID in relation to rules of conduct, best execution, handling of orders, transparency and integrity of the market.

2 Levels 2 and 3 of the MiFID

The specific work of regulators started up in July 2003. It was then when the European Commission ('Commission') asked the Committee of European Securities Regulators ('CESR') to advise on implementation of the content of several Articles of the MiFID which were subject to comitology (Level 2 of the Lamfalussy scheme). It did so pursuant to the recommendations of the final report of the Lamfalussy Committee[4], of 15 February 2001, which made it possible to adopt legally-binding implementation measures by the Level 2 comitology procedure.

The CESR began work with regulators of the then 15 EU Member States, and then extended the group to the 10 new members resulting from the enlargement of May 2004. The first phase of the CESR mandate ended in January 2005, and the second in April of the same year. As from that time the Commission began to prepare drafts to give the form of legal text to the said advice, which took specific form in Directive 2006/73/EC by which the MiFID was applied in relation to organisational requirements and operating conditions for IFs, and defined terms for the purposes of the Directive, and in Commission Regulation 1287/2006 of 10 August 2006, by which the MiFID was applied in relation to the obligations of IFs to maintain a register, information on operations, market transparency, admission to trading of financial instruments and defined terms for the purposes of the said Directive.

It should be emphasised that, for many Member States, application of a large part of the MiFID provisions and the Level 2 legal texts deriving from the CESR advice will involve very significant regulatory changes, all on the basis of more stringent requirements against a background of increasing investor protection; something which benefits Spain given our condition as an importer country of investment services.

The regime of cross-border activities under Articles 31 and 32 of the MiFID was not subjected to comitology, and therefore there was no Level 2 mandate from the Commission in this respect. On this question the Commission requested advice from the CESR in the context of Level 3 on the MiFID in the form of recommendations in order to achieve a uniform interpretation of Articles 31 and 32 of the MiFID, maximum harmonisation of the procedures for notifying passports, and the establishment of bases which will strengthen collaboration between home and host supervisors, both in the process of authorisation and in subsequent supervision. Adequate supervision of cross-border activity, a

4 The final report of the Lamfalussy Committee on the regulation of European securities markets, created by the Council on 17 July 2000, argued that each Directive should in equal parts contain framework principles and non-essential technical measures for application, which should be adopted by the Commission in accordance with the comitology procedures of the EU. The Stockholm European Council on 23 March 2001 gave its agreement to the intention of the Commission to establish a Committee on securities, which would have to act as regulation committee to assist the Commission when the latter adopted measures for application in accordance with the comitology procedure adopted. Thus, by means of this procedure, the European Commission is allowed to develop technical questions (Level 2) relating to the general principles established in the Directive (Level 1) with the technical advice of the Committee of European Securities Regulators (CESR) and favourable vote of the Securities Committee on which the administrative bodies are represented entrusted with preparation of the rules of Member States. Uniform application of the regulation, through recommendations, interpretations, etc. without legal force, likewise comes from the CESR (Level 3). Enforcement is the direct responsibility of the European Commission (Level 4).

distribution of supervisory tasks and, of course, proper co-ordination between supervisors, make up the key elements for the system to be effective.

3 CESR Level 3 document: passports under the MiFID

The principal questions dealt with in the Level 3 document prepared by the CESR "*The Passport under MiFID*[5]" , are as follows:

- Timetable in notification procedures.
- Division of responsibilities between the home/host supervisors in relation to branches.
- Passport of tied agents.
- Passport of multilateral trading facilities.
- Activities of representative offices.
- Transitional agreements.
- Additional harmonisation by establishment of a protocol between competent authorities.

We will now examine the contents of each section, entering fully into the CESR Level 3 document:

3.1 Timetable in notification procedures

The chapter relating to the timetable for notification procedures is fundamental when bringing about maximum harmonisation and uniform interpretation as to the time from which an IF to which a passport has been granted can begin providing investment services in the host Member State. This question, which may in principle look very simple, has given rise to many interpretative disagreements and a lack of co-ordination among supervisors of the home and host Member States.

The MiFID, as with the ISD, provides for maximum periods for the IF to be able to operate in the host Member State, but neither avoids nor resolves other types of question such as simultaneous registration in the home and host Member States, the contents of communications between supervisors, etc., which came to light with the experience of the ISD, and thus the need for the MiFID Level 3 to resolve these matters.

It should be said that this has not exactly been the subject to controversy in the

5 CESR/07-337. *The Passport Under MiFID. Recommendations for the implementation of Directive 2004/39/EC.* May 2007.

consultation published before approval of the CESR document. It seems justifiable that the industry has not made an impression on the question we are concerned with, since this is a question of procedures between supervisors without any repercussions on IFs covered by the passport.

With the Level 3 document, the CESR has managed to harmonise the contents and form of communications, and the periods and time when IFs must be included in the corresponding registers. Once again, experience will show whether the recommendations proposed in that document will be sufficient to avoid the errors and defects detected up to now.

3.2 Division of responsibilities between the home and host supervisors regarding branches

Without doubt the most important debate which has arisen over the course of meetings of the CESR intermediary experts group derives from the division of responsibilities between home/host supervisors regarding branches. This has also been the most controversial matter for the industry as far as the document is concerned. This has been shown by several responses from the sector to public consultation in which, again, a response has been missed from any representatives of the Spanish industry, which is at least surprising since it is a matter of particular importance in a country such as Spain which is one of the biggest recipients of passports throughout the EU.

According to Article 32.7, the supervision of organisational requirements is reserved to the supervisor of the home Member State origin, whilst the supervisor of the host Member State is made responsible for supervision of certain obligations, particularly rules of conduct. The main problem is found in cases when a branch may at the same time engage in cross-border activities and provide services in a third Member State in relation to that in which it has become established; an aspect which was not covered by the Directive but which came to light in the Level 3 experts working group. Co-operation between supervisors and the delegation of supervisory tasks has become fundamental to resolving this question.

In addition, the solution adopted for the division of responsibilities between home and host supervisors in relation to branches will be applicable to tied agents, insofar as the second paragraph of Article 32.2 of the MiFID provides that "*In cases where an investment firm uses a tied agent established in a Member State outside its home Member State, such tied agent shall be assimilated to the branch and shall be subject to the provisions of this Directive relating to branches*".

The document was drawn up however taking into account that some aspects are subject to interpretation by the Commission and consequently the corresponding consultation has been raised. Specifically, interpretation has been requested of the expression "*within its territory*" which is included in Article 32.7 of the MiFID ("*The competent authority of the Member State in which the branch is located shall assume responsibility for ensuring that the services provided by the branch within its territory comply with the obligations...*"), since there is no consensus as to its meaning. This interpretation is of vital importance in determining the supervisor responsible for the obligations reserved to the supervisor of the host Member State when the IF provides its services through a branch in a third Member State different from the State in which the branch is domiciled. Thus, for some time firms designed the structures of their branches in order to be able to provide services under the regime of freedom of provision of services in adjoining States. It is very common, for example, for the person responsible for a branch of a foreign IF in Spain to assume responsibility for business in Portugal, a country in which it acts under the regime of freedom of provision of services. In these cases the possibility has been raised of delegating supervision of various aspects, basically those relating to relations with clients, to the competent authority of the Member State where the branch is located. This practical problem was not contemplated by the MiFID but has arisen at CESR working groups.

Consequently, the only recommendation which the CESR issues under this heading is to encourage Member States to commit themselves to continue working to find a means of practical co-operation when dealing with the supervision of branches. It is intended to resume the Level 3 work of the MiFID shortly, since it seems clear that the success or failure of cross-border activities, and in short of the MiFID, to a large extent depends on co-operation and possible delegation of supervisory functions between regulators. Agreements reached in the near future will be of particular importance in developing the European passport which, in short, is a decisive step for achieving the single European market and the European project itself.

3.3 The passport of tied agents

The MiFID also provides the possibility for IFs to engage in their activities through tied agents. The ISD only mentioned agents in its recitals and Article 1. Its wording and the lack of effective development gave rise to different interpretations and, in short, uncertainty. The MiFID regulates cross-border activity by means of the use of agents subject to exclusivity, resolves the problem which as a result of lack of definition was raised by the ISD, and indicates the importance of agents to the development of cross-border activity, since their use may involve a large increase in foreign entities operating in other Member States with relatively low costs and therefore the ability to affect markets of the Member States which traditionally receive passports.

The main problem of interpretation which was faced by the CESR in this area arose from the second paragraph of Article 32.2 of the MiFID which provides that "*In cases where an investment firm uses a tied agent established in a Member State outside its home Member State, such tied agent shall be assimilated to the branch and shall be subject to the provisions of this Directive relating to branches*".

The difficulty consisted in clarifying the meaning of the words "shall be assimilated". The problem subject to discussion in the group was resolved by a consultation with the Commission which interpreted that the final paragraph of Article 32.2 must be read in conjunction with Article 31 which regulates freedom of provision of services. The Article states that an IF may engage in free provision of services in another Member State by using agents. Thus, in the case of an IF which provides services in another Member State by the use of an agent established in the said Member State, it must be considered that the IF is "*established*" in the said Member State and therefore the agent must be considered for the purposes of his supervision as if he were a branch (basically the rules would be applied of the host Member State with respect to rules of conduct, best execution, transparency, etc.). If the agent is not established in the Member State where the investment service is provided, Article 31.2 of the MiFID would be applied and all rules of conduct would be those of the home Member State.

In order to close this section it must be emphasised that while activities through agents in Spain have been provided for since entry into force of the Securities Market Act, 24/1988, for many Member States activities through agents is totally novel.

3.4 The passport of multilateral trading facilities

The MiFID provides that Member States must permit IFs and market managers who operate a multilateral trading facility (MTF) to establish appropriate mechanisms in their territory to facilitate remote access and use of their systems by users or participants established in the territory of the said Member State. It further provides a procedure for communication between the home and host Member States.

The problem of interpretation which could arise from Articles 31 (5) and (6) lies in elucidating whether there is cross-border activity or not when the MTF houses an automatic platform with direct access to users or participants in the territory of other Member States. In this respect the CESR considers that, based on the so-called connectivity test, it must be considered that cross-border activity exists under free provision of services.

Nevertheless, it must be stated that during the period in which the document was subject to public consultation, this matter had minimal effect in the sector.

3.5 The activities of representative offices

Although the MiFID does not mention representative offices, experience over the course of all these years provided by the ISD makes it desirable for the CESR to assess their inclusion in the passport document. Despite not being regulated in many Member States however, it seemed desirable to clarify some questions which arose over the course of the ISD and issue a series of recommendations in this respect.

The representatives of Member States attending the Level 3 negotiations reached a consensus in not identifying representative offices with branches since the former, unlike the latter, have the sole purpose of promotional or advertising activities for their parent and never that of engaging in investment services or activities. However, some Member States considered that the activity of promoting an investment service was an intrinsic part of the investment service which, even though not carried out in the host Member State, was in fact "initiated" in it. After various discussions agreement was therefore reached to consider that when a representative office is established in a Member State away from that of the parent, the competent authority of the home Member State would notify that of the host Member State pursuant to Article 31 of the cross-border activity based on free provision of services.

3.6 Transitional agreements

The MiFID provides that passports notified and in force under the ISD should be recognised as valid when implementing the MiFID, i.e. as from 1 November 2007.

The CESR is aware, however, that this automatic recognition will inevitably lead to additional inconsistencies and complexities, with particular effect in the event that an IF wishes to extend the investment services and/or activities of its passport. In an attempt insofar as possible to mitigate or avoid these problems, the CESR has prepared a proposal in the form of a table of equivalences in order to update and adapt registers, including the new 'MiFID' definitions and nomenclature of investment services and activities and the instruments with which they may be provided.

3.7 Additional harmonization by establishment of a protocol between competent authorities

By means of this protocol the CESR is seeking a three-fold objective. Firstly to strengthen collaboration between competent authorities in cross-border activities, secondly to achieve maximum harmonisation of passport notification procedures, and finally to improve information for and contact with the public.

4 Conclusions

The Commission has indicated on occasions that the MiFID does not give rise to a single supervision and that on many occasions there will be duality. Apart from arriving at delegation and collaboration in the supervisory field, mutual recognition, convergent interpretations, etc., which are of course highly necessary taking into account that the basis for proper functioning of the single European market is confidence between all supervisors, it is fundamental to determine who will carry out supervision in order to avoid regulatory arbitrage and increase transparency in relation to the industry. After this question is settled there must be delegation or the corresponding practical solution sought.

Lamfalussy Level 3 is the practical level *par excellence*, precisely designed to achieve uniform application of regulation through practical recommendations, interpretations or improvements in order that Member States avoid disparate interpretations.

The work which must now be undertaken by the CESR experts group without doubt constitutes an unprecedented challenge as a result of its nature and importance, a challenge which must demonstrate the proper functioning and maturity of the Lamfalussy procedure and, in short, of European regulation.

The agreement which is eventually adopted between the competent authorities to deal with the division of responsibilities, and the response to the consultation made to the Commission, will be of especial importance to the CNMV in relation to allocation of the human and technical resources necessary for adequate supervision of branches domiciled in Spain, above all if the final solution takes in cooperation and delegation of tasks between supervisors.

CESR Recommendations on Inducements in the sphere of the MiFID

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1 Introduction

Article 19 of Directive 2004/39/EC (MiFID) sets out the obligation for investment companies to act honestly, impartially and professionally, in the best interests of their clients, when providing investment and ancillary services.

The European Commission's Directive 2006/73/EC, enforcing Directive 2004/39/EC with regard to the organizational requirements and the operating conditions of investment companies, and terms defined for the purposes of the said Directive, establishes additional requirements for the fulfilment of this obligation. In its article 26, under the heading of Inducements, it stipulates the requirements that must be met in connection with the receipt or payment of both fees and commissions as well as non-monetary advantages by investment companies in connection with the rendering of investment or ancillary services.

Starting from the publication of Directive 2006/73/EC, the European Committee of Securities Regulators (CESR in its Spanish acronym) held a mandate to develop a consensus document among its members on the rules established in the sad article.

The so-called "level 3" of the Lamfalussy scheme, entrusted to CESR, has the goal of ensuring the consistent implementation and application of the European regulations on securities markets. Its works are materialized in the form of guidelines that are later adapted to the national level, recommendations and standards or benchmarks and reviews of regulatory practices.

In the case of inducements, the work carried out by the CESR has taken the form of Recommendations[1] in order to facilitate the consistent implementation of article 26 of Directive 2006/73/EC, without attempting in any case to impose additional obligations for investment companies.

When drafting these Recommendations, the CESR has held in high regard the main goal of the regulations developed under the heading of Inducements in the scope of the MiFID: protecting investors.

Furthermore, the CESR has been careful not to discriminate between the different types of financial products and the recommendations are therefore applied to all the financial products included within the scope of the MiFID (annexe I, section C). On the other hand, they are only applicable to the institutions included within the scope of the MiFID.

During the consultation proceedings that have taken place so that the CESR can take into account the opinion of both the sector and consumer organizations (two of the public consultations held with their respective *open hearings*), the controversy stirred up in the sector has been more than evident.

1 CESR/07-228b. *Inducements under MiFID Recommendations*. May 2007.

In some cases it was pointed out that the CESR's actions favoured savings sectors other than the financial sector, such as insurance, by imposing stricter operating conditions on the first than those in place in other sectors, or by being very restrictive in its recommendations on inducements.

However, it is important to remember that, first of all, the operating conditions on the financial market are not imposed by the CESR but by the European institutions in the exercise of their powers, so it is up to these institutions, where necessary, to take measures so that different savings products can compete on a similar footing. With regard to this possible regulatory arbitration indicated by the sector, the CESR pointed out that its only possible action is to highlight this to the European Commission so that it can be borne in mind for the drafting of future regulations.

In connection with the new restrictions or requirements imposed on certain payments/collections following the entry into force of the new regulations, it is important to point out that the CESR did not create any of them, rather they are imposed by article 26 of Directive 2006/73/EC.

In this sense, the CESR's recommendations are not an attempt to impose new obligations or requirements but to explain some of the concepts included in the regulations, such as the increase in service quality or the reference to the nature of the expenses included in part (c) to facilitate their application and make them more flexible.

Finally, it is important to recall that the recommendations given by the CESR are in no case regulatory and they therefore cannot create obligations other than those contained in the Directives, nor can they be used to facilitate the avoidance of their fulfilment.

For this same reason, their application in the supervisory practices of the countries that are members of the CESR is voluntary. Nonetheless, as they have been reached by consensus, they must be taken advantage of as an element to facilitate supervisory convergence throughout the European Union by helping investment companies to anticipate how the provisions contained in the regulations are going to be construed by the supervisors.

2 Content of the recommendations carried out by the CESR in connection with article 26 of European Commission Directive 2006/73/EC

The work carried out by the CESR has been materialized in six Recommendations, some examples to illustrate their operation and, finally, a series of annexes that attempt to describe schematically the operation of the different requirements contained in article 26 of the European Commission Directive 2006/73/EC. Because of their didactic interest, these annexes have been included at the end of this article.

2.1 Scope of application of the measures foreseen in the heading "inducements" (Recommendation 1 CESR)

The first of the Recommendations revolves around the scope of application of article 26 of Directive 2006/73/EC.

Article 26 begins by establishing that "The Member States will ensure that the investment companies are deemed not to be acting honestly, impartially and professionally in accordance with their clients' best interests if, in connection with the provision of an investment or ancillary service to the client, they pay or receive any fee or commission or if the provide or obtain any non-monetary benefit". Three exceptions to this rule are then established, whereby the entity is considered to be acting in the client's best interest when it receives or pays certain fees, commissions or non-monetary benefits.

In this first paragraph the Directive sets the scope of application of article 26. Based on its contents, the CESR points out that the restrictions appearing therein cover "all fees, commissions and non-monetary benefits paid or received by an investment company in connection with its rendering to a client of an investment or ancillary service". In addition, it also specifically establishes that those considered as market standards are also included in the scope of application.

Without a doubt, this has been one of the scopes subjected to the greatest debate and controversy throughout the consultations with the sector and consumer organizations, as many people considered the scope of application established by the CESR to be mistaken.

On the one hand, the sector argued that the standard commissions lay outwith the scope of application of this article and that, even if this were not so, they would in any case fall outside the scope of application of the second of the exceptions established in the Directive (as we shall see below, payments admitted under this exception require prior information to clients regarding their existence, a requirement that does not exist in the other two exceptions in article 26).

On the other hand, the sector argued that the concept of conflicts of interest is implicit in the concept of inducement and, therefore, article 26 would only be applicable when these collections or payments or the receipt of non-monetary benefits were liable to bias the provision of the service to the client. The regulations on inducements, according to these arguments, should always be contemplated in the context of article 21 of Directive 2006/73/EC.

The CESR put great stock in these arguments by the sector but concluded, nonetheless, that the approach given to the scope of application in its document was correct and that the sector's arguments lacked adequate legal basis for the following reasons:

- First of all, the text of article 26 refers to "all fees or commissions" throughout its text and not to "payments giving rise to conflicts of interest".

- Secondly, article 26 explicitly contains payments that, by their nature, are not going to create conflicts of interest, such as, for instance, “commissions, fees or non-monetary benefits paid to the client”. It is evident that such payments are never going to constitute a conflict of interest.

- Lastly, article 26 must not be interpreted within the scope of article 21 of the same Directive for the following reasons:

  - The legal basis of article 21 lies in articles 13.3 and 18 of the MiFID, which refer to organizational requirements and operating conditions of investment companies. In accordance with these precepts, investment companies must adopt reasonable measures to detect conflicts of interest that might arise in the provision of an investment service. When these measures are not sufficient to ensure that the risks of harm to client interests will be prevented, the investment company must disclose their existence to the client. Similarly, article 21 of Directive 2006/73 obliges the entities to identify and manage conflicts of interest.

  - The legal basis of article 26, however, lies in article 19 of the MiFID, specifically in article 19.1. Article 19 forms part of Section 2 in chapter II of the MiFID entitled “Provisions to ensure the protection of investors”. According to these provisions, investment companies have to act honestly, impartially and professionally, in the best interests of their clients. Both the content of this provision and the fact that it has been included in the section on investor protection show that its scope is very extensive and goes beyond the mere avoidance of conflicts of interest. The scope of application of article 26 is, therefore, different and more extensive than that of article 21. Interpreting article 26 in the context of conflicts of interest would, without a doubt, lead to a restriction of its intended scope.

Apart from these arguments about the different legal basis for both precepts, there are other reasons supporting the different approach given to the scope of application.

Thus, the other precepts included in the same article 26 are consistent with this approach. For a payment, commission or fee to be allowed, it must not only not hinder the fulfilment of the entity’s obligation to act in its client’s best interest, implying the avoidance of conflicts of interest; it must also increase the quality of the service rendered to the client.

CESR explains how article 26 does not in any case include payments made within the same entity, such as for example bonuses, even though these payments might give rise to conflicts of interest included in Article 21 of the Directive.

On the other hand, article 26 refers solely to payments or collections made or received by the entity, whereas through the concept of “competent or related persons” the rules on conflicts of interest may be applicable to individuals conducting their professional activity in the entity.

Since the entity has to act in its client’s best interest, it is not possible to exclude from the application of these rules those cases in which a payment does not create a conflict of interest but at the same time is not helping the client's best interest. This is why all of the payments made or received in the provision of a service are included in the scope of application of article 26.

In addition, with respect to the scope of application of article 26 as defined by the CESR and, apart from the arguments set out, it is pertinent to point out that the European Commission has given its agreement to the approach used by the CESR.

In connection with the controversy stirred up by the scope of application of article 26, it is important to point out that the fact of including a payment or collection within it does not in any way mean that the such payment or collection is not allowed. As explained below, article 26 itself establishes three exceptions in which these payments and collections are admitted, with no additional requirement in two of them.

The financial services industry, in its comments to the first of the CESR's drafts, expressed its concern at the fact that the different handling of payments to/from entities outside the investment company's group vis-à-vis the intra-group payments might harm the development of the so-called open architecture.

Nonetheless, this has never been the spirit of the CESR in any of the versions carried out in connection with the regulation of inducements but, so that there is no doubt in this regard, this first Recommendation referring to the scope of application of the regulations on inducements includes an explicit mention of the fact that all the Recommendations contained in the CESR document are equally applicable to the payments or non-monetary benefits provided by an entity other than the one rendering the investment service, regardless of whether or not it belongs to the group.

2.2 Payments made to the client or to a person acting on his or her behalf (Recommendation 2 CESR)

After establishing that the investment companies will not be acting honestly, impartially and professionally in accordance with their clients best interests if they pay or receive any fee, commission or non-monetary benefit in connection with the provision of an ancillary or investment service to a client, article 26 establishes three exceptions in which the receipt of commissions or other payments by the entity are compatible with its obligation to act for the benefit of the client.

The first of these refers to the case where these payments, commissions or non-monetary benefits are paid to or by the client or to/by a person acting on behalf of the client.

The application of this exception does not in principle present any difficulty. Nonetheless, the CESR provides some clarification.

First of all, it should be noted that, in all situations where a client negotiates or pays a commission, this payment clearly falls within the exception stipulated in article 26 (a). The fact that the payment falls within the first of these exceptions has the direct result that the additional requirements established for the other exceptions, such as the obligation to provide information, are not applicable.

The CESR highlights that the fact that the article devoted to inducements does not establish information obligations with respect to these payments does not imply that they are not subject to this obligation through other precepts in the MiFID, especially article 19.3. This clarification was interpreted by part of the sector as an attempt by CESR to extend the information obligation stipulated in article 26 (b) for certain payments to all of the payments included within the scope of application of the rules on inducements.

Nothing could be further from the intention of the CESR. Quite the contrary, what it is trying to highlight is that these payments may or may not be subject to certain obligations pursuant to article 26, but this does not in any way exclude application of the other obligations established in the MiFID in this regard.

With respect to the person "acting on the client's behalf", the CESR noted that it is necessary for it to be an independent third party with no relation to the entity rendering the service (such as a lawyer or an accountant). The fact that there is a separate, specific instruction from the client to the investment company to make or receive payment on his or her behalf would be a very relevant factor when it comes to identifying payments made on the client's behalf.

2.3 Conditions that must be met by other payments/collections in order to comply with the requirements stipulated for inducements

The conditions established in part (b) of article 26 for certain payments/collections related with the provision of the investment service to be admissible have stirred up a great deal of controversy. According to this part, two conditions are required:

- The client must be clearly informed of the "existence, nature and amount of the fees, commissions or benefits, or, if the amount cannot be determined in advance, the method for calculating the amount", in a "complete, exact and intelligible" manner prior to the provision of the ancillary or investment service.

- This fee, commission or non-monetary benefit must increase the quality of the service rendered to the client and it must not hinder the fulfilment of the company's obligation to act in the client's best interest. While these demands are drafted as a single requirement, it must not be forgotten that they are two different conditions to be borne in mind and complied with jointly.

This second demand has caused a certain upset in the sector because of the difficulty of specifying what supervisors are going to understand by "increasing service quality".

2.3.1 Factors to be taken into account to verify if the conditions stipulated in connection with the increase in service quality and the obligation to act at all times in the client's best interests are complied with (Recommendation 4 CESR)

In order to give the maximum possible flexibility to this issue, the CESR indicates that it is not possible to draw up a list of conditions to be met. This approach is in line with the method followed in the MiFID, a regulation based on principles and not on check lists. Thus, the way to analyze whether or not a payment is improving the service provision is to consider a series of factors emerging in each situation.

These factors must not be viewed as obligations to be fulfilled by the entity but rather as tools that the entities can use to analyze whether or not the service quality has increased and whether there has been any hindrance or impairment of the entity's obligation to act at all times in the client's best interests. It should not be seen as an exhaustive list in which all are applicable to all cases. It is up to the entity to decide which ones to use in each case. Nor should it be ignored that there may be other pertinent factors that are applicable in different cases.

The list of factors proposed by the CESR is as follows:

a) The kind of investment or ancillary service that is being provided to the client, as well as other obligations apart from those stipulated in this article.

   In connection with this factor, it must be remembered that many of the obligations established in other spheres of the MiFID may help to verify whether the obligations stipulated for inducements are being met. In particular, the principle of better execution is particularly pertinent in this area, as well as potentially the rules on handling conflicts of interest.

b) The benefit that can be expected for the client and the benefit that can be expected for the entity. This analysis can be carried out for a single group of clients, where a group of clients is taken to be those receiving the same service.

   It is important to point out that this factor is not intended to be a test of the proportionality between the respective expected benefits. When it comes to analyzing this factor, consideration must be given to whether or not the entity is going to receive payment from a third party at a cost that is somehow going to be passed on the client. It is to be hoped that some benefit should derive from this situation for the client and this should be large enough to consider that the entity is really acting in the latter's nest interest.

c) The fact that there is an inducement for the entity to act differently from what might be in the client's best interests may be causing the entity to change its behaviour.

   Although the suite of factors as a whole that may be pertinent in each case will always interact, there is no denying the importance acquired by this individual factor whereby it would be difficult, if not impossible, for the result of the analysis to be positive if the entity answers on this point that it has changed its behaviour because of the payment received and is acting in a way that is different from what would represent acting in the client's best interests.

   With regard to the mention made in the first of the factors to other obligations derived from other spheres of the MiFID, the analysis of this factor highlights the potential importance of the measures adopted for dealing with conflicts of interest. However, it is important to note that the measures for handling conflicts of interest may be considered as a complement to the measures adopted in connection with inducements, although in no case do they replace them. In other words, the fact that the provisions regarding the handling of conflicts of interest are being complied with is no guarantee that those referring to inducements are being met since, as has already been said, both of these have different scopes, with the scope of application of the measures under article 26 being wider than the scope of application of the measures for dealing with conflicts of interest.

d) Any kind of relationship existing between the investment company and entity making the payment or collection of the benefit.

   This factor is not intended to stress the fact of whether the two entities under consideration in the analysis belong to the same group[2] but rather to relationships such as competition, possible existence of commercial agreements and others that may exist in certain cases.

e) The nature of the asset received and other circumstances regarding it. This factor is of particular relevance in the case of non-monetary benefits.

As for how this test should be conducted, it is important to point out that, whereas the Spanish version of Directive 2006/73/EC stipulates that "the payment of fees or commissions or the provision of non-monetary benefits must increase the quality of the service rendered to the client...", the English version stipulates that it "must be designed/planned to increase service quality".

In this case it is clear that the expression "designed/planned to increase quality" highlights the regulator's intention that the test or valuation of fees, commissions or non-monetary benefits can be effected once the specific agreement is reached with the paying/recipient entity and not once the payments/collections have been effected.

On the other hand, the CESR considers that there may be a situation in which the payment/collection benefits other clients, as well as the main client receiving the service. In this case, the assessment of the increase in quality may be effected at the "service leve l", in other words, for all the clients who are going to enjoy the same service.

2.3.2 Conditions that must be met by the information requirement referred to in article 26 part (b) (Recommendation 6 CESR)

The second of the conditions established in part (b) of article 26 for some payments/collections to be admissible refers to the need for the client to be informed of the "existence, nature and amount of the fees, or, if the amount cannot be determined in advance, the method for calculating the amount".

2 It has already been shown that the treatment given to payments between entities in the group must be the same as that given to payments by entities outwith the group.

With regard to the minimum content of this information, the CESR has not made any recommendation as it is felt that this is clearly reflected in Directive 2006/73/EC. The only clarifications the CESR considers it is appropriate to add are as follows:

- General information referring only to the possibility that the investment company may receive these inducements is not considered sufficient for the client to be able to reach a sufficiently informed decision.

- The summary referred to in the last paragraph of article 26, regarding the possibility that the Member States may allow investment companies to provide information in this way, must contain sufficient information for the client to be able to take a sufficiently informed decision.

- The information in question must always be drafted by the entity rendering the ancillary or investment service to the client and given in connection with each of the services rendered.

2.3.3 Conditions established in connection with advice on investment matters or general recommendations (Recommendation 5 CESR)

As we have indicated, this second condition implies simultaneous compliance with two different requirements: an increase in the quality of the service provided to the client and the absence of any hindrance to the company's obligation to act in the client's best interests.

With respect to meeting these conditions, recital 39 of the Directive 2006/73/EC is particularly pertinent in that "For the purposes of the provisions contained in the present Directive regarding inducements, the receipt by an investment company of a commission for advice on investment matters or general recommendations, in circumstances in which the advice or recommendations do not take on any bias as a result of the said commission, must be deemed to respond to the purpose of increasing the quality of the advice on investment matters given to the client".

In connection with this recital, questions have been raised about its scope and whether it was intended to be an exception to the requirements stipulated in article 26 part (b), accepting as valid all payments made in connection with the provision of financial advice or general recommendations, insofar as these services are not biased.

In this sense, the CESR has understood that part (b) of article 26 contains a test with two conditions, apart from the information requirement. Thus, insofar as the advice is not biased, one of these is met ("increase in service quality") but regard must be had for the fulfilment of the other condition that there is "no hindrance to the company's obligation to act in the client's best interests", therefore it continues to be necessary to analyse compliance with the test included in part (b) of article 26 when advice is given and, of course, comply with the requirement of informing the client.

In connection with the fulfilment of the first of the conditions, "increasing the quality of the service", the CESR stipulates that there are other spheres to which the presumption that the quality of the service has increased might be extended.

In a clear exercise designed to make the requirements contained in article 26 more flexible for the acceptance of certain payments/collections, it establishes the possibility of extending this presumption to other cases. For example, when the supplier of a product pays an investment company for the distribution of its products without any advice or general recommendations. If we interpret, as does the CESR, that these products would not be distributed in the absence of such payments and, therefore, that no investment service would be rendered, then these payments could be interpreted as increasing the quality of the service by allowing the investment company to offer a wider variety of products to its clients. All of this is without forgetting, as in the previous case, the other obligations established in the Directive, the entity's obligation to act in the client's best interests and the provision of the necessary information about the payments/collections affected by the analysis.

2.4 Payments/collections that, by their nature, do not come into conflict with the obligation to act honestly, impartially and professionally in pursuit of the clients' best interest (Recommendation 3 CESR)

Directive 2006/73/EC considers a third exception whereby payments made/ collections received from a third-party entity in connection with an investment service conform to the obligation to act in the client's best interests.

This exception refers to the case of "appropriate fees allowing the provision of the investment services or that are necessary for this purpose, such as custody expenses, settlement and exchange expenses, regulators' levies or legal advice expenses and which, by their nature, cannot come into conflict with the company's duty to act honestly, impartially and professionally in pursuit of the clients' best interests".

With regard to this third exception, the CESR has focussed on highlighting that the expenses mentioned there are not exhaustive and that this exception includes all those payments and collections made which pass the test of not coming into conflict with the client's best interests "by their nature".

The industry pointed out that all payments/collections "that had not" prevented the entity from acting in the client's best interests would fit in this exception. However, it cannot be concluded that that was the will of the lawmaker, as the entity's obligation to act in the client's best interests is imposed by other rules, not just the Directive 2006/73/EC but also the MiFID itself and it must be complied with in any case, therefore without the acceptability or otherwise of the payments/collections generated around the provision of the service depending on such compliance.

In the opinion of the CESR, an examination must be made of their "nature" and, therefore, the possibility or otherwise of influencing the behaviour of the entity rendering the service and not the entity's ultimate action which, in any case, must be subject to the obligation stipulated in article 19.1 of the MiFID.

3 Application of the Recommendations contained in the CESR document

The CESR has been aware of the difficulty implied, in general, by the application of regulations based on principles for certain Member States and hence, the difficulty implied by the practical, specific application of the Recommendations contained in the document on inducements to the day-to-day activities of the entities.

Through several fora, the sector suggested the possibility that the CESR should draw up "lists" of "accepted" and "prohibited" practices. However, the CESR discarded this idea because they might be quickly outdated, in view of the constant innovation in products and in distribution channels and, as a result, in how entities remunerate each other.

Nonetheless, the CESR has included a list of examples illustrating the application of these recommendations and the most relevant factors for application of article 26 (b). The CESR particularly stresses the purely didactic purpose of these examples, with each case having to be decided on its own particular circumstances with no extrapolation of the conclusions except with a complete analysis of each context and the set of circumstances. These examples are summarized below for their special interest.

I. An entity's client agrees to pay a charge of 10 euros/hour, apart from the disbursements necessary for the investments themselves, for the provision of an advisory service. The investment company bills € 100 for 10 hours' work, in addition to the 200 euro charge for the investments made. The client pays the bill directly or gives instructions for the accountant to do so.

   This payment is clearly effected by the client or a person acting on his or her behalf so it falls directly in the first of the exceptions established in article 26 (a).

II. A client with an entity that provides a portfolio management service agrees to pay a commission of 1% per annum on the assets managed. This commission will be levied directly on the client's assets.

   The charging of the commission on the assets managed is clearly a payment effected by the client and therefore, like the preceding case, falls within the exception in article 26 (a).

III. A client of entity A agrees on the payment of a commission. The client gives instructions to entity C to pay the sums due directly to A. At any moment, the client may instruct C to cease these payments.

   Once more we would be facing one of the cases where 26 (a) is applicable as C is "an entity acting on behalf of the client" and not an independent third-party entity that would require application of the conditions imposed by article 26 (b).

IV. A client with an entity that provides a portfolio management service agrees to pay a commission of 1% per annum on the assets managed. This commission will be levied directly on the client's assets. The entity providing the portfolio management service arranges with a broker that 20% of the brokerage commissions will be reimbursed to the portfolio manager above a certain volume.

The 1% commission for the portfolio management service is a payment made by the client and is therefore in the scope of article 26 (a). As for the rebate received by the portfolio manager, this is a payment made by a third party and does not fit in with the exceptions in letters (a) or (c), so it has to comply with the conditions stipulated in part 26 (b). To this end, it is necessary to take into account the factors indicated by the CESR, as the agreement seems to benefit solely the entity that will have an inducement to operate through this broker without any noticeable increase in the service quality. The following factors would be particularly significant for assessing this situation: "type of service rendered" (a), " expected benefit for the client and entity" (b) and "existence of inducements to change the entity's behaviour" (c).

V. An entity renders a portfolio management service to a client and charges a commission for this. The entity acquires certain financial instruments for the client's portfolio and the party providing these instruments pays a commission to the investment company calculated on the amounts charged to the client.

The receipt of an additional commission over and above that charged to the client for the portfolio management service is clearly "of a nature" that may come into conflict with the entity's obligation to act in the client's best interests. A clear option for the entity would be to pass these collections on to the client. Otherwise, it should be examined with great attention, as it is considered difficult for the rest of the conditions stipulated in article 26 (b) to be met.

VI. A client C at an entity F wishes to operate with instruments that F does not offer. For this reason, the entity F presents the client to entity A, and C becomes its client. A renders investment services to C and charges brokerage commissions. A passes back part of these commissions to F.

This arrangement must be considered from the dual perspective of F and A as both are investment companies.

In the opinion of the CESR, the payment made by entity A would be covered by part (b) of article 26 and can be considered to increase the quality of the service rendered to the client. The client must be informed of this payment and the entity must comply with the obligation to act in the client's best interest.

In the same way, F will have to give careful consideration to whether this arrangement meets the requirements established in part (b) using the factors indicated by the CESR in its recommendations.

VII. An investment company providing an advisory service or giving general recommendations to a client transmits orders on the client's behalf to the suppliers of products. It does not charge its client any commission but receives a rebate from the product suppliers.

Starting from the basis that the advice or recommendation is not biased as a result of the receipt of commissions by the entity, then their receipt must be considered as an increase in the quality of the service as provided in recital 39 of the Directive. The other conditions of article 26 (b) must be complied with and the factors indicated by the CESR for the purpose will be particularly pertinent.

VIII. We are facing a case similar to the above, but on this occasion the entity providing the service receives an additional payment whenever a certain level of turnover is achieved with the product supplier.

In this case, the factors of "expected benefit for client and entity" (b), "existence of inducements to change the entity's behaviour" (c) and "nature of the asset received" (e) will be particularly pertinent to assess this arrangement and it is difficult for the requirements of article 26 (b) to be complied with. As the turnover comes closer to the threshold needed to collect the additional payment, the entity will be more inclined to furnish advice biased towards the acquisition of this product, to the detriment of its obligation to act in the client's best interests.

IX. An investment company that does not provide a financial advice service nor general recommendations has a distribution or placement agreement with a supplier of the product or the issuer from which it receives a commission.

In this case, it could be thought that, in the absence of this commission, the provision of the service would not take place so these payments must be understood as designed to increase the quality of the service. The other requirements of article (b) must be fulfilled and factor (c), "existence of inducements to change the entity's behaviour", would be particularly pertinent.

X. An investment company renders an ancillary advice service with regard to capital and industrial strategy. To this end, it incurs legal advice expenses that it does not pass on to the client.

These expenses are fully covered by the exception stipulated in article 26 (c).

XI. A product supplier provides training for the employees of an investment company rendering a financial advice service.

The training is an example of a non-monetary benefit. In order to evaluate its acceptability under article 26 (b), the factors of "expected benefit for client and entity" (b), "existence of inducements to change the entity's behaviour" (c) and "nature of the asset received" (e) would be particularly pertinent. For example, it will be necessary to assess the relationship between the training programme and the service provided to the client. If, in addition, the training were to take place, for instance, within the context of a holiday at an exotic destination, it is likely that it would not fit in with the investment company's duty to act in the client's best interests.

XII. A broker provides an investment company with software.

This is an example of a non-monetary benefit and falls under the cases stipulated in letter (b) of article 26. Once more, the factors of "expected benefit for client and entity" (b), "existence of inducements to change the entity's behaviour" (c) and "nature of the asset received" (e) will be of particular importance to confirm whether this situation complies with the requirements stipulated. The assessment of this kind of case will require the specific examination of the circumstances surrounding each one. The more directly the software or equipment in question is related to the services provided to clients, the easier it will be for the situation to fit in with those allowed by the requirements in this part.

4 Conclusions

Following the publication of the Commission's Directive 2006/73/EC and the new approach contained in it regarding the payments received or made by the entities in connection with the provision of investment services, it was considered necessary for the CESR to publish an explanatory document in the light of the new concepts that appeared, such as the increase in the quality of the service or the nature of the expenses.

CESR has tried to explain simply the operation of the Directive's article 26 mentioned in the preceding paragraph and on the basis of practical examples.

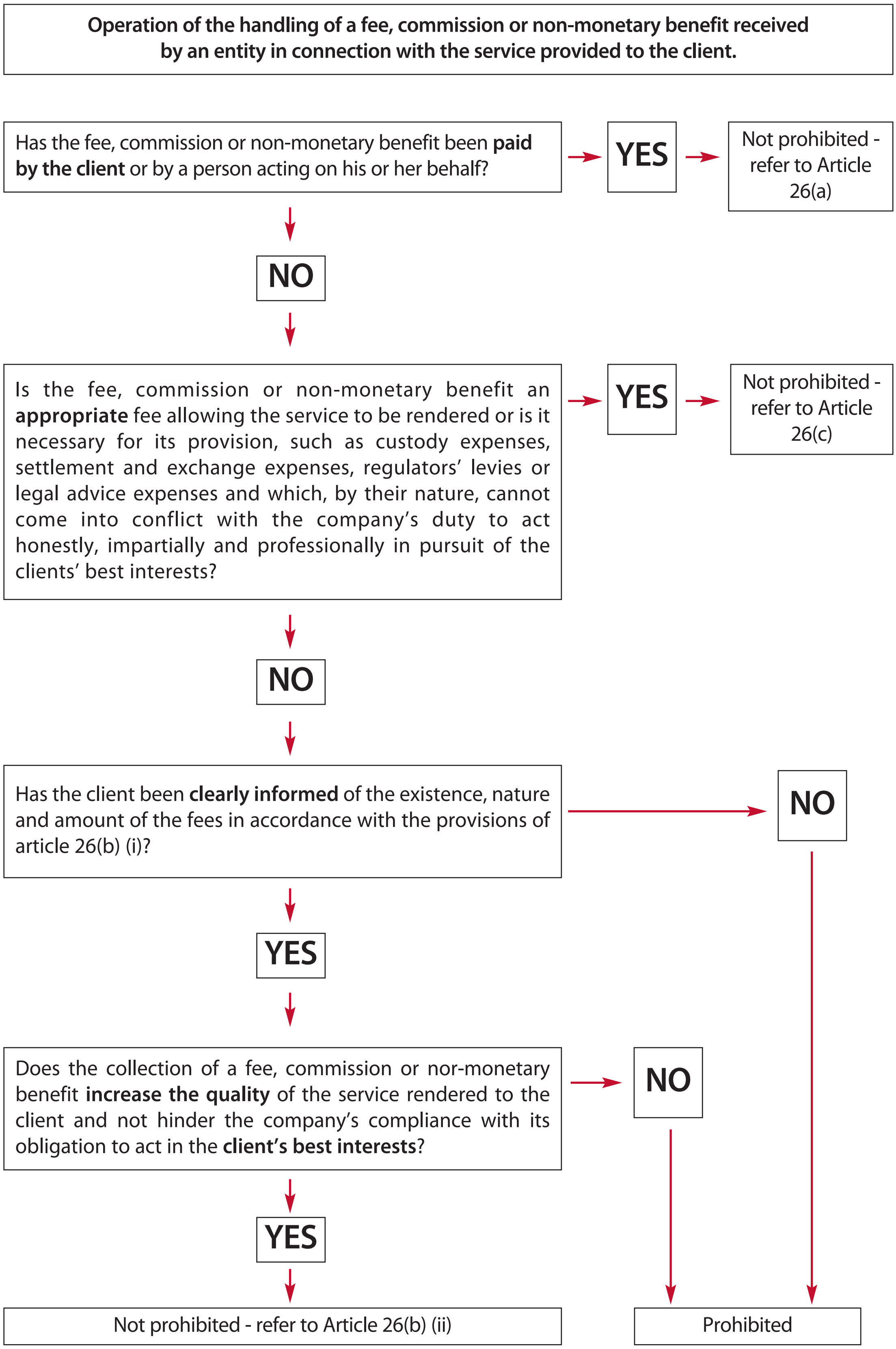
Thus, article 26 establishes that, in general, no payments may be received or made in connection with the provision of investment services unless the circumstances coincide with one of the cases expressly indicated.

First of all, payments made or received by the client or a person acting on his or her behalf are allowed. If the payments are not made or received by the client or a person acting on his or her behalf, they may still be made or received if the expenses are appropriate or necessary for the provision of the service, such as settlement and exchange expenses, regulators' levies or legal advice expenses, etc. and those which, by their nature (not their outcome), cannot come into conflict with the company's duty to act honestly, impartially and professionally in pursuit of the clients' best interests.

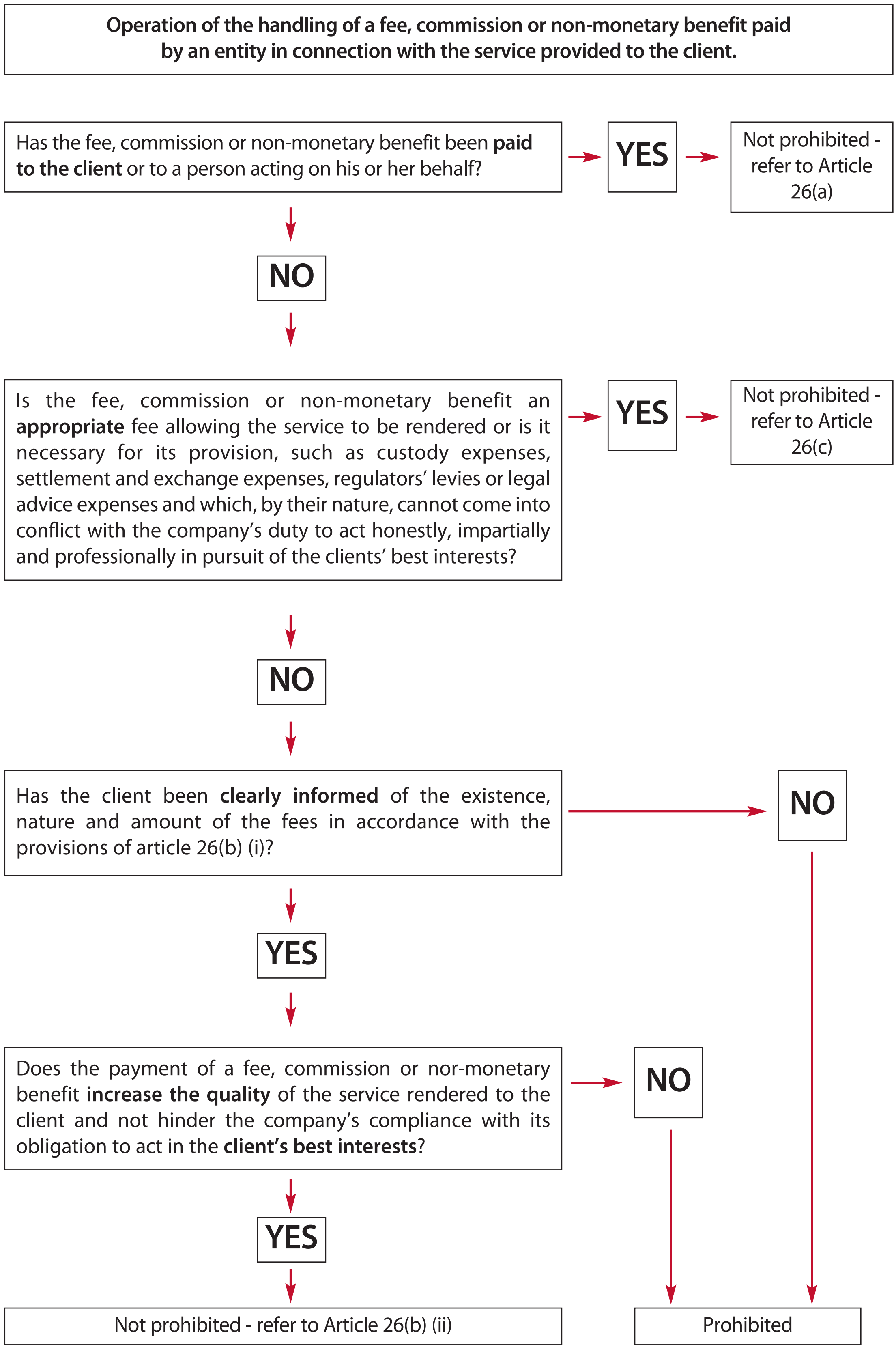
Finally, if the expenses or payments are not made or received by the client, and are not appropriate or necessary for the provision of the service or if by their nature they come into conflict with the entity's obligation to act in the client's best interests, then they will only be allowed in those cases where the client has been informed of their existence, nature and amount, and where they increase the quality of the service without hindering the entity's compliance with its obligation to act in the client's best interests; the factors recommended by the CESR may be used for their assessment.

5 Annexes

5.1 Annexe A



5.2 Annexe B



Operation of the handling of a fee, commission or non-monetary benefit paid by an entity in connection with the service provided to the client.
Has the fee, commission or non-monetary benefit been **paid to the client** or to a person acting on his or her behalf?
YES
Not prohibited - refer to Article 26(a)
NO
Is the fee, commission or non-monetary benefit an **appropriate** fee allowing the service to be rendered or is it necessary for its provision, such as custody expenses, settlement and exchange expenses, regulators' levies or legal advice expenses and which, by their nature, cannot come into conflict with the company's duty to act honestly, impartially and professionally in pursuit of the clients' best interests?
YES
Not prohibited - refer to Article 26(c)
NO
Has the client been **clearly informed** of the existence, nature and amount of the fees in accordance with the provisions of article 26(b) (i)?
NO
YES
Does the payment of a fee, commission or nor-monetary benefit **increase the quality** of the service rendered to the client and not hinder the company's compliance with its obligation to act in the **client's best interests**?
NO
YES
Not prohibited - refer to Article 26(b) (ii)
Prohibited

IV Regulatory Novelties

The new Spanish takeover bid legislation

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1 Introduction

On 13 April 2007, Act 6/2007, of 12 April, was published in the Spanish Official State Gazette, on reform of the Securities Market Act, 24/1988, of 28 July (Ley 24/1988, de 28 de julio, del Mercado de Valores) in order to modify the regime governing takeover bids and issuer transparency ("Act 6/2007").

This Act, which will come into force on 13 August 2007, partially incorporates two European directives into Spanish law, the Takeover Directive (Directive 2004/25/EC, of 21 April 2004) and the Transparency Directive (Directive 2004/109/EC, of 15 December 2004 modifying Directive 2001/34/EC).

In this article we will deal with the reforms brought about in the field of takeover bids. Act 6/2007 provides a new wording for Chapter V of Title IV, "On takeover bids", and Section 34, "Exclusion from trading" of the Securities Market Act ("SMA"). It also refers to takeover bids in its Additional Provision, " Rules governing certain increases in holdings in a listed company", in Transitional Provision Three, " Transitional rules for certain increases in holdings in listed companies prior to entry into force of this Act" , and in Transitional Provision Two, pursuant to which the Act will be applied to takeover bids submitted but not authorised before its entry into force.

The regulatory development provided for in Act 6/2007, which will enable the Takeover Directive to be fully transposed, has been translated into an in-depth reform of Royal Decree 1197/1991, of 26 July, on the regime of takeover bids, reflected in the Draft Royal Decree[1], which completed its public consultation stage on 10 May 2007.

The legislative changes will constitute a new era in the Spanish takeover market, a matter which is the subject of this article. Various figures on these operations are provided below on a preliminary basis in order to briefly characterise this market. In the 1989-2007 period (to date) in Spain there have been[2] 323 takeover bids involving, based on the results obtained, a volume in excess of 62 billion euros. Over 30% of this figure relates to takeover bids made in the 2006 financial year and, in particular, those which affected real estate undertakings which reached a volume of over 10 billion euros.

1 All references in this article to the Draft Royal Decree being processed must be treated with caution since it will be subject to the amendments which may be made in the final text.

2 Takeover bids taken into account include all those submitted and authorised independently of their outcome. Of the 323 bids made, 304 were successful, in 10 the takeover bid was withdrawn on one of the grounds laid down by law, 6 were unsuccessful (acceptances did not reach the minimum under the conditions of the takeover bid and the bidder did not waive this condition) and a further 3 were voided (no acceptances were received). Furthermore, of the 323 bids made, in the 1989-2007 (up to 31 May) a further 14 takeover bids were submitted which were eventually not implemented, in 3 cases as a result of refusal of authorisation from the CNMV (in respect of 3 exclusion bids submitted in 1993), 5 were withdrawn with the approval of the CNMV as a result of different circumstances which prevented a takeover bid being made, and another 6 submitted are being processed at the present time.

Some 73% of takeover bids made during this period sought to obtain or increase a significant holding in order to achieve a certain degree of control or strengthen a majority position. Some 91% of takeover bids were made by way of purchase with payment in cash.

Although the regulation still in force allows for so-called partial takeover bids, aimed at a certain percentage of capital, these only represent 17% of the total. The remaining 83% were directed at the whole of the securities of the target undertaking.

The principal novelties which will transform this market and provide it with equivalent regulation to the more common takeover bid systems in surrounding markets can be summarised in the following points:

- Replacement of the current regime of mandatory partial or total takeover bids after obtaining certain significant holdings by a system of mandatory total takeover after obtaining control.

- Elimination of the current thresholds [25% and 50%] which require that a takeover bid be made, replacing them with a single threshold [30%] calculated in respect of the total number of voting rights in the company, with the possibility for the CNMV to grant a dispensation when another shareholder has a holding equal to or exceeding that achieved by the person obliged to make the bid.

- Establishment of a minimum price for the mandatory takeover bid which must be equal to the highest price paid by the bidder within a previous period on terms to be determined by regulations.

- Development of applicable rules in the field of defence of takeover bids, distinguishing between preventative measures whose regime will be optional, and specific actions which will require prior authorisation of the shareholders general meeting, with the possibility of applying the reciprocity rule in both cases.

- Incorporation of rights of forced sale and purchase (squeeze-out and sell-out) after a takeover bid is made.

- Regulation of a special regime for increases in holdings situated on entry into force of Act 6/2007 at between 30% and 50% of voting rights.

- Definition of the territorial scope of application of the new regulation determined in accordance with the Takeover Directive based on the registered office of the company concerned, the location of the regulated market in which its securities are admitted to trading, and the time when the said admission took place.

- Separate rules for mandatory and voluntary takeover bids.

- Definition of infringements in the penalty regime linked to breach by the bidder and the company concerned of obligations laid down in the takeover bid legislation.

Before going into detail on the new Spanish takeover bid legislation we must briefly look back and recall the broad features of the long and complex process of gestation of the Takeover Directive in which the origins of the reforms are set.

The Takeover Directive is set in a process of integration of the financial markets of European Union Member States. The intention is thereby to provide European undertakings with greater legal certainty when faced with takeover bids and ensure protection of the parties involved, particularly shareholders and employees.

The Directive is the outcome of long and tough negotiations which go back to 1989. It was an ambitious proposal since its origins, which aspired to a detailed harmonisation which nevertheless encountered strong opposition from some Member States which made it necessary to water down the initial ambitions. Some criticised the excessive regulation deriving from the legislation, and others that it was not needed.

Faced with this rejection, the European Commission stated its intention of revising the initial proposal based on consultation with Member States, which gave rise in 1996 to a new proposal. This was a framework Directive which established various general principles and left a considerable margin for national regulation. After a conciliation procedure, however, the European Parliament in July 2001 rejected the text of the compromise adopted by the Council.

There were various reasons which led to rejecting the proposal, but in particular these included three basic grounds which serve to understand the content and meaning of the Directive finally approved.

Firstly, there was objection to the principle that the board of directors of the company concerned must have the authorisation of the shareholders meeting in order to take defensive measures. The reason given was that this principle could not be applied until there were some uniform “rules of play” or level playing field in the area of takeover bids for all European companies.

Secondly, the insufficient protection was raised, given by the Directive to employees of the companies in the event of a takeover bid.

Finally, there was a fear that application of the Directive would facilitate takeover bids made by companies from third party countries for European listed companies.

The principal objection came from Germany as a result of the strong presence of its companies in key economic sectors such as automotive and energy, the strength of German unions which are actively involved in the management of companies through their presence on supervisory boards, and the existence of various corporate operations affecting German companies close to the time when the proposed Directive was rejected. At that time the purchase took place of the German mobile telephony company Mannesmann, A.G. by the British mobile telephony operator Vodafone AirTouch, Plc., after a long takeover bid process which was resisted by the Board of Directors of Mannesmann, union representatives and the German Government. This operation gave rise to a broad debate on the business model of the country and the conflicts of interest between the parties involved in takeover bids.

In 2002 the European Commission presented a new Directive proposal which attempted to provide solutions to some of the problems raised by the European Parliament. The new proposal incorporated several recommendations made by a group of experts appointed by the European Commission contained in the "Winter Report". This document dealt with questions relating to public takeovers such as fixing uniform rules of play or level playing field for public takeover bids in all Members States, definition of a fair price in mandatory takeover bids and the introduction of forced purchases and sales.

The objective of promoting equality in rules of play was instrumented by Articles 9 and 11 of the Directive, on which debate on the new proposal was focused. Article 9 incorporated compliance with the rule of passivity on the part of the Board of Directors of any company affected by a takeover bid, such that it could only adopt defensive measures against a bid with express authorisation of the shareholders meeting. This rule was intended to ensure that the future of the company was decided by its shareholders or owners. Article 11, for its part, established the neutralisation (breakthrough) rule consisting of suppression of restrictions on transfers of securities and voting rights on a takeover bid, as laid down in both company articles of association and in company/shareholder agreements.

Finally, the Takeover Directive was adopted on 21 April 2004 by the European Parliament and Council. It came into force on 20 May 2004 and on 20 May 2006 the deadline ended which was established for transposition by all Member States.

Many have criticised the Takeover Directive and described it as a rule of minima which, in its desperate zeal to be approved, had to give up a large part of its initial aspirations. In this respect the Directive leaves it to the discretion of Member States to fix several fundamental aspects of regulating bids. One of the most controversial points is Article 12, which was not included in the text of the original proposal but was included because several States considered it essential in order to reach agreement.

Article 12 raises serious doubts regarding the possibility of achieving uniform rules of play or a level playing field in the area of takeover bids by permitting Member States to decide whether companies in their respective territories must apply the rules of Articles 9 and 11 or not. By means of the so-called "reciprocity rule", it further allows Member States to grant exemption from the said rules when the bid is made by a company which does not apply equivalent rules.

The Directive also leaves other important questions in the hands of Member States, which runs against the intended harmonisation sought by all Community legislation, such as: definition of percentage control for the purposes of a mandatory takeover bid: determination of the reference period - between 6 and 12 months - for calculating a fair price, the list of circumstances in which the fair price may be modified upwards or downwards, and criteria to be used in such circumstances, minimum thresholds after a bid in order to exercise forced purchase and sale, penalty regime, exceptions to the obligation to make a bid, and regulation of competing bids.

Despite everything, the Takeover Directive has enabled various common minimum rules to be established which must be applied to bids made for those companies with securities listed on regulated markets in Member States, with the basic objective of providing an adequate level of protection for shareholders.

Furthermore, the Directive establishes the criteria for applying the different rules of Member States in acquisitions of control of cross-border dimensions and the manner of determining the competent supervisory authority, criteria which are binding on all and which will be fully adopted in the Spanish regulation.

2 Scope of application

The new legislation will apply to all public offers for the acquisition of securities admitted to trading, in whole or in part, on an official Spanish secondary market (stock exchange) whose issuer company has its registered office in Spain (listed company).

When the issuer company of the securities affected by the offer has its registered office in a European Union Member State other than Spain and the said securities are not listed on the regulated markets of that state, the CNMV will be responsible for authorising the bid in the following cases:

- If the shares are only listed on a Spanish stock exchange or the first admission to trading was on a Spanish stock exchange.

- If the admission to trading took place simultaneously on a Spanish stock exchange and on other regulated markets in the European Union and the company decides on the first day of trading to submit to the Spanish takeover bid regulation; and, in the case of securities admitted before 21/05/06, (i) when the CNMV agrees with the authorities of the other markets that the same be subject to Spanish regulation, or (ii) in the absence of agreement the company itself so decides.

In both cases the following rules will be applied:

- Spanish regulation:

  - Consideration offered.

  - Offer procedure.

  - Information on submission of the offer.

  - Contents of the explanatory prospectus.

  - Dissemination of the offer.

- Regulation of the State in which the company concerned has its registered office:

  - Company Law.

  - Percentage of voting rights which grant control.

  - Exceptions to the obligation to make a bid.

  - Conditions on which the board of directors of the company concerned can take action against the bid.

  - Information which must be provided to employees of the company concerned.

In intra-Community cross-border operations which need not be authorised by the CNMV in accordance with the foregoing, the bid prospectus approved by the competent authority of another State will be valid, and supplementary information may only be required regarding the procedures for acceptance and settlement of the bid and applicable tax regime. In the light of the planned regulatory development the CNMV may require a summary of the prospectus translated into Spanish.

The Spanish rules referred to will also be applicable, in accordance with the Draft Royal Decree currently being processed, and it will be the responsibility of the CNMV to authorise the bid in the case of shares listed on the Spanish stock exchange of an issuer which has its registered office in a non-EU State. The CNMV may, whenever necessary, adapt the procedure, time limits and other formal requirements.

3 New model takeover bid

3.1 Mandatory bid

3.1.1 Takeover bid 'after the event'

As already indicated, the traditional system of prior intentional takeover bids is transformed by the new Act into a regime of 'bid after the event' in which the obligation to make a bid arises when the threshold established is reached and it may take place afterwards within the maximum period to be established by regulations. Furthermore, mandatory partial bids are replaced by a system of total bids. The new Section 60 of the SMA thus provides:

"An obligation shall arise to make a public offer for the whole of the shares or other securities which may directly or indirectly grant entitlement to subscription or acquisition thereof, addressed to all holders thereof at a fair price on the part of a person who achieves control of a listed company, whether this is achieved:

a) By the acquisition of shares or other securities which directly or indirectly grant the right to subscription or acquisition of shares with voting rights in the said company;

b) By means of agreements with other holders of securities; or

c) As a result of other circumstances of similar nature which may be established by regulations."

Consequently, the obligation still in force to make a prior bid, which may be partial, when it is intended to achieve certain holdings will be replaced by the obligation to make a bid after the threshold is achieved, as we will see later, but directed at the whole of the securities.

It is relevant here to emphasise that it will no longer be necessary to examine the intentional nature of one or more successive acts in order to determine whether they require that a takeover bid be made. It suffices now to verify that the factual circumstances have arisen or been exceeded at a precise moment which determines a mandatory takeover bid in order for the need to arise to make the bid, and in particular the bid must be made in respect of all of the securities.

3.1.2 Controlling holding

The Takeover Directive provides that the threshold or percentage of voting rights which grants control of a company must be determined by the rules of the Member State in which the company has its registered office.

The Spanish regulation has elected to establish the threshold at 30%, adding as circumstances of control the appointment by a shareholder of a majority of the members of the board of the company, even if his percentage of voting rights does not reach 30%. Control in the field of takeover bids is determined by the new Section 60 of the SMA in the following terms:

"It shall be deemed that an individual or legal entity has control of a company, whether individually or jointly with persons acting in concert therewith, when the same directly or indirectly achieves a percentage of voting rights equal to or exceeding 30 per cent, or when the same has reached a lower holding and designates, on the terms laid down by regulations, a number of directors who, together as the case may be with those who have already been so appointed, represent more than one half of the members of the management body of the company".

The regulation being processed specifies the foregoing by referring to a so-called 'controlling holding' which includes both achieving 30% or more of voting rights of a listed company and also a lower holding of any shareholder who designates in the 24 months after an acquisition a number of directors who, along with those the same has already appointed, represent more than one half of members of the board of the company.

Consequently, the threshold of 50% which currently requires that an offer be made for 100% of the securities is reduced to 30% of voting rights, and other than as provided in the case of appointment of a majority of the Board, obtaining holdings of less than 30% will not be subject to a mandatory bid. On the other hand this threshold or a higher threshold cannot be achieved by a partial bid directed, as up to now, at a minimum of 10%.

After 30% is achieved and the mandatory bid is made, the holding finally obtained may be freely increased without limit in time or amount. The current mandatory takeover bids provided in the case of increases equal to or exceeding 6% in 12 months of holdings of between 25% and 50% are therefore eliminated.

3.1.3 Special rules governing increase in certain holdings

The foregoing must be taken to be without prejudice to the special rules laid down by Act 6/2007 for increases in holdings which, on entry into force of the said Act, are between 30% and 50%. In these cases a mandatory takeover bid will be required (i) when the holding is increased by 5% or more within a 12-month period, (ii) when 50% or more of voting rights is achieved, or (iii) when an additional holding is acquired and more than one half of the directors of the company can be designated.

Otherwise, these special rules will be subject to the terms, conditions, exceptions and dispensations established in the new general regime of mandatory takeover bids.

3.1.4 Dispensation from mandatory takeover bid

Act 6/2007 adds a further novelty consisting of the fact that the mandatory bid need not be made even if 30% is achieved provided that a dispensation is obtained from the CNMV.

The circumstances enabling this dispensation to be granted are set out in the new Section 60 of the SMA in the following manner:

"The Spanish Securities Market Commission (Comisión Nacional del Mercado de Valores) shall, on the terms laid down by regulations, conditionally dispense with the obligation to make the takeover bid established in this Section when another person or entity directly or indirectly has percentage voting rights equal to or exceeding those of the person under an obligation to make the bid".

If the conditions disappear which have enabled the dispensation to be granted, in other words when the control structure of the company is altered in relation to the situation existing when granting it, the shareholder granted dispensation will be faced with an intervening situation -equivalent to others which are also covered by the regulations being processed- and consequently within the period established must make a bid or dispose of the necessary number of securities to reduce the excess voting rights, and in the meantime not exercise the voting rights.

3.1.5 Fair price

In line with the provisions of the Takeover Directive, the concept of fair price required on mandatory takeover bids was included in the new Section 60 of the SMA, with the following definition:

“It shall be deemed that the price is fair when it is at least equal to the highest price which the person under an obligation to make the bid or persons acting in concert with the same has paid for the same securities within a period of time prior to the bid determined by regulations and on the terms which may be established”.

The Takeover Directive allows Member States to authorise supervisory authorities to modify the price of the bid so calculated and the new Spanish Act has incorporated this possibility on the terms laid down by the Directive itself.

The CNMV may consequently make a reasoned modification of the fair price in the circumstances and in accordance with the criteria to be established by regulations.

These circumstances include:

- The highest price has been fixed by agreement between buyer and seller.

- The market prices of the securities in question have been manipulated.

- Market prices in general or certain prices in particular have been affected by exceptional events.

- It is intended to favour restructuring of the company.

In these cases, determination of the bid price may be based on the following criteria, amongst others:

- Average market value in a particular period.

- Liquidating value of the company.

- Other generally used objective valuation principles.

As we have seen, the rules on fair price must be developed by regulations. In accordance with the published Draft, it is provided that the reference period which will serve to calculate the fair price is twelve months, equal to the maximum contemplated by the Takeover Directive.

Other relevant rules laid down in the Draft Royal Decree include:

- If the prior operation which determines the fair price derives from exercise of an option or derivative, the premiums paid or received must be taken into account.

- When the prior acquisition has taken place through an exchange or conversion, the price must be calculated by applying the weighted average list price of the securities on the date of acquisition.

- When the controlling holding has been achieved without making acquisitions in the reference period -by company/shareholder agreements, designation of directors or other circumstances- the price may not be less than the weighted average list price of the securities to be acquired during the three months prior to announcement of the bid.

It can be seen how the regulation being processed incorporates various references to the list price of securities even though it does not establish a two-fold requirement as in the case of various States -Germany and Poland for example- in which the rule of highest price paid is completed by a minimum price equal to the average list price of the securities in the period prior to announcement of the bid (3 months in the case of Germany and 6 in Portugal).

With respect to modification of the fair price, the Draft specifies the circumstances which may constitute a variation downwards, and those in which the CNMV must require a price higher than the fair price.

It thus provides that when the fair price is lower than the range of list prices of the securities on the day of the determining acquisition, the bid price must be increased up to at least the lower limit of the said range. Whereas, if the highest price in the period corresponds to an acquisition at list price in respect of an insignificant volume in relative terms, the price of the bid may be reduced to the highest paid on the remaining acquisitions in the reference period.

The possibility is also provided of making objective corrections of the price when the list price of securities is affected in the reference period by payment of a dividend, a corporate operation or an extraordinary event which permits the correction. Furthermore, when acquisitions in the period include some compensation in addition to the price, the amount of the compensation must be added to the price paid for the purpose of determining fair price.

Finally, in the case of manipulating list prices, modification of the fair price will require that the CNMV has initiated a penalty process for infringement of the provisions of Section 83.ter of the SMA, and when the company concerned is in demonstrable financial difficulties the price of the bid will be fixed by applying the valuation methods provided for exclusion bids.

The incorporation of a regulated minimum price combined with the requirement that the takeover bid extend to 100% of the securities has its basis in the principle of equivalent treatment and protection of shareholders on acquisition or change of control. It has a two-fold objective: that all shareholders can realise their investment if they wish at the best price paid by the new member, and ensuring distribution of the control premium, if it exists, amongst them all.

With the same objective the Takeover Directive provides that when the consideration for the bid does not consist of an exchange of liquid securities listed on a regulated market, it must mandatorily include a cash price as alternative. The same requirement must be complied with when the bidder has acquired 5% or more with payment in cash in the reference period.

The Directive in any event expressly allows for the possibility that Member States require a cash price in all mandatory bids, at least as an option. In Spain this decision will depend on what is finally determined in the new takeover bid regulations.

Fair price therefore appears in the new regulation as one of its fundamental elements and for the CNMV represents an additional responsibility in the supervision of takeover bids, which will not always be a simple task, all the more so in cases which derive from the modifications previously mentioned.

3.1.6 Computation of voting rights

For the purposes of determining when a person reaches the mandatory bid threshold established in the Act, the rules or criteria for computation must be fixed, as up to now. Since the new regulation, following the provisions of the Takeover Directive, fixes the mandatory bid threshold by reference to the percentage of voting rights achieved in the company, this will be the datum to be taken into account for the calculation.

In the regulation being processed, coinciding with the rules currently applicable to the computation of significant holdings (Section 2 of Royal Decree 1197/1991), the percentages of voting rights of all persons or entities belonging to the same group[3], the percentage voting rights of members of management bodies of the said entities and those which are held by other persons who act in their own name but on behalf of or in concert with the former, are attributed to a single person.

In short, the percentage voting rights in the company affected must be less than 30% when the sum of those held by the shareholder, those of other persons or entities in the same group, and the votes of persons acting in concert with the same do not reach this level.

The Draft furthermore sets out various rules which are not expressly covered by the current Takeover Royal Decree. It thus provides that the following must be added to the voting rights of a person in a listed company:

- The voting rights held by persons or entities who have reached an agreement of those indicated in Section 112 of the SMA which regulates voting rights on shareholders general meetings.

- The voting rights which the said person may exercise freely on a continuing basis pursuant to a power of attorney granted by the holders of the shares in the absence of specific instructions regarding the same.

- The voting rights of an interposed person, taken as one for whom the said person wholly or partly covers the risks inherent in acquisitions or transfers or possession of the shares.

3 As defined in Section 4 of the Securities Market Act, i.e.:
"Entities will be deemed to belong to the same group who constitute a decision-making unit because any of them has or may directly or indirectly have control of the others or because the said control lies with one or more individuals who act systematically in concert.
It shall be presumed that unity of decision-making exists in any event when any of the circumstances are found covered by Section 42.1 of the Commercial Code, or when at least one half plus one of the Directors of the entity controlled are Directors or senior executives of the controlling entity, or of another entity controlled by the latter.
For the purposes of the foregoing paragraphs, the rights shall be added to those of the controlling person held through other entities controlled or through persons who act on behalf of the controlling entity or of others controlled, or those held in concert with any other person".

- The voting rights of persons who have entered into any financial contracts or exchanges which have the shares as their subject matter or underlying factor, when such contracts or exchanges in whole or in part cover the risks inherent in ownership of the securities and consequently they have a similar effect to that of holding shares through an intermediary.

Consequently, the factual circumstances which determine a mandatory bid do not necessarily require the prior acquisition of shares with voting rights, since a single person is attributed or, which is equivalent, is deemed to have acquired or to possess the shares with voting rights belonging to other holders when they are in any of the aforesaid situations.

With respect to the concept of concerted action, at the moment there is a definition in the Takeover Directive itself which considers to be persons acting in concert "natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid". And two references are found in the Spanish regulation pursuant to the Securities Market Act:

Firstly, according to Section 2 of Royal Decree 377/1991, on notification of significant holdings, "the entry into agreements or arrangements with other shareholders pursuant to which the parties are under an obligation by concerted exercise of voting rights held by them to adopt a common continuing policy in relation to management of the company shall be assimilated to an acquisition of shares".

A similar provision, but one which does not coincide in all respects, is contained in Annex I of CNMV Circular 1/2004, when stating that "Concerted action shall mean the entry into agreements or arrangements with other shareholders which generate an obligation to give notice of a significant holding in accordance with Royal Decree 377/1991, pursuant to which the parties are under an obligation, by concerted exercise of the voting rights which they hold, to adopt a common policy in relation to management of the company or which has the purpose of having a relevant affect thereon".

Finally, the Draft provides that the percentage of voting rights is calculated on the basis of all shares in which they are inherent, even if their exercise has been suspended, excluding shares which in accordance with the information available on the date of computation belong directly or indirectly to the company concerned itself. In other words, the voting rights of shares in portfolio of own shares must be deducted from the number of voting rights of the company.

We would indicate on this matter that the regulation being processed includes amongst cases of intervening control, which will be dealt with later, that deriving from variations in portfolio of own shares. In this manner, if any shareholder reaches the mandatory bid threshold as a result of a variation in own shares held, he may not exercise the voting rights which exceed the percentage without making a mandatory bid unless within the three months following he disposes of the number of shares necessary to reduce the excess.

3.1.7 Appointment of directors

Determination of the number of directors designated by the same shareholder is set out in the Draft by establishing several presumptions equivalent to those covered by current regulations.

Clarification by the new text should be emphasised when specifying that in no event shall designation be attributed to a person of those members of the Board who have the status of independent directors in accordance with the rules of corporate governance referred to by Section 116 of the SMA.

3.2 Voluntary bids

Under this new model voluntary takeover bid means one which is made prior to obtaining the threshold for a mandatory bid as well as one which does not aim to achieve this threshold.

Both the Takeover Directive and Act 6/2007 make provision for the voluntary bid. The latter incorporates a new specific Section 61 into the SMA for voluntary bids, with the following wording:

"Public offers for the acquisition of shares or other securities which directly or indirectly grant voting rights in a listed company, made on a voluntary basis, must be addressed to all of their holders, be subject to the same procedural rules as the bids covered by this Chapter and may be made, on the conditions laid down by regulations, for a number of shares less than the total.

The mandatory bid covered by Section 60 of this Act shall not be required when control has been acquired after a voluntary bid for the whole of the securities, addressed to all of their holders, which has complied with the requirements set out in this Chapter".

Regulation of this type of bid is completed by the provisions of the regulation being processed which makes the possibility of making a partial voluntary bid subject to not achieving a controlling holding.

The Draft also expressly provides for the possibility that those who already have a controlling holding may make a voluntary bid in order to increase their holdings, except in the cases subject to the special regime established in the foregoing section 3.1.3.

Consequently, we may shortly find several modes of voluntary bid with the common denominator that the bidder has not previously achieved a controlling holding which requires the same to make a mandatory bid.

The voluntary bid may be total, directed at 100% of the securities, or partial, when the maximum number of securities to be acquired is limited, but in any event must extend to all holders. In the case of a partial bid the result will be subject, as up to now, to application of the pro rata rules laid down by regulations.

The relevant factor, if the bid is partial, is that the maximum number of securities to be acquired will be limited in amount such that the bidder does not, together with those already held, achieve a controlling holding. If the bidder already has this controlling holding as a result of previously making a mandatory bid, or when the previous holding is equal to or exceeds 50% of voting rights, a partial bid may extend to any percentage.

In accordance with the provisions of the Draft Royal Decree, as well as the possibility that a voluntary bid may be partial, there will be two significant differences in relation to mandatory bids:

- The efficacy of the voluntary bid may be subject to compliance with certain conditions.

  The regulation being processed in fact allows for voluntary bids to be subject to certain conditions, provided that their fulfilment or otherwise can be verified before the end of the acceptance period.

  One of the standard conditions, such as establishment of a minimum number of acceptances in order for the bid to be valid, will only be possible in voluntary bids. Likewise, other possible conditions such as elimination of restrictions in articles of association on voting at the shareholders meeting of the company concerned, or approval by the shareholders meeting of the bidder company of an issue of shares to be delivered in consideration for the bid, will only be admissible on a voluntary bid.

- A voluntary takeover bid may be made at a price other than fair price.

  No specific rules are provided for determining the price of a voluntary bid. It is therefore considered that if the bidder wants the operation to be successful he will procure that the price offered is attractive to its recipients.

  In any event, if the bidder obtains 30% or more of voting rights in the company by means of a voluntary bid directed at the whole of the securities, the same will be under an obligation to make a further bid, this time mandatory and subject, amongst others, to the rules as to fair price unless, as indicated in the new Section 61 of the SMA, the voluntary bid has fulfilled all requirements for a mandatory bid, including fair price.

  In this respect, and following common practice in other markets, the regulation being processed provides that such mandatory bid will also not be required when the voluntary bid has been accepted by holders of securities representing at least 50% of the voting rights to which it has been aimed, excluding from computation those already held by the bidder and those of shareholders who have reached an agreement with the bidder in relation to the bid.

  The degree of acceptance of the offer is thus converted into a type of arbiter in relation to the fairness of the price offered.

In other respects, it is provided that voluntary bids are subject to the same requirements as mandatory bids in relation to their publicity, documentation, information obligations, acceptance period, modification of terms and conditions, etc. The provisions relating to measures for neutralisation (breakthrough) and obligations of the management body of the company concerned will also be fully applicable.

If, in the course of a voluntary bid, it becomes mandatory as a result, for example, of acquisitions made outside the bid, the bidder must logically adapt the bid to the extent necessary in order to comply with the rules governing mandatory bids.

In the light of the possibilities presented by a voluntary bid compared with a mandatory bid, it may be considered that in several cases it will be more interesting to come closer to the controlling holding which requires a mandatory bid without achieving it in order then to make a voluntary bid subject to certain conditions which may be essential from a financial or strategic point of view. However, the greater the percentage previously reached, the less will be the incentives for entry by potential competitors, and therefore the bidder may achieve success of the operation more easily by means of a mandatory bid.

3.3 Withdrawal of the bid

Consistently with the foregoing, the bidder under a voluntary bid may withdraw from it when the conditions are not fulfilled to which its validity has been made subject and he may also waive these conditions.

Authorisation of a competing bid is another of the cases which enable a bidder to withdraw from his previous bid. Under the new model, however, withdrawal of a mandatory bid will only be possible to the extent that at least one competing bid is maintained which is not subject to any conditions and which improves the terms of the former.

In addition, the regulation being processed provides that when a bid, whether mandatory or voluntary, cannot be made or becomes manifestly non-viable as a result of exceptional circumstances outside the control of the bidder, then the bidder may withdraw it.

We consider that such an important distinction between voluntary and mandatory bids in the area of withdrawal and cessation of the effect of the bid is logical. When a bid is mandatory, the bidder will have previously and knowingly placed himself in a position of control and consequently it would not make sense to leave the establishment of conditions which may not be fulfilled to his discretion, rendering the bid without effect when a controlling holding has already been achieved. The option of establishing another model with conditional mandatory bids in which, on failure of the bid, the bidder may be required to re-sell the securities previously acquired, presents more drawbacks than advantages as a result of the effect which such to and fro operations could have on the market.

3.4 Defences against takeover bids

3.4.1 Defensive measures after the event. The passivity rule

In relation to actions of the Board of Directors of the company affected by a takeover bid, Act 6/2007 transposes the rules provided in the Takeover Directive, incorporating a new Section 60.bis into the SMA.

Consequently, Spain, unlike other states such as Germany, has not made use of the power contained in the Directive which permits Member States not to require listed companies to apply the passivity rule.

Section 60.bis of the SMA provides that management bodies of the company concerned or of companies in its group must obtain prior authorisation from the shareholders general meeting before taking any action which could prevent success of the bid, except for seeking other bids. It also specifies that the resolution must be passed with the requirements laid down by Section 103 of the Companies Act (Ley de Sociedades Anónimas). And, by way of exception to the general rules under the Act, the said general meeting may be convened on 15 days notice (instead of one month).

Application of the passivity rule is not new in Spain. Section 14 of the current Royal Decree on takeover bids limits the actions of the Board of Directors of the target company of a bid, preventing it from engaging in any operations which do not fall within the ordinary course of activities of the company or which have the principal purpose of frustrating the bid.

This seems totally logical and consistent with the idea that listed companies belong to their shareholders and therefore solely the latter in principle should be entitled to assess a bid and on this basis decide whether it is suitable or not, authorising the directors of the company to take the measures approved in order to prevent the bid achieving its objectives.

The same idea underlies the provision included in the Directive and in our own Act when providing that the shareholders general meeting must endorse any decision taken before announcement of the bid and not yet applied which does not fall within the normal course of activities of the company and whose implementation could frustrate the success of the bid.

As stated, the new regulation expressly confirms a normal practice, search by the board of directors for other bids without the need for authorisation of the shareholders meeting of the company.

For its part, the Draft Royal Decree extends the duty of passivity to any delegate or authorised body of the board of directors and those who act in concert and lists the following actions which are restricted to prior express authorisation of the shareholders meeting:

- Issues of securities which prevent the bidder obtaining control of the company concerned.

- Transactions in securities affected by the bid, including actions aimed at encouraging purchase of such securities.

- Disposal, encumbering or leasing of real estate or other company assets when such operations could frustrate success of the bid.

- Distribution of dividends or remuneration of any other type to shareholders unless the corresponding resolutions have been previously passed by the competent company body and made public.

The foregoing must all be taken as without prejudice to possible application of the rule of reciprocity to which we will refer in section 3.4.3.

3.4.2 Prior defensive measures. The breakthrough rule

Unlike the passivity rule, the new regulation has taken up the option provided for Member States in the Takeover Bid Directive and does not require listed companies to apply neutralisation (breakthrough) measures of the so-called "armour-plating" type against a bid.

Other States, such as Germany, France and the United Kingdom, for example, have followed the same practice.

The rules governing neutralisation measures contained in the new Section 60.ter of the SMA are optional, and pursuant thereto companies may decide whether or not to apply the following:

- The inefficacy, during the bid acceptance period, of restrictions on transfer of securities laid down in company/shareholder agreements.

- The inefficacy at the shareholders general meeting which decides on possible defensive measures proposed by the board of directors of restrictions on voting rights laid down in the articles of association of the company concerned and in company/shareholder agreements.

- The inefficacy of the restrictions previously indicated when, after a takeover bid, the bidder has achieved a percentage equal to or exceeding 75% of capital with voting rights.

The decision to apply these neutralisation measures must be taken by the shareholders general meeting of the company with the quorum and subject to the majority laid down by Section 103 of the Companies Act and be notified to the CNMV and to other supervisors of regulated markets in Member States in which the shares are admitted to trading, or where admission has been applied for. The CNMV must publicise these communications on the terms and within the period laid down by regulations. At the present time the Draft being processed provides that the said shareholders meetings be held within a maximum of six months from entry into force of the new Royal Decree.

When a company decides to apply the neutralisation measures it must provide for suitable compensation for the loss suffered by holders of the rights concerned. This is required by the Takeover Bid Directive itself and on this matter the regulation being processed adds that this compensation must be included in the Articles of Association of the company.

Nevertheless, the new Section 60.ter of the SMA expressly provides that the shareholders general meeting of the company may at any time revoke the decision to apply the neutralisation measures with the same rules regarding majority as the previous decision. The reciprocity rule may also be applied, which is explained below.

3.4.3 The reciprocity rule

As already indicated in the introduction, some of the provisions of the Takeover Directive form part of the compromise solution reached in order to bring about its approval. These include the reciprocity rule which permits Member States to exempt companies from application of the passivity and breakthrough rules when they are the subject of a takeover bid made by a company which does not apply the same or equivalent provisions.

Both the new Section 60.bis of the SMA, relating to the obligations of management bodies of the company concerned, and 60.ter devoted to optional neutralisation measures, incorporate the reciprocity rule with one difference: in both cases the companies subject to a bid may cease applying the rules relating to passivity and neutralisation in relation to a bidder who does not apply the same or equivalent rules, but nevertheless in order to cease applying the passivity rule it is further required that the bidder does not have its registered office in Spain.

Furthermore, application of the reciprocity rule requires in both cases that it has been authorised by the shareholders general meeting in accordance with the provisions of Section 103 of the Companies Act held less than 18 months before the bid has been made public.

We consider that the inclusion of this rule could end up, at least implicitly, by reducing the number of potential bidders. It should be taken into account that a large proportion of bidder companies are unlisted, or may even be individuals who are not subject to these rules, and therefore will not normally have adopted them, bringing about a discrimination between them and listed companies. In turn, listed companies in regulated European Union markets will be companies which do not apply the rules because their respective Member States have elected not to require them, or will be listed in other States in which equivalent rules simply do not exist. Insofar as the companies affected by bids cease to apply the passivity and neutralisation rules in such cases, the rules themselves would eventually be restricted to bids made between listed companies which are voluntarily or obligatorily subject to them.

We would finally add that subjection or otherwise of a bidder to the passivity and neutralisation rules should be a matter of indifference to the company affected, at least theoretically, unless it is interested in making a bid for the bidder in question. In any event, the requirement that application of this rule be authorised by the general meeting of the company ensures that the interest will prevail of a majority of shareholders over other possible objectives which may be pursued.

3.5 Forced sales

One of the principal novelties of the new Spanish regulation relating to the securities market is the concept of the forced sale and purchase, known as squeeze out and sell out, respectively.

Their incorporation in the Directive was based on one of the amendments by the European Parliament of the proposal which was rejected in July 2001 and sought to harmonise mechanisms which, although present in different European Union countries, were fairly heterogeneous with respect to the requirements for their application.

Forced sale, or squeeze out, consists of the right of the bidder, after having made a takeover bid for the whole of the securities, to require the remaining holders to sell their securities at a fair price. In the opposite sense, a forced purchase, or sell out, consists of the right of any of the said holders to require the bidder to purchase their securities at the same price.

In particular, Act 6/2007 includes a new Section 60.quater to the SMA with following content, in subsection 1:

"When, as a result of a takeover bid for the whole of the securities on the terms of Sections 60 and 61 of this Act, the bidder holds securities representing at least 90 per cent of capital with voting rights and the bid has been accepted by holders of securities representing at least 90% of voting rights, other than those already in possession of the bidder:

a) The bidder may require the remaining holders of securities to sell the said securities to it at a fair price,

b) The holders of securities in the company affected may require the bidder to purchase their securities at a fair price".

Consequently, there must be a bid for 100%, which may be mandatory or voluntary, and which furthermore fulfils a two-fold condition. It does not suffice that the bidder achieves 90% of the voting rights, but the bid must receive a minimum level of acceptance of 90% of the securities at which it is directed.

This two-fold condition means that the requirements for exercising the right of forced purchase and sale are more stringent than those in the regulation of other Member States which have for the most part, of the alternatives offered by the Takeover Bid Directive, elected to establish a single condition relating to the percentage achieved by the bidder.

In particular, Germany, France, Greece and the Netherlands have opted for a condition relating to the percentage of capital in the company affected held by the bidder after the bid, fixing the threshold at 90%, whilst Austria, Ireland and Sweden have fixed it at 95%.

Portugal and the United Kingdom however have the same system as Spain, although in the case of the United Kingdom there is a distinction between forced sale and purchase, and shareholders may exercise the right of forced purchase when the bidder reaches 90% or more, irrespective of the level of acceptance of the bid.

Apart from giving greater protection to minority shareholders, the advantage of the system established in Spain is that it enables the price to be determined for exercising the right of forced sale and purchase automatically, since it coincides with the bid price. And this is so because, according to the provisions of the Takeover Directive itself, compliance with this two-fold threshold enables it to be presumed that the consideration for a voluntary bid is fair and, therefore, the price for exercising forced sale and purchase rights will be equal to the bid price. In the case of a mandatory bid, the consideration will be deemed fair in any event.

At the same time, however, the two-fold condition will hamper the possibility of exercising forced sale and purchase rights since compliance with one of the thresholds only ensures the other when the bidder does not previously hold any securities in the company concerned. The greater the holding of the bidder before the bid, the more difficult it will be to achieve the minimum threshold for exercising forced sale and purchase rights, since an acceptance of 90% of the securities covered by the bid - discounting those previously held - is equivalent to a final holding of the bidder exceeding 90% of capital.

Thus, for example, if a shareholder reaches 50% of capital, it must make a mandatory bid for the remaining 50%. In order to exercise forced sale and purchase rights, the bid will have to receive 90% acceptance of the securities covered by it, equivalent to 45% of capital, and consequently the holding of the bidder will reach 95%. If the bidder only has 90% after the bid, acceptances would have amounted to 80% of the securities covered by the bid, a percentage below the minimum threshold required of 90%.

Furthermore, the regulation being processed which must develop the other matters necessary to regulate this new concept provides that when the consideration for the bid has consisted in whole or in part of an exchange of securities, the price for exercising these rights must be established in cash, at least as an alternative, and to this end the weighted average list price of the securities offered in exchange corresponding to the date of delivery of the said securities will be applied to the bid exchange equation.

This latter question is closely linked to the decision which is finally taken regarding the requirement or otherwise in mandatory exchange bids of an alternative price in cash which is financially equivalent to at least the exchange offered. If so, the cash price of the forced sale and purchase rights would have to coincide with that which has been fixed in the bid, which will be calculated by applying to the exchange equation the average list price for the three months prior to the initial announcement of the bid. Shareholders will have to assess, based on their expectations and in the light of movements in the list price of the securities, which alternative they prefer, exchange of securities or price in cash. In the case of a voluntary exchange bid, even though an alternative cash price will not be required in the bid itself, it will be necessary for the purpose of forced sale and purchase rights and its establishment should following the same principle.

The maximum period for exercising these rights, in accordance with the Takeover Directive, is three months from the end of the bid. We believe that a longer period could invalidate the fairness of the bid price by being affected by the passage of time or circumstances which may affect the business of the company concerned, or financial markets.

It will be more attractive to the bidder to make a bid if he has this right of forced sale which will enable him to obtain 100% of the securities and, thereby, exclusion of the securities from the stock exchange. The absence of minority shareholders will enable the costs to be reduced associated with the right of shareholder information and infrastructure costs. He may also achieve a greater degree of integration into the bidder group, greater efficiency in the resource transfer policy between companies and take greater advantage of synergies.

The shareholders of the company concerned will benefit from the introduction of this concept insofar as the bidder, in his zeal to reach the threshold which enables him to exercise the right of forced sale, may be prepared to offer a more attractive price than that which he would pay in the absence of this right.

The simultaneous application of the forced purchase mechanism gives shareholders who have made their decision depend on the level of acceptances achieved by the bid an additional opportunity to realise their investment when, in the light of the final outcome, the liquidity of their shares is reduced.

The possibility that the right of forced purchase, as a mechanism opposed to that of the right of forced sale, ends up affecting the level of acceptance of the bid and consequently the success of the operation, is reduced to a problem of collective action: if many shareholders fail to accept the bid, waiting for the time to use their right of forced purchase, the possibilities will be increased that the bid does not eventually reach the minimum level necessary to exercise this right. In the end, the success of the operation will be basically determined by the conditions of the bid, and in particular by its price, matters which as well as being adapted to the minimum required by legislation must be adequately assessed by the bidder based on the purpose sought.

In conclusion, we would venture to state that this new concept of forced sale and purchase, repeatedly demanded by several Spanish undertakings, will be converted into one of the most attractive elements in takeover bids processed as from entry into force of the new Act; and without doubt will be subject to extensive public debate.

3.6 Breaches and penalty regime

A person in breach of the obligation to make a takeover bid will not be able to exercise voting rights on the securities in the listed company held pursuant to any title, without prejudice to the penalties laid down by the Securities Market Act.

This provision was included in the former Section 60 of the SMA and continues in the new one, which adds: "For the purposes of this subsection it shall be deemed that a person who fails to submit, submits beyond the maximum period established, or submits the same with basic irregularities, is in breach of the obligation to make a takeover bid".

The maximum period for submitting a mandatory bid must be established by regulations. Likewise, the maximum period must be established for submitting a voluntary bid which has been previously announced.

The notable difference, as shown by the new Section 60 of the SMA, is that failure to comply with a voluntary bid as a result of failure to submit it after having announced it, or as a result of submission beyond the maximum period determined by regulations, does not result in a prohibition on exercising voting rights which the person in breach may hold.

With respect to restoring voting rights suspended by the breach, the regulation being processed, as with the current regulation, provides that the said rights may only be recovered by making a bid for the whole of the securities of the company in which the price is fixed in accordance with the provisions for exclusion bids or by obtaining the unanimous consent of the remaining holders of the securities given individually.

The new regulation states that simple re-sale of securities acquired with infringement of the duty to make a bid will not prevent application of the corresponding penalties or permit the voting rights to be exercised in respect of securities held which have not been disposed of.

In this way, on a mandatory bid submitted beyond the deadline laid down, the recovery of voting rights in respect of the whole of the holding achieved by making the bid will require a revision of the price initially proposed (the fair price) such that there is compliance with the provisions covering exclusion bids.

As we will see later, the price of an exclusion bid may not be less than the greater of the fair price and that resulting from the methods applicable to an exclusion bid itself. In the event of breach by submitting the bid beyond the legal deadline, the Draft Royal Decree provides that the price so calculated will be increased by the interest accrued on the fair price at the legal interest rate until the date on which the bid is eventually made.

On the other hand, in a voluntary bid breach by submission beyond the deadline laid down by regulations does not involve suspension of voting rights and therefore, apart from the penalty which may apply in respect of the breach, the bid eventually made out of time will be able to maintain its initial conditions.

In the field of penalties, the new wording of Section 99.r) provided by Act 6/2007 states that breach of obligations laid down in Section 60 (mandatory bid) and 61 (voluntary bids) of the SMA, and in subsidiary legislation pursuant to the said sections, constitutes a very serious infringement and refers, amongst others, to breach of the obligation to submit a bid, submission beyond the deadline established, or one with basic irregularities which prevent the CNMV from treating it as submitted or from authorising it, or making the bid without the due authorisation.

Consequently, after the decision has been announced to submit a voluntary bid, failure to submit it or its submission beyond the deadline established by regulations, will be subject to the penalty regime, as with a mandatory bid.

Nevertheless, as we have already indicated (unless the new subsection 3 of Section 60 of the SMA can be considered applicable to all types of bid), a person in breach in the case of a voluntary bid may exercise the voting rights on securities held, in the same manner as a person may exercise them who submits a new bid before the maximum period has elapsed of regulatory prohibition laid down when the prior voluntary bid has been rendered without effect as a result of its negative outcome.

As well as the foregoing, Act 6/2007 defines the following as very serious infringements:

- Lack of publication or failure to send to the CNMV the information and documentation required for submission of a takeover bid, during the course thereof or after completion, when the information or documentation concerned is relevant or the amount of the bid or number of investors affected is significant.

- Publication or provision of information or documentation relating to a takeover bid with the omission of data or inclusion of inaccuracies, falsifications or information which is deceptive, when the information or documentation concerned is relevant or the amount of the bid or number of investors affected is significant.

- Breach by management bodies of the obligations laid down in Section 60.bis of the SMA and subsidiary regulations.

- Breach of the obligations laid down in Sections 34 (Exclusion from trading) and 60.ter (Optional neutralisation measures) of the SMA and subsidiary regulations.

4 Other matters pending regulatory development

In this section the principal aspects are highlighted which merit special attention and whose definitive regulation will depend on the text of the new Royal Decree which is finally approved.

4.1 Acquisition of indirect or intervening control

Another form of reaching the mandatory takeover bid threshold is through the so-called indirect or intervening acquisition of control. This concept, covered by legislation still in force, currently constitutes the only circumstances in which the takeover bid may be made after the holding is achieved.

Under the new regulation the possibilities of complying with the obligation established by means of a partial takeover bid disappear. The bid must be directed in all cases at 100% of the securities affected and the minimum and single threshold which triggers the obligation, as in other mandatory takeover bids, is 30%.

We are referring to the following operations through which a shareholder can in an indirect or intervening manner reach 30% or more of voting rights in a listed company:

- Merger or acquisition of control of another company which has a holding in the capital of a listed third party company.

- Reduction in the capital of a listed company.

- Subscription for or conversion of securities or instruments which grant entitlement to the acquisition of shares in a listed company.

- Underwriting an issue of shares in a listed company.

- Changes in the own shares held by the listed company.

In all cases, two possibilities will be allowed, always within three months (under current legislation it is six months) following the date on which the controlling holding intervenes: (i) making a bid for 100%, or (ii) disposing of the necessary number of securities to reduce the excess voting rights over 30% and, meanwhile, not exercising voting rights which exceed that percentage.

We must look in more detail at some of the operations referred to. Firstly, the need arises here to clarify the concept of control, because as from now two different rules can be found in the Securities Market Act, that contained in Section 4 and that in the new Section 60.

On acquisition of control by a first company, "A" of company "B" which has 30% or more of the votes in a third listed company, "C", a case which determines, as we have seen, intervening acquisition of control by "A" of "C", several situations must be distinguished.

The question to be clarified is when it is considered that "A" has taken control of "B". The final result will depend on whether company "B" has its registered office or not in Spain and whether or not it is a company listed on the Spanish Stock Exchange.

When "B" is a listed company, "A" will have to firstly make a mandatory bid for "B" by which it could achieve different positions:

(i) If, as a result of the bid, "A" achieves, for example, 90% of "B", "A" will have an intervening acquisition of control of company "C" and will have to make another bid for "C" or reduce the excess;

(ii) If, as a result of the bid, "A" reaches less than 50% of "B" and furthermore does not designate a majority of directors, it could be considered that "A" does not have effective control of "B" and, therefore, there would not be an intervening acquisition of control by "A" of company "C".

Furthermore, "B" may be a company which is not listed on any market and then "A" will be able to acquire control of "B" without making a bid.

The question again becomes in what circumstances is it considered that "A" has taken control of "B" and, consequently, also intervening control of the listed company "C". The answer will depend on the law which is applicable in the State where "B" has its registered office. In the case of a Spanish company we will have the concept of control laid down by Section 4 of the Securities Market Act which would certainly have to apply to the above case (ii).

Secondly, it can be seen how some cases in which a person or entity may gain an intervening 30% or more of the voting rights of a listed company could be considered to be not expressly covered by the new legislation.

Thus, the case does not appear to be covered of a shareholder who, on the date of entry into force of Act 6/2007 has, for example, 40% of the voting rights of a listed company, "A", and 30% in another listed company, "B", and as a result of merger of the two by absorption of "B" by "A", achieves 49% of the voting rights in the listed company "A", in this manner increasing his holding by more than 5%.

With respect to the conversion of securities into shares and subscription for securities with the right to acquire shares, we can distinguish two cases:

- The holder reaches the mandatory bid threshold as a result of conversion of a number of securities equivalent to 30% of theoretical voting rights (by subscription for a complete issue with conversion of all securities issued). This case may receive a treatment equivalent to that of a mandatory bid as a result of acquiring shares. Reaching the threshold as a result of exercising previously-acquired subscription rights should be treated in the same manner.

- The holder reaches the mandatory bid threshold as a result of conversion of a number of securities equivalent to less than 30% of theoretical voting rights but, as a result of incomplete subscription for the issue or in the light of the resulting capital figure after issues devoted to meeting the conversion of securities, this percentage represents 30% or more of total voting rights. In this case the shareholder will have an intervening holding which must receive the treatment for an indirect or intervening acquisition of control.

In order to complete this section, we would refer to the price of bids as a result of indirect or intervening acquisition of control. The Draft, as up to now, maintains that in these cases the valuation rules must be applied established for exclusion bids. Consequently, the pricing principles will be stricter than in other mandatory bids made at a fair price. However, taking into account the new model, in which all mandatory bids can be made 'after the event', the justification for this penalty is difficult to understand.

4.2 Restrictions on the actions of the bidder

We have seen how the mandatory bid coexists with the voluntary bid under the new model, in the latter case partial or total, but above all the system of the intentional mandatory bid will disappear. As a result of this the possibilities for and restrictions on actions of the bidder before, during and after the bid must be adapted to the new times. Consequently, the Draft Royal Decree provides a broad development of this area.

As an initial novelty, the information is regulated which the bidder can disseminate regarding the bid, restricting it in the period between announcement of the bid and its submission to that which the bidder itself has included in this first announcement.

In both this period and in the subsequent periods it has become widespread practice, at least in major operations, to submit the bid to analysts, disseminate it in securities markets, press releases, etc., and therefore the bidder will have to take care as to the information and data which it provides and, as the case may be, utilise the normal path of communicating relevant information through the CNMV website.

One of the new restrictions which will affect the bidder in the case of a mandatory bid consists of temporary suspension of voting rights which the same may have achieved until the bid is authorised. It is also provided that, until that time, the bidder may not designate any member of the management bodies of the company concerned.

This restriction has the purpose of preventing the bidder from being able to interfere with decisions of the company concerned through the controlling holding already achieved and from being subject to possible conflicts of interest while submission and authorisation of the mandatory bid is pending, which will enable the same to exercise its position in the company fully.

Furthermore, the Draft Royal Decree expressly authorises the bidder to acquire securities of the company concerned outside the bid and further indicates the consequences of and restrictions on this action.

Logically, in a voluntary bid submitted with conditions and which consequently may be rendered without effect, acquisition by the bidder of securities concerned outside the bid requires that all conditions be eliminated and, if it is a partial bid, it must be extended to the whole of the securities.

Furthermore, if the voluntary bid becomes mandatory as a result of these acquisitions it will be subject to the rules for mandatory bids and the bidder must adapt it to the extent necessary.

Likewise, acquisition by the bidder of securities affected by the bid with payment in cash whilst the consideration for the bid itself consists of an exchange of securities -in the event that this possibility is eventually allowed, which is currently expressly prohibited- will have to be accompanied by the obligation to include a cash price in the bid equal to the highest price paid outside the bid and, if necessary, modification of the exchange equation in order to make it equivalent to the said price in financial terms.

In addition, consistent with the primary objective of the bid which is the acquisition of securities, the Draft Royal Decree prohibits the bidder from transferring the securities affected by the bid until it is settled. And the bidder is also prohibited from transferring securities which may be offered in consideration, an operation which could affect the exchange equation and, as we have seen, the latter may be affected by the acquisition of securities covered by the bid.

Lastly, but not least in importance, acquisition by the bidder of securities at a price higher than that of the bid will, as up to now, result in automatic increase in the bid price.

In order to give maximum transparency to these operations and to the bid itself, the bidder will be under an obligation to give detailed notice of them to the market through the CNMV and, if the said operations give rise to a modification of the bid, it must provide the corresponding supplement to the registered prospectus.

The time limit for the bidder to make acquisitions outside the bid would have to be established within the period for accepting the bid. For example, it would be consistent to make this limit compatible with the deadline laid down by regulations (five days prior to the end of the acceptance period) for submitting improvements to the bid. The foregoing must be taken to be without prejudice to the special restrictions which may be appropriate under the rules for competing bids which we will see later on.

In short, on the one hand the least possible interference is sought in the process, giving freedom to the bidder to make up his holding in the most efficient possible manner but, at the same time, the recipients of the bid must have the necessary information to take a decision on the bid which best suits them before the end of the acceptance period.

With respect to restrictions on the bidder in the event that the bid is rendered without effect, we consider that the prohibition in force on submitting a new bid until six months have elapsed following publication of the negative result of the bid and acquiring securities in an amount which determines a mandatory bid, should be extended to the other cases in which cessation of the effect of the bid or its withdrawal may take place. In other words, in the event of a negative result as a result of not reaching the minimum acceptance limit established for its efficacy or not having complied with other conditions laid down by the bidder, and in cases of withdrawal from the bid provided by regulation. No substantial difference can be seen between these cases which justifies applying different rules.

Furthermore, as a result again of consistency with the bid itself and in order to preserve the integrity of the market and the seriousness of all of its participants, a further prohibition could be clarified which is applicable in other markets. This consists of the bidder not being able to acquire securities in the company concerned on more favourable terms than those of the bid which was rendered without effect, at least while competing bids are in course. Otherwise it could be considered a practice which disrupts bids in progress which will end up prejudicing the market itself and its participants and the recipients of bids.

4.3 Competing bids

One of the most controversial matters, which has attracted most attention in security markets, relates to competing bids. The matters to be laid down by regulations pursuant to Act 6/2007 include the rules governing competing bids.

The Draft Royal Decree, in a specific chapter, deals with the rules which will govern competing bids made in our market and incorporates the following modifications in relation to the rules still in force:

- The system is maintained of last improvements in all bids under the system known as "sealed envelope", but the possibility is incorporated, before this time arrives, for all competing bids, including the initial bid, to be improved, on condition that no bid is still being processed and the submission of a new bid has not been announced. Logically if on the date laid down by regulations for submitting last improvements only one bid remains in progress, this could be improved in accordance with the general rules which permit modification of the bid until some days before the end of the acceptance period, without therefore meaning that new periods begin for submitting other bids.

- Any bidder will be able to act in concert with third parties provided that the latter do not in turn participate in other bids, modifying the structure of the bid thereof in order to improve it.

- The initial bidder will have an advantage over the others by being able to present the last improvement of his bid depending on the final terms of the other bids, and of his own after opening the "sealed envelopes". In order to benefit from this advantage, its bid price may not be less than that of the best bid by more than 2% and the latter must be increased by at least 1% or, in the case of partial bids, the bid extended to a number of securities at least 5% more than the best of the competitors.

  In addition, the first bidder will be able to agree with the company concerned on receipt of a commission, known as a break-up fee, in respect of expenses of the bid in the event that it does not succeed as a result of submission of other competing bids.

- Voluntary bids may be conditional on acceptance by any percentage of securities and any other condition permitted by regulations, independently of the conditions of previous bids.

- There may be multiple declarations of acceptance of competing bids. Shareholders must simply indicate the order of preference between the different bids. At the same time acceptances must be revocable at any time prior to the final day of the period for accepting bids. It is planned to incorporate this latter possibility in any bid, whether or not competing.

Finally, as with other bids, bidders subject to competing bid rules may acquire shares in the company concerned outside the bid. The time limits on this action must be consistent with those laid down for the modification of bids and the submission of last improvements. This is so to insofar as the acquisition of shares outside the bid at a higher price requires modification of the bid itself and the latter (i) must respect the conditions previously laid down -that there is no other offer in progress and the presentation has not been announced of a new competing offer- and (ii) the final date has not arrived for submission of last improvements by “sealed envelope”.

Consequently, if a competing voluntary bid becomes mandatory as a result of acquisitions made by the bidder outside the bid, and this action requires that the terms of the bid be improved, extending it to all securities or increasing its price, the periods previously indicated must be respected. In short, the bidder in a voluntary bid will not be able to place itself in the situation of a mandatory bid while a bid being processed exists, the presentation of a new bid has been announced, or after the time of submission of last improvements of all bids by sealed envelope.

Nevertheless, in the case of a new bidder, the Draft being processed expressly provides for the possibility that a third party achieves a controlling holding which requires the same to submit a mandatory bid at any time in the competing bid process, even if the deadline has elapsed for the submission of competing bids or opening has already taken place of the “sealed envelopes” with the last improvements.

In these cases, the bidder will be under an obligation to submit a competing bid within a maximum of 5 days, complying with both the rules for mandatory bids and the rules for competing bids and, with respect to deadlines, the CNMV will have to extend them to the extent necessary and reopen the process of submitting last improvements of all bids if it has already taken place.

The intention is thereby that the bidder can comply with obligations deriving on a mandatory basis from the bid and in turn ensure due protection of shareholders, permitting its existence as a further bid under the competing bid rules.

Nevertheless, the possibility that the said circumstances arise when the previous bids have entered the settlement stage would lead to a serious distortion of the system of takeover bids and therefore should be expressly prohibited, unless the possibility is considered feasible of undoing the settlement work already commenced and again reopening the process as a whole.

Likewise, we consider that the announcement of any bid, whether voluntary or mandatory, outside the procedures regulated by the legislation or conditional on the failure of other bids which may be in progress, incorporates such a degree of uncertainty in securities markets that it should be rejected outright and submitted to the strictest penalty regime.

We finally believe that the period for submitting competing bids could be extended, for example to 30 days following that of publication of authorisation of the initial bid, with adjustment insofar as necessary of the new minimum periods for acceptance which, in accordance with the text being processed, may be less than one month. In this case, in other words when the acceptance period for the initial bid has been fixed by the bidder at less than 30 days, competing bids would have to be submitted some days before the end of this acceptance period.

4.4 Information obligations

The Takeover Directive provides for more extensive information obligations than those set out in our current legislation, which has given rise to these requirements being included in the Draft Royal Decree.

The Directive particularly emphasises the information which must be provided to employees of the company concerned and also to those of the bidder company.

The current Royal Decree 1197/1991 only refers to employees when it states that the report from the management body of the company affected by the bid must be sent before its publication to employee representatives of the company.

According to the provisions of the Draft Royal Decree, obligations to provide information to employees arise at the time of announcement of the bid, which must be notified by the bidder and the company concerned to representatives of their respective employees. These obligations continue after the bid is authorised such that the prospectus and supplementary documentation must be sent by the bidder and the company affected to their employees.

The planned new legislation also provides that the bidder company must provide information in the bid prospectus regarding its intentions in relation to the location of work centres, maintenance of jobs of workers and executives and any major change in the employment conditions of the company affected over a 12-month period. Furthermore, the bidder company must supply the same information in relation to itself when it anticipates that the bid may affect it.

Finally, as with the current legislation, the Draft Royal Decree provides for a report from the board of directors of the company affected to be sent to its employees. The novelty is that this report must contain the repercussions of the bid and the strategic plans of the bidder company regarding, amongst other aspects, employment and location of work centres of the company affected. When employees of the company are not in agreement with the said repercussions they will be able to prepare their own report which must be attached to the report from the management body.

It is also important to emphasise that under the new regulation the information to be included by the bidder company in the bid prospectus is more extensive. We would emphasise the following:

- Resolutions passed by the bidder company and company affected relating to the application of neutralisation or equivalent measures and the compensation provided for each one of them.

- List of transactions carried out by the bidder company in securities of the company affected after announcement of the bid indicating for each transaction the type, date and price or consideration.

- Justification of the consideration and valuation method used to determine the fair price, when appropriate.

- Strategic plans and intentions regarding the future activities of the company affected over a minimum of 12 months.

- Possible effects which the operation may have as the case may be on the bidder company.

- Intention to apply the right of forced sale or otherwise, and the formalities which must be complied with by holders of securities in order to request forced purchase.

The Draft Royal Decree furthermore introduces the concept of the supplement to the prospectus in which information must be included or additional data which is relevant and arises after the prospectus has been registered.

The new takeover legislation also provides for other information obligations on the part of the bidder company which include notification by means of relevant event of the acquisitions of securities in the company affected made by the bidder outside the bid, indicating the price paid and notification to the CNMV after completion of the bid of compliance or otherwise with the conditions for forced sales and purchases.

All these new information obligations, together with those which are already laid down in the current Regulation, seek compliance with one of the general principles of the Directive: recipients of the bid must have sufficient information to take a decision regarding the bid, with full knowledge.

5 Exclusion bids

In this section the principal aspects are highlighted which merit special attention and whose definitive regulation will depend on the text of the new Royal Decree which is finally approved. Act 6/2007 provides a new wording for Section 34 of the SMA in relation to exclusion from trading, making the decision by an issuer to exclude its shares from official secondary markets subject to making a takeover bid.

As has occurred up to now, the CNMV may dispense with the obligation of making an exclusion bid when protection is ensured of the legitimate interests of holders of securities affected by the exclusion by means of another equivalent procedure.

The principal novelty added by the new Section 34 is the incorporation of an obligation for directors of the company to issue a report which must be made available to shareholders at the time of convening the general meeting which is to pass the exclusion resolutions relating to the bid and to the price offered. In this report the directors will have to justify the proposal and price in detail.

The Draft Royal Decree develops this area, as does the current Section 7 of Royal Decree 1197/1991, specifying various aspects which have become normal practice in this type of operation.

In particular it expressly states that the exclusion bid may be made by the company issuing the securities to be excluded itself, or by another person or entity which has the approval of the shareholders general meeting of the company affected.

The directors' report justifying the bid price must be based on the following valuation methods which have been applied in exclusion bids made to date:

- Theoretical book value.

- Liquidating value. It specifies that calculation by this method will not be necessary when the report records that the resulting values will be significantly lower than those obtained by the other methods.

- Weighted average list price of shares during a period prior to announcement of the exclusion proposal.

- Price of a bid made one year before the announcement of the exclusion proposal.

- Other applicable valuation methods such as discounted cash flow or multiples of comparable transactions and companies.

The exclusion bid price may not be less than the higher of the fair price and that resulting from the foregoing methods based on their respective relevance.

The foregoing does not mean that the exclusion bid price must necessarily be equal to the maximum obtained by these methods. It is a question of the directors, through an independent expert or directly as the case may be, extracting a reasonable value range for the company, justifying the suitability of the methods applied to the specific case and adding the sensitivity analysis which may be appropriate.

In order to complete treatment of exclusion bids we must again mention the mechanisms of forced sale and purchase as a result of the impact which they will have in the field of exclusion from listing. As we mentioned earlier and as provided in the Draft being processed, after the forced sale operation is carried out covered by the new legislation the securities affected will be excluded from stock exchange listing.

Consequently, the new concept will save time and procedures for exclusion from dealing, and at the same time preserve shareholder protection since it will be the latter whose acceptance permits the bid to reach the minimum threshold required to exercise forced sale and purchase rights, implicitly confirming the adequacy of the price.

6 Final considerations

The transposition of the Takeover Directive into Spanish law has given rise to a profound transformation of the Spanish system of takeover bids.

This transformation should help bring about an efficient functioning of the company control market whilst at the same time contributing to the stability and integrity of the securities market and permit the participation of all shareholders in a change of control.

Nevertheless we must still await the final version of the new Royal Decree on Takeovers which will complete these reforms. The complications which may arise from applying an Act as a result of being new, and the importance of many of the aspects which depend on regulatory development, made it advisable for the Royal Decree to be promulgated without delay. Its rules will be essential for the implementation of takeover bids which will certainly be considered in the final quarter of the year.

Bidders in the market as a whole need answers to various basic questions: what is the maximum period for making bids? What would be the period and other specific rules applicable to determining a fair price and consideration for the bid? What restrictions will there be on the bidder during the process? What will be the rules eventually applicable to competing bids?

We trust that the series of rules and procedures laid down in the Royal Decree being processed will provide the necessary answers adapted to the new Spanish takeover model, and we also hope that its promulgation is possible at the same time as entry into force of the new legislation.

V Statistics Annex

1 Markets

1.1 Equity

Share issues and public offerings [1]

TABLE 1.1

	2004	2005	2006	2006 II	III	IV	2007 I	II[2]
CASH VALUE [3] (million euro)	21,735.6	2,960.5	5,021.7	2,335.8	1,472.6	941.4	803.9	9,771.2
Capital increases	18,748.0	2,803.4	2,562.9	756.0	1,188.4	497.5	696.1	8,971.8
Of which, primary offerings	1,101.9	0	644.9	487.3	0	99.7	0	0
With Spanish tranche	537.9	0	613.6	456.0	0	99.7	0	0
With international tranche	564.0	0	31.3	31.3	0	0	0	0
Secondary offerings	2,987.6	157.1	2,458.8	1,579.8	284.2	443.9	107.8	799.4
With Spanish tranche	1,664.4	54.7	2,167.5	1,364.3	208.5	443.9	107.8	799.4
With international tranche	1,323.2	102.5	291.3	215.6	75.7	0	0	0
NO. OF FILES[3]	42	27	30	13	7	7	7	8
Capital increases	37	25	23	10	4	6	6	6
Of which, primary offerings	4	0	10	6	1	2	0	2
Of which, bonus issues	15	6	0	0	0	0	0	0
Secondary offerings	7	2	15	7	4	3	1	3
NO. OF ISSUERS [4]	37	24	23	12	6	6	7	8
Capital increases	31	23	18	9	4	5	6	6
Of which, primary offerings	3	0	6	5	1	1	0	2
Secondary offerings	6	1	10	7	3	2	1	3

1 Total files registered with the CNMV (including supplements of initial files).
2 Available data: May 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 II	III	IV	2007 I	II[1]
PRIMARY OFFERINGS	1,101.9	0	644.9	487.3	0	99.7	0	0
Spanish tranche	536.4	0	613.6	456.0	0	99.7	0	0
Private subscribers	348.1	0	0	0.0	0	0	0	0
Institutional subscribers	188.3	0	613.6	456.0	0	99.7	0	0
International tranche	564.0	0	31.3	31.3	0	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	2,458.8	1,579.8	284.2	443.9	107.8	799.4
Spanish tranche	1,657.9	54.7	2,164.4	1,362.7	208.5	442.4	107.8	791.6
Private subscribers	657.4	27.3	398.7	253.9	31.8	81.7	16.2	244.9
Institutional subscribers	1,000.5	27.3	1,765.7	1,108.8	176.7	360.7	91.7	546.7
International tranche	1,323.2	102.5	291.3	215.6	75.7	0	0	0
Employees	6.5	0	3.1	1.6	0	1.5	0	7.8
Others	0	0	0	0	0	0	0	0

1 Available data: May 2007.

Admission to listing. Files registered with the CNMV

TABLE 1.3

Million euro	2004	2005	2006	2006 II	III	IV	2007 I	II[1]
NOMINAL VALUE								
With issuance prospectus	1,909.6	498.0	963.4	259.6	620.0	53.5	69.1	3.8
Capital increases	1,699.3	494.0	575.9	176.2	340.9	28.4	69.1	2.1
Of which, primary offerings	45.4	0	145.3	145.2	0	0.1	0	0
Secondary offerings	210.3	4.0	387.5	83.4	279.1	25.1	0	1.6
Without issuance prospectus	564.6	167.3	564.7	213.0	185.9	118.6	316.5	815.7
NO. OF FILES								
With issuance prospectus	36	26	18	7	5	4	5	2
Capital increases	34	25	13	5	3	3	5	1
Of which, primary offerings	2	0	5	4	0	1	0	0
Secondary offerings	3	1	9	5	2	2	0	1
Without issuance prospectus	16	27	61	14	17	20	17	9

1 Available data: May 2007.

Companies listed [1]

TABLE 1.4

	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[2]
Total electronic market[3]	128	126	135	131	133	135	135	133
Of which, without Nuevo Mercado	115	115	124	120	122	124	124	123
Of which, Nuevo Mercado	13	11	11	11	11	11	11	10
Of which, foreign companies	6	5	6	5	6	6	6	6
Second Market	17	14	12	14	14	12	12	11
Madrid	2	2	2	2	2	2	2	2
Barcelona	12	10	9	10	10	9	9	8
Bilbao	0	0	0	0	0	0	0	0
Valencia	3	2	1	2	2	1	1	1
Open outcry ex SICAV	53	47	38	42	40	38	34	34
Madrid	28	22	16	19	17	16	15	15
Barcelona	31	28	24	24	24	24	21	21
Bilbao	15	14	10	12	11	10	9	9
Valencia	21	18	13	16	16	13	11	11
Open outcry SICAV	3,086	3,111	744	3,015	2,642	744	81	25
MAB[4]	-	-	2,405	86	497	2405	3,096	3,162
Latibex	30	32	34	33	34	34	34	34

1 Data at the end of period.
2 Available data: May 2007.
3 Without ETF (Exchange Traded Funds).
4 Alternative Stock Market.

Capitalisation[1]

TABLE 1.5

Million euro	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[2]
Total electronic market [3]	525,695.1	616,684.7	813,764.7	673,851.3	735,680.9	813,764.7	885,715.3	924,648.3
Of which, without Nuevo Mercado	511,770.8	607,062.8	800,144.5	663,180.9	724,521.4	800,144.5	870,815.3	913,212.7
Of which, Nuevo Mercado	13,924.3	9,621.9	13,620.2	10,670.3	11,159.5	13,620.2	14,900.0	11,435.6
Of which, foreign companies	54,734.6	64,312.7	105,600.9	66,388.0	96,456.9	105,600.9	137,859.2	148,670.6
Ibex 35	344,240.2	407,797.4	502,828.0	438,870.8	464,171.3	502,828.0	533,589.0	551,704.0
Second Market	292.5	307.4	392.7	447.3	828.7	392.7	713.3	525.8
Madrid	11.0	9.2	18.9	15.8	14.6	18.9	32.6	36.8
Barcelona	184.1	154.4	184.2	271.8	649.3	184.2	404.2	150.2
Bilbao	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valencia	97.3	143.8	189.6	159.7	164.8	189.6	276.4	338.8
Open outcry ex SICAV	5,311.3	6,142.5	7,905.3	6,778.8	7,184.5	7,905.3	8,989.9	9,543.2
Madrid	2,411.2	2,754.4	2,698.1	2,910.7	3,119.7	2,698.1	3,159.6	3,888.0
Barcelona	2,517.2	3,129.2	4,966.3	3,614.0	3,817.6	4,966.3	5,333.9	5,647.9
Bilbao	317.1	405.9	59.5	381.7	28.8	59.5	56.2	38.2
Valencia	1,556.7	836.1	741.9	706.8	699.8	741.9	767.6	732.5
Open outcry SICAV	28,972.7	33,997.6	9,514.9	32,544.5	30,466.0	9,514.9	2,168.0	1,315.4
MAB[4]	-	-	29,864.4	1,040.0	5,460.6	29,864.4	38,711.9	40,863.9
Latibex	124,754.8	222,384.1	271,641.8	228,834.9	233,979.4	271,641.8	278,554.2	294,072.3

1 Data at the end of period.
2 Available data: May 2007.
3 Without ETF (Exchange Traded Funds).
4 Alternative Stock Market.

Trading

TABLE 1.6

Million euro	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[1]
Total electronic market [2]	636,527.4	847,663.7	1,144,562.9	261,343.7	263,333.6	349,801.5	414,929.6	259,300.3
Of which, without Nuevo Mercado	618,574.3	817,834.7	1,118,546.1	255,857.2	257,271.8	341,252.0	399,828.6	254,835.9
Of which, Nuevo Mercado	17,953.1	29,829.0	26,016.8	5,486.5	6,061.8	8,549.6	10,872.5	3,624.1
Of which, foreign companies	6,165.7	15,115.1	11,550.3	2,446.7	3,664.0	2,378.8	4,228.5	840.3
Second Market	21.3	25.9	49.3	11.1	11.4	18.6	121.9	18.7
Madrid	4.7	1.8	7.2	1.0	3.5	1.8	4.7	1.7
Barcelona	16.1	22.9	41.6	9.9	7.8	16.5	116.6	16.7
Bilbao	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valencia	0.6	1.3	0.5	0.2	0.1	0.2	0.6	0.2
Open outcry ex SICAV	423.9	860.6	736.3	60.6	107.6	267.2	316.4	122.6
Madrid	122.6	187.8	257.6	35.6	45.8	75.9	66.6	36.5
Barcelona	293.3	667.0	297.8	21.2	58.8	174.3	239.2	84.3
Bilbao	1.7	1.1	159.2	1.8	1.4	0.5	0.0	0.0
Valencia	6.2	4.6	21.8	1.9	1.7	16.5	10.6	1.8
Open outcry SICAV	4,770.0	5,037.9	4,581.9	1,146.4	866.6	1,090.9	257.6	34.0
MAB[3]	-	-	1,814.2	16.9	92.8	1,704.5	1,770.9	1,106.9
Latibex	366.4	556.7	723.3	200.5	160.2	158.0	217.0	155.2

1 Available data: May 2007.
2 Without ETF (Exchange Traded Funds).
3 Alternative Stock Market.

Trading on the electronic market by type of transaction [1]

TABLE 1.7

				2006			2007	
Million euro	2004	2005	2006	II	III	IV	I	II[2]
Regular trading	599,874.2	798,934.5	1,080,117.5	247,945.4	238,809.8	331,649.8	401,231.1	255,017.7
Orders	353,532.0	488,416.3	658,839.2	153,077.2	138,709.9	203,310.4	255,425.4	154,093.1
Put-throughs	71,360.1	82,403.1	105,910.7	24,232.9	21,955.4	32,102.3	39,297.4	26,468.0
Block trades	174,982.0	228,115.1	315,367.7	70,635.3	78,144.5	96,237.1	106,508.3	74,456.5
Off-hours	26,037.3	27,863.0	11,651.6	512.6	2,587.5	6,847.5	3,644.2	1,675.3
Authorised trades	1,367.2	4,773.4	4,052.0	559.9	169.3	2,975.6	1,455.1	1,633.4
Art. 36.1 SML trades	826.0	1.3	6,439.7	0.0	6,439.7	0.0	0.0	0.0
Tender offers	1,698.8	6,682.8	18,094.6	29.7	11,960.2	3,922.5	4,158.7	50.0
Public offerings for sale	3,057.2	226.3	3,264.0	1,584.6	1,102.5	576.8	0.0	124.0
Declared trades	278.5	2,298.9	10,347.9	8,337.3	586.1	215.0	2,280.0	261.7
Options	3,388.3	5,268.0	8,279.8	1,754.7	1,274.8	3,073.3	1,608.2	197.8
Hedge transactions	-	1,615.4	2,315.7	619.5	403.8	541.1	552.3	340.4

1 Without ETF (Exchange Traded Funds).
2 Available data: May 2007.

Margin trading for sales and securities lending

TABLE 1.8

				2006			2007	
Million euro	2004	2005	2006	II	III	IV	I	II[1]
TRADING								
Securities lending[2]	306,056.7	393,964.1	550,850.4	147,751.3	116,996.8	162,875.2	196,697.8	157,226.6
Margin trading for sales of securities[3]	139.2	152.2	379.9	106.6	96.7	94.2	129.3	84.1
Margin trading for securities purchases[3]	401.8	465.0	511.9	106.3	105.7	152.3	146.1	72.1
OUTSTANDING BALANCE								
Securities lending[2]	54,518.5	66,737.5	62,058.2	60,024.0	52,604.7	62,058.2	75,199.6	92,160.8
Margin trading for sales of securities[3]	18.2	28.5	73.6	88.1	74.2	73.6	103.8	102.6
Margin trading for securities purchases[3]	46.7	52.3	70.1	48.4	60.9	70.1	74.5	62.9

1 Available data: May 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	II	III	IV	I	II[2]
NO. OF ISSUERS	157	155	159	61	48	69	60	38
Mortgage covered bonds	9	9	11	4	5	6	6	3
Territorial covered bonds	2	2	5	1	2	3	2	0
Non-convertible bonds and debentures	50	49	46	23	20	18	21	14
Convertible bonds and debentures	2	4	1	0	0	0	0	0
Backed securities	48	53	61	15	11	28	13	12
Commercial paper	58	68	68	22	13	20	28	11
Of which, asset-backed	3	3	3	2	1	0	0	1
Of which, non-asset-backed	55	65	65	20	12	20	28	10
Other fixed-income issues	4	1	0	0	0	0	0	0
Preference shares	12	6	9	1	2	6	2	0
NO. OF ISSUES	257	264	335	85	66	98	88	49
Mortgage covered bonds	17	21	37	8	11	7	8	9
Territorial covered bonds	2	3	6	1	2	3	2	0
Non-convertible bonds and debentures	95	93	115	30	27	26	31	16
Convertible bonds and debentures	3	4	1	0	0	0	0	0
Backed securities	48	54	82	23	11	34	17	13
Commercial paper	62	81	83	22	13	20	28	11
Of which, asset-backed	3	3	3	2	1	0	0	1
Of which, non-asset-backed	59	78	80	20	12	20	28	10
Other fixed-income issues	5	1	0	0	0	0	0	0
Preference shares	26	7	11	1	2	8	2	0
NOMINAL AMOUNT (Million euro)	329,962.3	414,253.9	523.131,4	120,852.7	121,497.2	146,023.2	173,448.3	102,349.4
Mortgage covered bonds	19,074.0	35,560.0	44,250.0	7,070.0	10,950.0	5,030.0	8,400.0	7,195.5
Territorial covered bonds	1,600.0	1,775.0	5,150.0	150.0	1,800.0	3,200.0	1,450.0	0.0
Non-convertible bonds and debentures	38,093.6	41,907.1	46,687.5	14,246.1	9,980.0	8,272.0	9,982.0	6,057.0
Convertible bonds and debentures	97.4	162.8	68.1	0.0	0.0	0.0	0.0	0.0
Backed securities	50,524.8	69,044.3	91,607.7	22,645.8	9,772.4	39,766.4	39,392.2	18,363.0
Spanish tranche	38,099.5	63,908.3	85,099.9	21,696.6	9,772.4	34,207.8	39,392.2	18,363.0
International tranche	12,425.3	5,136.0	6,507.8	949.2	0.0	5,558.6	0.0	0.0
Commercial paper[3]	214,602.8	264,359.5	334,457.0	76,710.8	88,897.9	88,970.8	114,144.1	70,733.9
Of which, asset-backed	3,723.6	2,767.5	1,992.7	179.0	802.3	137.0	156.0	86.0
Of which, non-asset-backed	210,879.2	261,592.0	332,464.3	76,531.8	88,095.6	88,833.8	113,988.1	70,647.9
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	30.0	97.0	784.0	80.0	0.0
Pro memoria:								
Subordinated issues	8,871.2	11,078.5	27,361.5	3,961.7	4,725.8	13,157.2	14,481.7	871.7
Underwritten issues	97,791.9	94,368.0	92,213.5	22,634.1	9,772.4	40,066.4	39,392.2	18,363.0

1 This Includes the volume of issues admitted to trading without register issuance prospectuses.
2 Available data: May 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	II	III	IV	I	II[1]
Total	353,772.2	425,137.4	507,525.3	121,163.7	126,312.2	135,910.4	175,621.7	103,297.3
Commercial paper	211,984.5	263,728.9	332,328.4	74,889.3	89,005.7	88,120.0	115,256.1	71,099.3
Bonds and debentures	63,878.7	56,771.5	45,155.4	13,213.4	11,980.0	6,454.0	10,673.6	6,235.0
Mortgage covered bonds	20,550.0	31,600.0	43,720.0	6,870.0	10,100.0	6,500.0	9,550.0	4,995.5
Territorial covered bonds	2,300.0	1,775.0	2,650.0	150.0	300.0	2,200.0	2,950.0	1,000.0
Backed securities	50,884.7	67,480.5	83,042.5	26,040.9	14,806.6	32,127.5	36,830.0	19,967.5
Preference shares	4,174.3	3,781.5	629.0	0.0	120.0	509.0	362.0	0.0
Matador bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

1 Available data: May 2007.

AIAF. Issuers, issues and outstanding balance

TABLE 1.11

	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[1]
NO. OF ISSUERS	324	384	438	402	416	438	448	456
Commercial paper	63	66	69	65	69	69	68	67
Bonds and debentures	76	82	80	88	91	80	93	93
Mortgage covered bonds	10	12	14	14	14	14	15	15
Territorial covered bonds	3	3	5	3	4	5	7	7
Backed securities	163	211	257	226	236	257	268	277
Preference shares	33	42	46	42	42	46	49	49
Matador bonds	20	20	20	20	20	20	18	17
NO. OF ISSUES								
Commercial paper	1,593	1,724	2,242	2,138	2,199	2,242	2,451	2,556
Bonds and debentures	271	329	398	364	385	398	423	431
Mortgage covered bonds	41	54	83	67	77	83	90	97
Territorial covered bonds	5	8	11	9	10	11	14	15
Backed securities	468	631	856	696	746	856	916	959
Preference shares	47	58	65	58	60	65	69	69
Matador bonds	34	32	26	30	30	26	22	20
OUTSTANDING BALANCE [2] (million euro)	307,428.8	448,679.3	588,942.3	513,817.5	548,592.0	588,942.3	645,466.6	673,903.2
Commercial paper	45,176.7	57,719.4	70,778.6	60,110.4	67,489.2	70,778.6	77,054.5	82,893.0
Bonds and debentures	68,044.8	103,250.7	131,107.8	121,429.5	128,308.6	131,107.8	138,282.1	139,292.6
Mortgage covered bonds	57,324.5	90,550.0	129,710.0	114,110.0	124,210.0	129,710.0	139,260.0	144,255.5
Territorial covered bonds	5,800.0	7,575.0	9,525.0	7,725.0	8,025.0	9,525.0	12,475.0	13,475.0
Backed securities	109,862.5	164,810.0	222,866.1	185,878.7	195,875.4	222,866.1	253,378.5	269,151.0
Preference shares	18,705.1	22,486.6	23,115.6	22,486.6	22,606.6	23,115.6	23,417.6	23,417.6
Matador bonds	2,515.1	2,287.6	1,839.2	2,077.2	2,077.2	1,839.2	1,598.8	1,418.5

1 Available data: May 2007.
2 Nominal amount.

AIAF. Trading

TABLE 1.12

Nominal amount in million euros	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[1]
BY TYPE OF ASSET. Total	572,030.0	877,812.1	910,493.9	216,705.3	214,330.4	270,334.3	286,751.4	172,697.0
Commercial paper	291,902.6	408,185.0	489,069.5	104,543.9	139,298.9	140,827.7	153,727.0	94,335.0
Bonds and debentures	51,263.3	86,585.7	82,421.1	25,043.4	17,962.7	19,567.1	27,225.5	14,759.4
Mortgage covered bonds	46,014.4	60,060.9	70,113.5	12,326.1	15,466.1	21,803.3	21,073.3	10,962.9
Territorial covered bonds	3,356.9	2,740.1	3,659.1	335.1	618.0	2,588.9	1,216.9	230.6
Backed securities	171,724.6	313,778.5	257,628.9	72,344.6	39,549.6	83,470.8	81,543.8	51,340.1
Preference shares	4,139.4	4,046.2	4,647.8	1,018.1	952.2	1,512.0	1,409.7	718.5
Matador bonds	3,628.8	2,415.7	2,954.1	1,094.2	482.8	564.7	555.2	350.6
BY TYPE OF TRANSACTION. Total	572,030.0	877,812.0	910,493.9	216,705.3	214,330.4	270,334.3	286,751.4	172,697.0
Outright	242,333.0	322,819.0	386,368.8	93,496.4	84,178.3	118,623.9	114,776.5	62,804.7
Repos	197,778.0	284,520.0	330,839.9	72,340.1	91,538.6	98,597.3	120,468.5	78,668.7
Sell-buybacks/Buy-sellbacks	131,919.0	270,473.0	193,285.1	50,868.8	38,613.5	53,113.1	51,506.4	31,223.6

1 Available data: May 2007.

AIAF. Third-party trading. By purchaser sector

TABLE 1.13

Nominal amount in million euros	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[1]
Total	430,127.3	591,837.2	702,608.8	162,265.7	171,695.1	213,205.3	231,894.9	138,901.1
Non-financial companies	176,479.7	218,139.5	260,108.1	53,542.0	74,115.1	78,073.8	88,151.6	69,435.5
Financial institutions	138,401.6	218,381.1	247,876.4	58,287.2	63,569.6	68,679.6	68,858.1	44,909.6
Credit institutions	43,446.8	71,118.9	83,999.1	23,187.9	19,304.5	26,313.7	20,027.7	15,058.7
CIS[2], insurance and pension funds	90,163.8	138,580.4	145,911.5	31,090.9	40,199.8	37,714.5	40,317.3	25,363.4
Other financial institutions	4,790.9	8,681.8	17,965.8	4,008.4	4,065.2	4,651.4	8,513.2	4,487.5
General government	1,695.9	5,629.4	7,058.9	2,070.3	1,311.1	2,317.3	2,514.1	1,358.8
Households and NPISHs[3]	16,100.1	14,433.3	23,675.9	6,017.3	4,445.8	7,080.9	16,311.1	3,071.1
Rest of the world	97,450.1	135,253.9	163,889.4	42,348.9	28,253.5	57,053.7	56,060.0	20,126.0

1 Available data: May 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	II	III	IV	I	II[1]
NOMINAL AMOUNTS (Million euro)	113.3	1,234.6	68.1	0	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	0	0	0	0	0
Others	0	0	0	0	0	0	0	0
NO. OF FILES	3	6	1	0	0	0	0	0
Non-convertible bonds and debentures	1	3	0	0	0	0	0	0
Convertible bonds and debentures	2	3	1	0	0	0	0	0
Others	0	0	0	0	0	0	0	0

1 Available data: May 2007.

Equity markets. Issuers, issues and outstanding balances

TABLE 1.15

				2006			2007	
	2004	2005	2006	II	III	IV	I	II[1]
NO. OF ISSUERS	52	56	57	55	56	57	56	54
Private issuers	35	39	40	38	39	40	40	38
Non-financial companies	12	12	10	11	10	10	10	8
Financial institutions	23	27	30	27	29	30	30	30
General government	17	17	17	17	17	17	16	16
Regional governments	3	3	3	3	3	3	3	3
NO. OF ISSUES	264	267	264	254	261	264	252	249
Private issuers	113	122	131	115	123	131	129	123
Non-financial companies	28	22	18	20	18	18	17	15
Financial institutions	85	100	113	95	105	113	112	108
General government	151	145	133	139	138	133	123	126
Regional governments	87	92	89	92	91	89	87	90
OUTSTANDING BALANCES [2] (million euro)	14,460.0	16,323.0	17,105.4	15,767.6	16,914.7	17,105.4	16,952.6	16,829.5
Private issuers	4,533.2	5,507.3	6,784.3	4,961.4	5,973.3	6,784.3	6,596.0	6,441.8
Non-financial companies	1,244.7	835.4	492.1	492.2	491.9	492.1	486.3	484.5
Financial institutions	3,288.5	4,671.9	6,292.2	4,469.2	5,481.5	6,292.2	6,109.7	5,957.3
General government [3]	9,926.8	10,816.1	10,321.1	10,806.2	10,941.3	10,321.1	10,356.6	10,387.7
Regional governments	7,198.2	8,457.2	8,319.8	8,456.4	8,591.6	8,319.8	8,665.6	8,696.7

1 Available data: May 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	II	III	IV	I	II[1]
Electronic market	227.0	220.0	257.3	160.1	22.8	37.7	87.2	17.3
Open outcry	490.1	4,538.3	5,009.9	112.9	2,641.2	1,899.0	2,067.1	48.1
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	75.3	2,616.8	1,867.8	2,033.0	28.9
Bilbao	309.2	9.2	24.8	14.0	1.3	2.6	1.6	1.4
Valencia	130.5	124.8	105.5	23.6	23.1	28.5	32.4	17.8
Public book-entry debt	40.8	36.1	35.6	9.9	7.9	9.9	7.7	6.5
Regional governments debt	76,258.8	83,204.0	84,443.6	22,471.4	21,182.1	18,365.4	20,980.3	14,975.6

1 Available data: May 2007.

Organised trading systems: SENAF and MTS. Public debt trading by type

TABLE 1.17

				2006			2007	
Nominal amounts in million euro	2004	2005	2006	II	III	IV	I	II[1]
Total	381.1	219.5	175.1	37.1	45.5	36.4	26.1	14.9
Outright	104.1	71.0	94.3	19.2	34.9	19.1	17.3	8.5
Sell-buybacks/Buy-sellbacks	274.8	148.5	80.2	17.9	10.6	17.3	8.8	6.4
Others	2.2	0.1	0.6	0.0	0.0	0.0	0.0	0.0

1 Available data: May 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	II	III	IV	I	II[1]
Debt products	98	46	15	4	4	3	1	2
Debt futures[2]	98	46	15	4	4	3	1	2
Ibex 35 products[3,4]	4,767,871	5,490,958	7,119,853	1,845,622	1,677,721	1,998,653	2,246,165	1,548,934
Ibex 35 plus futures	4,354,868	4,935,648	6,408,961	1,680,845	1,545,699	1,755,309	2,056,808	1,419,790
Ibex 35 mini futures	118,250	114,563	159,830	45,390	34,313	46,228	62,981	43,947
Call mini options	148,119	232,825	288,542	52,077	48,399	116,334	48,028	31,068
Put mini options	146,634	207,922	262,521	67,310	49,310	80,783	78,348	54,129
Stock products[5]	20,255,113	29,728,916	33,655,790	7,823,784	6,354,792	8,397,012	6,916,993	2,376,241
Futures	12,054,799	18,813,689	21,229,811	4,663,777	4,294,517	4,888,296	3,777,996	720,218
Call options	5,226,872	6,803,863	7,664,125	1,533,493	1,183,228	2,587,277	1,624,490	838,933
Put options	2,973,442	4,111,364	4,761,854	1,626,514	877,047	921,439	1,514,507	817,090
Pro-memoria: MEFF trading on Eurex								
Debt products[6]	2,815,703	1,440,370	1,117,956	319,145	258,349	222,213	242,092	140,783
Index products[7]	1,784,965	1,080,801	1,423,441	461,528	374,207	287,166	338,709	232,148

1 Available data: May 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	II	III	IV	I	II[1]
WARRANTS[2]								
Premium amount (Million euro)	1,525.3	1,840.0	5,144.3	906.7	642.5	1,713.0	1,941.6	1,496.2
On stocks	929.0	1,180.8	3,697.6	755.8	465.8	1,243.1	1,411.9	1,077.8
On indexes	553.8	559.9	1,064.9	124.5	135.8	414.2	449.4	380.9
Other underlyings[3]	42.5	99.3	381.8	26.5	40.9	55.6	80.2	37.5
Number of issues	1,600	1,720	4.063	755	671	1,652	1,667	1,404
Number of issuers	7	6	8	5	7	7	7	6
OPTION BUYING AND SELLING CONTRACTS								
Nominal amounts (Million euro)	247.7	112.2	206.8	18.0	101.2	42.0	61.0	30.0
On stocks	195.3	87.8	196.2	18.0	101.2	32.0	55.0	30.0
On indexes	48.7	16.4	0.6	0.0	0.0	0.0	0.0	0.0
Other underlyings[3]	3.8	8.0	10.0	0.0	0.0	10.0	6.0	0.0
Number of issuers	31	13	12	1	3	4	4	1
Number of issues	8	4	4	1	2	2	3	1

1 Available data: May 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 II	2006 III	2006 IV	2007 I	2007 II[1]
WARRANTS								
Trading (Million euro)	1,826.9	2,142.4	2,907.4	773.2	554.0	849.9	1,169.4	858.8
On Spanish stocks	1,141.7	1,431.7	1,803.9	411.8	341.4	603.3	784.1	541.8
On foreign stocks	95.1	155.8	294.7	66.5	45.0	97.8	120.8	96.3
On indexes	550.7	516.8	727.4	273.9	149.6	119.2	237.8	208.9
Other underlyings[2]	39.3	38.0	81.4	21.0	18.0	29.6	26.8	11.9
Number of issues[3]	2,207	2,520	4,284	1,834	1,991	2,475	3,073	2,990
Number of issuers[3]	8	8	9	7	9	9	9	9
CERTIFICATES								
Trading (Million euro)	78.6	69.8	58.8	11.5	11.4	15.3	14.3	7.5
Number of issues[3]	16	15	14	12	11	11	10	12
Number of issuers[3]	5	5	5	5	4	4	3	3
ETF								
Trading (Million euro)	-	-	-	-	609.1	1,218.00	927.2	530.7
Number of funds	-	-	-	-	2	5	5	5
Assets[4] (Million euro)	-	-	-	-	204.4	376.8	507.8	na

1 Available data: May 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.

1.3.1 Non- financial derivatives

Trading on MFAO[1]

TABLE 1.21

Number of contracts	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[2]
On olive oil								
Extra – virgin olive oil futures[3]	10,693	21,145	35,079	7,032	7,027	6,400	16,679	10,698

1 Olive oil futures market.
2 Available data: May 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 II	2006 III	2006 IV	2007 I	2007 II[1]
Broker – dealers								
Spanish firms	48	46	47	45	46	47	45	46
Branches	90	96	108	102	107	108	95	95
Agents	6,453	6,562	6,610	6,617	6,587	6,610	6,466	6,545
Brokers								
Spanish firms	55	56	57	59	58	57	55	55
Branches	13	11	11	11	10	11	11	12
Agents	363	516	589	575	585	589	601	640
Portfolio management companies								
Spanish firms	21	17	15	15	15	15	14	13
Branches	4	4	4	4	4	4	4	4
Agents	3	14	5	4	4	5	5	5
Credit institutions[2]	207	206	204	205	205	204	204	202

1 Available data: May 2007.
2 Source: Banco de España.

Investment services. Foreign firms

TABLE 2.2

	2004	2005	2006	2006 II	III	IV	2007 I	II[1]
Total	1,107	1,196	1,321	1,260	1,296	1,321	1,357	1,377
European Economic Area investment services firms	801	867	973	923	950	973	1,005	1,023
Branches	19	18	22	16	17	22	24	25
Free provision of services	782	849	951	907	933	951	981	998
Credit institutions[2]	306	329	348	337	346	348	352	354
From EU member states	297	320	339	328	337	339	344	346
Branches	37	38	44	40	42	44	45	48
Free provision of services	259	281	294	287	294	294	298	297
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	8	8
Branches	8	8	8	8	8	8	7	7
Free provision of services	1	1	1	1	1	1	1	1

1 Available data: May 2007.
2 Source: Banco de España.

Intermediation of spot transactions

TABLE 2.3

Million euro	I 2006 Spanish Stock Exchange	Other Spanish markets	Foreign markets	Total	I 2007 Spanish Stock Exchange	Other Spanish markets	Foreign markets	Total
FIXED – INCOME								
Total	18,866	2,349,064	370,118	2,738,048	6,375	2,808,308	300,208	3,114,891
Broker-dealers	18,730	414,735	38,768	472,233	6,225	205,120	53,678	265,023
Brokers	136	1,934,329	331,350	2,265,815	150	2,603,188	246,530	2,849,868
EQUITY								
Total	465,472	1,055	41,670	508,197	598,107	2,423	29,104	629,634
Broker-dealers	435,646	600	35,121	471,367	549,502	1,379	26,481	577,362
Brokers	29,826	455	6,549	36,830	48,605	1,044	2,623	52,272

Intermediation of derivative transactions[1]

TABLE 2.4

Million euro	I 2006 Spanish organised markets	Foreign organised markets	Non-organised markets	Total	I 2007 Spanish organised markets	Foreign organised markets	Non-organised markets	Total
Total	232,038	1,585,259	848,933	2,666,230	236,641	1,390,967	1,097,890	2,725,498
Broker – dealers	94,761	270,040	3,349	368,150	110,433	325,995	78,458	514,886
Brokers	137,277	1,315,219	845,584	2,298,080	126,208	1,064,972	1,019,432	2,210,612

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

	I 2006 Total	IIC[1]	Other[2]	I 2007 Total	IIC[1]	Other[2]
NUMBER OF PORTFOLIOS						
Total	16,987	99	16,888	18,705	104	18,601
Broker – dealers	9,411	21	9,390	10,201	36	10,165
Brokers	2,794	44	2,750	4,088	33	4,055
Portfolio management companies	4,782	34	4,748	4,416	35	4,381
ASSETS UNDER MANAGEMENT (thousand euro)						
Total	14,125,271	1,261,746	12,863,525	13,677,219	1,438,719	12,238,500
Broker – dealers	4,384,402	519,598	3,864,804	5,647,280	699,469	4,947,811
Brokers	5,924,868	485,902	5,438,966	3,494,627	450,252	3,044,375
Portfolio management companies	3,816,001	256,246	3,559,755	4,535,312	288,998	4,246,314

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 II	2006 III	2006 IV	2007 I	2007 II[2]
I. FINANCIAL INCOME	78,435	57,653	17,325	-8,354	20,034	17,325	8,484	1,026
II. NET INCOME FROM SECURITIES TRADING	-44,315	200,360	48,335	63,438	138,978	48,335	38,135	-158,130
III. NET COMMISSION	539,154	653,273	775,377	358,392	548,181	775,377	240,751	314,104
Commission revenues	700,061	847,524	1,009,089	469,809	716,306	1,009,089	312,113	407,442
Brokering	449,067	526,241	629,952	298,730	432,407	629,952	215,607	274,604
Placement and underwriting	39,904	58,685	73,278	28,009	61,443	73,278	9,161	9,670
Securities deposit and recording	15,237	17,593	22,367	10,742	16,322	22,367	5,743	7,998
Portfolio management	14,141	20,599	23,883	11,284	16,119	23,883	6,757	8,827
Design and advising	35,131	52,180	55,918	24,910	42,403	55,918	20,736	34,113
Stocks search and placement	12	6	0	5	6	0	9	9
Market credit transactions	128	56	33	20	27	33	5	11
IIC subscription and redemption	104,909	118,871	141,312	67,301	102,479	141,312	34,771	46,131
Other	41,532	53,293	62,346	28,808	45,100	62,346	19,324	26,079
Commission expenses	160,907	194,251	233,712	111,417	168,125	233,712	71,362	93,338
IV. TOTAL NET REVENUES	573,274	911,286	841,037	413,476	707,193	841,037	287,370	157,000
V. OPERATING INCOME	207,113	498,362	395,105	197,008	383,776	395,105	173,463	6,858
VII. EARNINGS AFTER TAXES	215,903	266,734	430,651	211,316	484,790	430,651	280,510	309,678

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: April 2007.

Results of proprietary trading. Broker – dealers

TABLE 2.7

Thousand euro[1]	Total I 2006	Total I 2007	Financial income I 2006	Financial income I 2007	Securities portfolio I 2006	Securities portfolio I 2007	Other charges I 2006	Other charges I 2007
Total	-13,855	45,081	-11,325	8,484	5,174	38,135	-7,704	-1,538
Money market assets and public debt	2,096	-5,784	2,852	908	-756	-6,692	0	0
Other fixed – income securities	6,647	19,558	5,536	13,595	1,111	5,963	0	0
Domestic portfolio	7,471	19,359	5,044	11,132	2,427	8,227	0	0
Foreign portfolio	-824	199	492	2,463	-1,316	-2,264	0	0
Equities	17,669	-5,267	4,968	37,469	12,701	-42,736	0	0
Domestic portfolio	15,646	49,909	1,753	17,501	13,893	32,408	0	0
Foreign portfolio	2,023	-55,176	3,215	19,968	-1,192	-75,144	0	0
Derivatives	-5,585	85,774	0	0	-5,585	85,774	0	0
Repurchase agreements	-1,475	-1,230	-1,475	-1,230	0	0	0	0
Market credit transactions	0	0	0	0	0	0	0	0
Deposits and other transactions with financial intermediaries	-25,745	-48,266	-25,745	-48,266	0	0	0	0
Other transactions	-7,462	296	2,539	6,008	-2,297	-4,174	-7,704	-1,538

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 II	2006 III	2006 IV	2007 I	2007 II[2]
I. FINANCIAL INCOME	7,677	10,665	12,934	4,713	10,041	12,934	3,275	4,223
II. NET INCOME FROM SECURITIES TRADING	622	3,306	3,906	1,011	1,796	3,906	437	614
III. NET COMMISSION	157,362	184,113	233,447	121,371	172,783	233,447	62,888	80,765
Commission revenues	191,091	229,752	297,030	152,278	218,924	297,030	81,545	105,275
Brokering	88,168	97,948	114,111	57,124	83,035	114,111	34,088	43,358
Placement and underwriting	1,355	3,821	3,183	1,197	2,074	3,183	465	1,038
Securities deposit and recording	1,389	1,357	1,520	849	1,280	1,520	683	759
Portfolio management	13,747	14,868	28,672	15,925	22,916	28,672	8,177	10,102
Design and advising	1,959	2,664	2,360	1,302	1,703	2,360	423	652
Stocks search and placement	0	0	0	0	0	0	0	0
Market credit transactions	0	0	0	0	0	0	1	1
IIC subscription and redemption	26,452	46,171	68,513	32,237	49,242	68,513	17,629	23,573
Other	58,021	62,923	78,671	43,644	58,674	78,671	20,079	25,792
Commission expenses	33,729	45,639	63,583	30,907	46,141	63,583	18,657	24,510
IV. TOTAL NET REVENUES	165,661	198,084	250,287	127,095	184,620	250,287	66,600	85,602
V. OPERATING INCOME	43,424	66,420	95,026	53,143	76,220	95,026	28,709	35,592
VII. EARNINGS AFTER TAXES	20,763	38,264	62,449	49,040	74,660	62,449	33,484	44,115

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: April 2007.

Aggregated income statement. Portfolio management companies

TABLE 2.9

				2006			2007	
Thousand euro[1]	2004	2005	2006	II	III	IV	I	II[2]
I. FINANCIAL INCOME	550	575	895	334	594	895	338	458
II. NET INCOME FROM SECURITIES TRADING	89	65	6	7	-5	6	-1	-2
III. NET COMMISSION	15,155	17,164	15,195	6,789	10,146	15,195	3,875	5,040
Commission revenues	15,868	25,508	27,625	13,196	19,789	27,625	7,435	9,855
Portfolio management	10,450	18,813	22,068	11,190	16,893	22,068	6,028	8,203
Design and advising	3,265	4,380	4,951	1,494	2,252	4,951	898	964
IIC subscription and redemption	320	592	261	228	228	261	393	531
Other	1,833	1,723	345	284	416	345	116	157
Commission expenses	713	8,344	12,430	6,407	9,643	12,430	3,560	4,815
IV. TOTAL NET REVENUES	15,794	17,804	16,096	7,130	10,735	16,096	4,212	5,496
V. OPERATING INCOME	4,528	6,051	6,352	2,232	3,496	6,352	1,661	2,138
VII. EARNINGS AFTER TAXES	1,730	3,465	4,112	1,609	2,479	4,112	1,420	1,739

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: April 2007.

Surplus equity over capital adequacy requirements[1]

TABLE 2.10

	Surplus		Number of companies according to its surplus percentageo									
Thousand euro	Total amount	%[2]	< 50[3]	<100	<150	<200	<300	<400	<500	<750	<1000	>1000
Total	1,063,402	362.5	23	14	15	10	12	8	6	12	7	7
Broker – dealers	932,993	439.5	4	2	6	3	7	5	4	5	5	4
Brokers	119,273	204.2	14	10	7	5	5	2	1	7	1	3
Portfolio management companies	11,136	49.1	5	2	2	2	0	1	1	0	1	0

1 Available data: March 2007.
2 Average percentage is weighted by the required equity of each company. It is an indicator of the number of times, in percentage terms, that the surplus contains the required equity in an average company.
3 Includes all registered companies, even if they have not sent information.

Return on equity (ROE) before taxes[1]

TABLE 2.11

		Number of companies according to its annualized return								
	Average[2]	Losses	0-5%	6-15%	16-30%	31-45%	46-60%	61-75%	76-100%	>100%
Total	71.4	13	12	10	16	12	11	5	11	24
Broker – dealers	76.0	2	1	3	7	6	4	4	5	13
Brokers	52.5	9	8	5	5	5	7	1	5	10
Portfolio management companies	14.9	2	3	2	4	1	0	0	1	1

1 Available data: March 2007.
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

				2006			2007	
	2004	2005	2006	II	III	IV	I	II[1]
Total financial IIC	5,717	5,841	6,007	5,911	5,966	6,007	6,072	6,143
Mutual funds	2,620	2,723	2,850	2,791	2,829	2,850	2,885	2,915
Investment companies	3,097	3,118	3,150	3,120	3,137	3,150	3,179	3,200
Funds of hedge funds	-	-	2	-	-	2	2	19
Hedge funds	-	-	5	-	-	5	6	7
Total real estate IIC	9	13	17	15	15	17	17	17
Real estate investment funds	7	7	9	9	9	9	9	9
Real estate investment companies	2	6	8	6	6	8	8	8
Total foreign IIC marketed in Spain	238	260	340	280	312	340	354	358
Foreign funds marketed in Spain	93	115	163	122	144	163	169	169
Foreign companies marketed in Spain	145	145	177	158	168	177	185	189
Management companies	116	112	114	113	113	114	116	116
IIC depositories	137	135	132	133	132	132	129	128

1 Available data: May 2007.

* In this document, neither hedge funds nor funds of hedge funds are included in the figures referred to mutual funds.

Number of IIC investors and shareholder

TABLE 3.2

	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[1]
Total financial IIC	8,261,376	8,869,084	9,048,207	9,437,286	9,348,199	9,048,207	9,156,645	-
Mutual funds	7,880,076	8,450,164	8,637,781	9,015,250	8,924,673	8,637,781	8,740,972	8,716,306
Investment companies	381,300	418,920	410,403	422,036	423,526	410,403	415,539	-
Funds of hedge funds	-	-	2	-	-	2	26	89
Hedge funds	-	-	21	-	-	21	108	126
Total real estate IIC	86,490	119,113	151,053	131,882	140,284	151,053	153,656	154,719
Real estate investment funds	86,369	118,857	150,304	131,416	139,818	150,304	152,902	153,954
Real estate investment companies	121	256	749	466	466	749	754	765
Total foreign IIC marketed in Spain	321,805	560,555	779,165	753,416	806,305	779,165	782,020	-
Foreign funds marketed in Spain	51,364	104,089	144,139	140,263	141,164	144,139	158,900	-
Foreign companies marketed in Spain	270,441	456,466	635,026	613,153	665,141	635,026	623,120	-

1 Available data: April 2007.

IIC total net assets

TABLE 3.3

Million euro	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[1]
Total financial IIC	261,191.7	289,810.7	300,584.0	297,721.9	300,523.1	300,584.00	305,058.2	306,717.3
Mutual funds	236,088.4	262,200.9	270,406.3	269,777.9	271,361.1	270,406.3	273,412.8	274,638.7
Investment companies	25,103.3	27,609.8	30,152.7	27,944.0	29,162.1	30,152.7	31,516.0	31,899.9
Funds of hedge funds	-	-	0.6	-	-	0.6	9.5	51.1
Hedge funds	-	-	24.4	-	-	24.4	119.9	127.6
Total real estate IIC	4,434.4	6,690.8	9,052.0	8,078.3	8,450.7	9,052.0	9,240.8	9,345.0
Real estate investment funds	4,377.9	6,476.9	8,595.9	7,703.9	8,072.8	8,595.9	8,781.7	8,884.5
Real estate investment companies	56.4	213.9	456.1	374.4	377.9	456.1	459.2	460.5
Total foreign IIC marketed in Spain	17,785.6	33,668.1	44,102.9	41,655.8	41,595.1	44,102.9	45,113.8	-
Foreign funds marketed in Spain	3,498.1	8,267.3	12,099.3	10,687.5	10,719.6	12,099.3	12,464.3	-
Foreign companies marketed in Spain	14,287.4	25,400.8	32,003.5	30,968.3	30,875.5	32,003.5	32,649.6	-

1 Available data: April 2007.

Mutual funds asset allocation[1]

TABLE 3.4

Million euro	2004	2005	2006	2006 II	2006 III	2006 IV	2007 I	2007 II[2]
Asset	236,088.4	262,200.9	270,406.9	269,777.9	271,361.1	270,406.9	273,422.3	274,689.8
Cash	6,506.5	8,207.5	10,462.9	9,645.5	11,860.2	10,462.9	11,228.2	11,249.0
Portfolio investment	230,212.7	255,273.6	260,002.9	260,197.9	259,249.8	260,002.9	262,034.2	263,380.2
Domestic securities	114,058.9	123,683.6	127,355.4	126,390.2	126,103.1	127,355.4	130,070.3	130,354.9
Shares	9,578.3	11,602.1	13,806.8	12,095.5	13,614.7	13,806.8	14,389.8	14,055.5
Mutual funds units	16,782.6	17,255.9	17,322.8	18,518.1	17,148.5	17,322.8	17,377.4	17,360.8
Public money market assets	4,434.9	4,149.4	2,887.7	4,265.2	3,877.0	2,887.7	3,306.6	2,632.8
Other public fixed-income	11,422.9	10,088.7	9,891.6	9,436.1	9,929.2	9,891.6	10,178.1	9,940.8
Private money market assets	19,735.9	26,850.7	28,483.2	27,334.4	27,931.5	28,483.2	29,522.6	29,920.8
Other private fixed-income	14,235.6	18,835.6	23,105.3	19,913.9	20,985.5	23,105.3	24,646.1	24,652.6
Spanish warrants and options	157.0	483.1	603.3	479.6	580.0	603.3	578.1	580.4
Repos	37,706.7	34,417.8	31,229.4	34,347.2	32,036.3	31,229.4	30,046.1	31,186.0
Unlisted securities	5.0	0.2	25.4	0.2	0.2	25.4	25.4	25.3
Foreign securities	116,153.8	131,590.0	132,647.4	133,807.6	133,146.7	132,647.4	131,963.9	133,025.3
Euros	107,682.4	118,871.5	118,664.1	120,406.0	119,488.4	118,664.1	118,953.6	119,867.7
Shares	7,065.6	8,925.1	11,418.0	9,713.5	10,459.1	11,418.0	12,823.3	13,232.2
Mutual fund units	11,184.8	15,986.0	23,414.2	24,000.6	23,961.8	23,414.2	22,849.5	23,277.8
Fixed-income	86,833.3	90,220.7	78,933.4	83,048.1	80,881.9	78,933.4	78,365.1	78,143.0
Foreign warrants and options	2,598.8	3,739.7	4,898.7	3,643.8	4,185.5	4,898.7	4,915.7	5,214.7
Unlisted securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	8,471.4	12,718.5	13,983.3	13,401.6	13,658.3	13,983.3	13,010.3	13,157.6
Shares	4,991.0	7,019.5	7,343.0	6,898.3	6,992.1	7,343.0	7,085.0	7,111.6
Mutual fund units	2,576.7	4,395.6	5,491.5	5,208.4	5,441.2	5,491.5	4,812.2	4,941.6
Fixed-income	875.9	1,204.8	1,011.7	1,154.6	1,103.4	1,011.7	978.0	951.9
Foreign warrants and options	27.7	97.2	136.0	139.0	120.3	136.0	134.2	151.5
Unlisted securities	0.0	1.4	1.2	1.3	1.3	1.2	1.0	1.0
Net balance (Debtors -Creditors)	-630.9	-1,280.3	-58.8	-65.5	251.1	-58.8	160.0	60.6

1 Hedge funds are not included in these figures. The information is not available because hedge funds have different accounting regulation.
2 Available data: April 2007.

Investment companies asset allocation

TABLE 3.5

Million euro	2004	2005	2006	2006 II	III	IV	2007 I	II[1]
Asset	25,103.3	27,610.0	30,152.7	27,944.0	29,162.1	30,152.7	31,516.0	31,899.9
Cash	632.6	728.9	802.2	809.5	813.7	802.2	870.9	984.5
Portfolio investment	24,338.5	26,884.9	29,294.1	27,048.0	28,258.3	29,294.1	30,407.1	30,804.2
Domestic securities	13,710.4	13,851.1	15,553.8	14,030.6	14,970.1	15,553.8	15,929.3	15,820.2
Shares	4,831.2	5,906.5	6,727.3	5,834.2	6,581.5	6,727.3	7,050.5	6,902.4
Mutual funds units	755.2	941.2	1,095.0	893.6	1,093.6	1,095.0	1,143.6	1,212.5
Public money market assets	90.0	128.1	463.4	152.0	445.8	463.4	362.7	356.5
Other public fixed-income	754.8	897.0	678.2	867.8	754.8	678.2	737.3	779.2
Private money market assets	152.0	359.1	555.4	442.0	497.5	555.4	623.6	672.7
Other private fixed-income	339.5	397.3	554.8	446.7	540.0	554.8	571.5	546.1
Spanish warrants and options	7.3	15.3	19.7	11.5	12.6	19.7	21.1	29.9
Repos	6,779.2	5,206.2	5,459.1	5,382.4	5,044.0	5,459.1	5,418.1	5,320.1
Unlisted securities	1.2	0.3	0.8	0.3	0.3	0.8	0.8	0.8
Foreign securities	10,628.1	13,033.8	13,740.3	13,017.3	13,288.3	13,740.3	14,477.8	14,984.0
Euros	7,590.0	9,178.6	9,847.7	9,361.2	9,555.0	9,847.7	10,522.9	10,962.2
Shares	2,315.2	2,885.6	3,379.9	2,962.4	3,064.0	3,379.9	3,676.0	4,064.4
Mutual fund units	2,520.8	3,351.6	4,169.1	3,758.3	4,001.5	4,169.1	4,523.4	4,591.9
Fixed-income	2,642.5	2,755.8	2,041.5	2,404.3	2,236.0	2,041.5	2,061.5	2,083.1
Foreign warrants and options	109.8	185.7	257.2	236.1	253.5	257.2	262.0	222.7
Unlisted securities	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	3,038.0	3,855.2	3,892.6	3,656.1	3,733.3	3,892.6	3,954.9	4,021.8
Shares	1,888.0	2,173.9	2,104.7	2,036.0	2,067.3	2,104.7	2,080.2	2,064.5
Mutual fund units	934.1	1,403.7	1,517.7	1,376.4	1,422.5	1,517.7	1,672.9	1,702.8
Fixed-income	214.4	270.0	234.8	234.1	235.7	234.8	188.3	213.2
Foreign warrants and options	1.6	7.5	11.3	9.6	7.8	11.3	13.6	16.2
Unlisted securities	0.0	0.1	24.1	0.0	0.0	24.1	0.0	25.0
Net balance (Debtors - Creditors)	132.2	-3.8	56.4	86.6	90.0	56.4	238.0	111.2

1 Available data: April 2007.

Financial mutual funds: number, investors and total net assets by category[1]

TABLE 3.6

	2004	2005	2006	2006 I	II	III	IV	2007 I
NO. OF FUNDS								
Total financial mutual funds	2,594	2,705	2,822	2,743	2,771	2,803	2,822	2,872
Fixed-income[2]	627	624	606	611	612	613	606	609
Mixed fixed-income[3]	231	217	212	214	208	210	212	207
Mixed equity[4]	232	222	222	222	222	222	222	215
Spanish equity	110	116	118	117	116	118	118	118
Foreign equity[5]	443	454	467	464	465	461	467	480
Guaranteed fixed-income	191	211	220	215	220	218	220	232
Guaranteed equity	474	514	559	524	535	559	559	577
Global funds	286	347	418	376	393	402	418	434
Funds of hedge funds	-	-	2	-	-	-	2	2
Hedge funds	-	-	5	-	-	-	5	6
INVESTORS								
Total financial mutual funds	7,880,076	8,450,164	8,637,781	9,026,533	9,015,250	8,924,673	8,637,781	8,740,972
Fixed-income	2,929,836	3,071,656	2,960,879	3,022,098	3,028,497	3,034,437	2,960,879	2,933,505
Mixed fixed-income	457,701	492,988	524,827	539,666	534,893	544,308	524,827	551,786
Mixed equity	447,452	408,757	357,013	407,745	393,214	377,923	357,013	374,508
National equity	333,020	365,301	317,386	417,640	391,990	371,730	317,386	341,396
Foreign equity	1,091,711	1,199,460	1,258,426	1,424,214	1,340,735	1,284,729	1,258,426	1,274,138
Guaranteed fixed-income	459,047	455,237	497,540	462,006	472,703	482,550	497,540	518,940
Guaranteed equity[2]	1,655,196	1,849,626	1,783,867	1,869,941	1,849,107	1,831,944	1,783,867	1,771,469
Global funds	506,113	607,139	937,843	883,223	1,004,111	997,052	937,843	975,230
Funds of hedge funds	-	-	2	-	-	-	2	26
Hedge funds	-	-	21	-	-	-	21	108
TOTAL NET ASSETS (Million euro)								
Total financial mutual funds	236,088.4	262,200.9	270,406.3	271,765.1	269,777.9	271,361.1	270,406.3	273,412.8
Fixed-income	120,466.7	123,890.7	116,511.9	117,439.6	119,929.2	118,494.2	116,511.9	116,963.0
Mixed fixed-income	11,795.7	14,625.8	15,314.5	16,575.7	14,833.4	15,103.3	15,314.5	15,755.0
Mixed equity	9,357.3	10,005.6	10,149.2	10,714.0	10,142.9	10,233.6	10,149.2	10,090.7
National equity	8,042.1	9,741.7	10,416.4	10,796.8	9,206.8	10,421.2	10,416.4	11,238.3
Foreign equity	14,623.6	20,925.1	24,799.6	24,644.2	21,377.3	22,361.7	24,799.6	25,759.1
Guaranteed fixed-income	13,803.5	13,442.0	14,484.8	13,201.8	13,398.2	14,139.1	14,484.8	15,179.1
Guaranteed equity[2]	39,658.2	45,839.8	44,796.6	46,441.1	44,818.0	45,642.4	44,796.6	43,998.9
Global funds	18,341.3	23,730.1	33,933.3	31,951.9	36,072.2	34,965.6	33,933.3	34,428.9
Funds of hedge funds	-	-	0.6	-	-	-	0.6	9.5
Hedge funds	-	-	24.4	-	-	-	24.4	119.9

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

	2004	2005	2006	2006			2007	
				II	III	IV	I	II[1]
INVESTORS	7,880,076	8,450,164	8,637,804	9,015,250	8,924,673	8,637,804	8,741,106	8,716,522
Individuals	7,666,310	8,202,638	8,389,315	8,761,826	8,674,470	8,389,315	8,490,813	8,464,266
Residents	7,558,501	8,101,310	8,292,264	8,661,021	8,576,300	8,292,264	8,394,044	8,367,545
Non-residents	107,809	101,328	97,051	100,805	98,170	97,051	96,769	96,721
Legal entities	213,766	247,526	248,489	253,424	250,203	248,489	250,293	252,256
Credit Institutions	1,378	1,634	1,609	1,655	1,600	1,609	1,576	1,542
Other resident Institutions	210,888	244,223	244,980	249,978	246,752	244,980	246,819	248,786
Non-resident Institutions	1,500	1,669	1,900	1,791	1,851	1,900	1,898	1,928
TOTAL NET ASSETS (Million euro)	236,088.4	262,200.9	270,431.3	269,777.9	271,361.1	270,431.3	273,542.2	274,817.4
Individuals	172,068.9	193,948.6	201,411.0	200,274.4	201,607.3	201,411.0	202,506.4	203,770.2
Residents	168,792.7	190,753.2	198,330.5	197,152.4	198,501.3	198,330.5	199,482.9	200,741.3
Non-residents	3,276.2	3,195.4	3,080.5	3,122.0	3,106.0	3,080.5	3,023.5	3,028.9
Legal entities	64,019.5	68,252.3	69,020.3	69,503.5	69,753.7	69,020.3	71,035.8	71,047.2
Credit Institutions	5,128.8	4,253.2	5,318.0	5,376.0	4,992.6	5,318.0	5,569.0	5,604.3
Other resident Institutions	54,271.1	62,749.8	61,646.6	62,685.7	62,863.6	61,646.6	63,305.8	61,133.9
Non-resident Institutions	4,619.6	1,249.4	2,055.70	1,441.8	1,897.6	2,055.70	2,160.9	2,309.0

1 Available data: April 2007.

Subscriptions and redemptions of financial mutual funds by category[1]

TABLE 3.8

Million euro	2004	2005	2006	2006				2007
				I	II	III	IV	I
SUBSCRIPTIONS								
Total financial mutual funds	144,489.9	169,807.0	194,787.4	60,310.0	50,177.0	37,435.8	46,864.6	52,761.5
Fixed-income	90,646.7	108,566.1	118,705.9	33,928.7	29,928.1	25,539.0	29,310.1	31,678.8
Mixed fixed-income	4,164.8	6,677.3	8,476.6	3,337.4	1,948.5	1,208.2	1,982.5	2,322.7
Mixed equity	1,513.1	2,065.2	2,783.6	1,056.6	642.6	375.6	708.7	908.8
Spanish equity	4,031.4	5,588.5	5,590.4	1,466.9	1,216.2	1,500.5	1,406.7	1,984.6
Foreign equity	8,166.6	14,006.2	17,662.3	5,979.9	4,143.8	2,688.1	4,850.4	5,518.9
Guaranteed fixed-income	7,700.7	6,923.9	6,126.2	1,397.3	1,480.0	1,450.3	1,798.7	2,073.6
Guaranteed equity	11,373.3	13,520.7	8,914.1	2,399.4	2,205.3	1,852.2	2,457.2	1800.2
Global funds	16,893.3	12,459.2	26,528.3	10,743.8	8,612.5	2,821.7	4,350.2	6,474.0
Funds of hedge funds	-	-	0.6	-	-	-	0.6	8.9
Hedge funds	-	-	24.4	-	-	-	24.4	47.0
REDEMPTIONS								
Total financial mutual funds	125,168.6	155,304.2	198,600.1	55,213.2	49,106.6	41,714.4	52,565.8	52,566.6
Fixed-income	83,463.6	107,150.9	127,469.1	40,719.2	27,866.4	27,519.7	31,363.9	32,087.4
Mixed fixed-income	4,616.9	4,339.6	7,048.4	1,515.7	2,093.8	1,403.6	2,035.2	1,967.4
Mixed equity	2,581.1	2,602.5	3,644.7	788.1	966.6	723.8	1,166.2	1,023.0
Spanish equity	2,922.1	5,323.3	7,824.6	1,493.5	2,490.3	1,438.9	2,401.9	1,750.2
Foreign equity	7,594.2	11,390.2	16,490.9	3,805.5	6,038.3	2,794.5	3,852.6	4,986.4
Guaranteed fixed-income	5,723.2	7,014.0	5,029.3	1,582.7	1,306.9	695.1	1,444.6	1,452.0
Guaranteed equity	9,411.5	8,931.6	11,830.1	2,311.8	2,901.7	2,486.6	4,130.0	2,785.1
Global funds	8,856.1	8,552.1	19,263.1	2,996.6	5,442.6	4,652.3	6,171.5	6,515.1
Funds of hedge funds	-	-	0.0	-	-	-	0.0	0.0
Hedge funds	-	-	0.1	-	-	-	0.1	0.0

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	2006				2007
				I	II	III	IV	I
NET SUBSCRIPTIONS/REDEMPTIONS								
Total financial mutual funds	18,424.3	14,444.3	-4,524.5	5,171.5	1,065.6	-4,292.3	-6,469.2	231.8
Fixed-income	7,184.0	1,445.5	-9,423.4	-6,760.5	2,070.2	-2,107.6	-2,625.5	-415.0
Mixed fixed-income	-440.8	2,349.6	1,539.2	1,796.1	-166.5	-36.0	-54.4	355.9
Mixed equity	-1,109.2	-546.5	-854.7	294.2	-319.1	-369.7	-460.0	-112.4
Spanish equity	1,130.0	276.0	-2,219.4	-25.7	-1,300.1	92.4	-986.0	242.4
Foreign equity	514.8	2,652.4	1,133.8	2,196.7	-1,831.4	-159.9	928.4	553.5
Guaranteed fixed-income	1,853.1	-354.4	1,018.9	-205.5	176.7	694.2	353.5	621.7
Guaranteed equity	1,222.3	4,693.6	-3,021.1	140.2	-754.4	-589.7	-1,817.2	-982.8
Global funds	8,070.1	3,928.2	7,302.1	7,736.0	3,190.2	-1,816.0	-1,808.1	-40.6
Funds of hedge funds	-	-	0.6	-	-	-	0.6	8.9
Hedge funds	-	-	24.3	-	-	-	24.3	47.0
RETURN ON ASSETS								
Total financial mutual funds	7,038.9	11,670.2	12,733.7	4,393.3	-3,052.0	5,876.3	5,516.1	2,784.2
Fixed-income	1,870.5	1,837.6	2,260.2	312.6	426.2	794.8	726.6	831.1
Mixed fixed-income	444.6	620.3	606.6	190.2	-127.8	305.8	238.4	140.9
Mixed equity	567.8	1,053.4	984.2	401.6	-250.3	454.1	378.7	163.0
Spanish equity	1,182.8	1,623.7	2,882.9	1,069.6	-290.0	1,122.0	981.2	579.5
Foreign equity	851.9	3,507.1	2,736.1	1,528.2	-1,427.0	1,150.6	1,484.3	420.5
Guaranteed fixed-income	334.0	222.8	112.3	-34.7	11.4	101.0	34.6	87.2
Guaranteed equity	1,470.5	1,635.5	1,995.2	463.2	-773.0	1,381.3	923.7	242.0
Global funds	316.8	1,169.8	1,156.2	462.6	-621.5	566.5	748.6	320.0
Funds of hedge funds	-	-	0.0	-	-	-	0.0	0.0
Hedge funds	-	-	0.1	-	-	-	-	0.8

Financial mutual funds return on assets. Detail by category

TABLE 3.10

% of daily average total net assets [1]	2004	2005	2006	2006 I	II	III	IV	2007 I
MANAGEMENT YIELDS								
Total financial mutual funds	4.31	5.87	5.73	1.91	-0.84	2.44	2.15	1.31
Fixed-income	2.51	2.31	2.51	0.44	0.56	0.84	0.67	0.90
Mixed fixed-income	4.96	6.18	5.30	1.54	-0.51	2.39	1.89	1.22
Mixed equity	7.46	12.96	11.31	4.31	-1.99	4.94	4.14	2.03
Spanish equity	19.40	20.10	30.10	10.85	-2.44	11.94	9.65	5.77
Foreign equity	7.80	22.82	13.82	7.15	-5.59	5.80	6.75	2.09
Guaranteed fixed-income	3.49	2.45	1.67	-0.05	0.30	0.95	0.44	0.78
Guaranteed equity	5.47	5.26	5.86	1.38	-1.31	3.43	2.39	0.91
Global funds	3.30	7.41	4.84	2.06	-1.46	1.94	2.58	1.28
Funds of hedge funds	-	-	ns	-	-	-	ns	1.47
Hedge funds	-	-	ns	-	-	-	ns	-0.31
EXPENSES. MANAGEMENT FEE								
Total financial mutual funds	1.08	1.07	1.04	0.27	0.25	0.27	0.26	0.26
Fixed-income	0.78	0.73	0.63	0.17	0.17	0.16	0.14	0.16
Mixed fixed-income	1.29	1.24	1.21	0.30	0.30	0.31	0.31	0.29
Mixed equity	1.64	1.69	1.63	0.42	0.38	0.42	0.42	0.40
Spanish equity	1.80	1.77	1.83	0.47	0.40	0.49	0.47	0.45
Foreign equity	1.65	1.80	1.78	0.45	0.37	0.46	0.49	0.43
Guaranteed fixed-income	0.84	0.77	0.75	0.19	0.19	0.19	0.18	0.17
Guaranteed equity	1.44	1.38	1.34	0.34	0.34	0.34	0.33	0.33
Global funds	1.26	1.41	1.26	0.35	0.24	0.32	0.37	0.32
Funds of hedge funds	-	-	ns	-	-	-	ns	0.40
Hedge funds	-	-	ns	-	-	-	ns	0.37
EXPENSES. DEPOSITORY FEE [2]								
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	0.02	0.02
Mixed equity	0.11	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Spanish equity	0.11	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Foreign equity	0.12	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Guaranteed fixed-income	0.09	0.09	0.09	0.02	0.02	0.02	0.02	0.02
Guaranteed equity	0.10	0.11	0.11	0.03	0.03	0.03	0.03	0.03
Global funds	0.09	0.09	0.10	0.02	0.03	0.03	0.03	0.03
Funds of hedge funds	-	-	ns	-	-	-	ns	0.04
Hedge funds	-	-	ns	-	-	-	ns	0.04

1 The % refers to monthly average total net assets for the Hedge fund category
2 Instead of the depository fee, the figures for the Hedge fund category refers to the financial expenses.
ns: it is not significant.

Mutual fund quarterly returns. Detail by category

TABLE 3.11

In %	2004	2005	2006	2006 I	II	III	IV	2007 I
Total financial mutual funds	3.38	5.00	5.59	1.90	-0.97	2.31	2.28	1.11
Fixed-income	1.65	1.53	1.95	0.25	0.38	0.68	0.63	0.72
Mixed fixed-income	3.79	5.00	4.18	1.26	-0.79	2.09	1.58	0.94
Mixed equity	6.20	11.85	10.34	3.98	-2.26	4.61	3.78	1.71
Spanish equity	19.06	20.60	33.25	11.12	-2.34	11.90	9.73	5.78
Foreign equity	7.55	24.18	14.98	7.54	-5.15	5.74	6.60	2.12
Guaranteed fixed-income	2.62	1.66	0.83	-0.26	0.10	0.75	0.24	0.59
Guaranteed equity	4.07	3.95	4.66	1.04	-1.64	3.12	2.12	0.56
Global funds	2.17	6.16	4.01	1.78	-1.60	1.61	2.21	0.99
Funds of hedge funds	-	-	ns	-	-	-	ns	-0.55
Hedge funds	-	-	ns	-	-	-	ns	1.26

ns: it is not significant.

Management companies. Number of portfolios and assets under

TABLE 3.12

	2004	2005	2006	2006 II	III	IV	2007 I	II[1]
NUMBER OF PORTFOLIOS								
Mutual funds	2,620	2,723	2,850	2,791	2,829	2,850	2,885	2,904
Investment companies	2,962	2,989	3,049	2,995	3,025	3,049	3,049	3,086
Funds of hedge funds	-	-	2	-	-	2	2	14
Hedge funds	-	-	5	-	-	5	6	6
Real estate investment fund	7	7	9	9	9	9	9	9
Real estate investment companies	2	6	8	6	6	8	8	8
ASSETS under management (Million euro)								
Mutual funds	236,088.4	262,200.9	270,406.3	269,777.9	271,361.1	270,406.3	273,412.8	274,638.7
Investment companies	22,923.8	25,486.0	28,992.7	26,644.0	27,959.5	28,992.7	30,293.3	30,662.4
Funds of hedge funds	-	-	0.6	-	-	0.6	9,5	51.1
Hedge funds	-	-	24.4	-	-	24.4	119.9	127.6
Real estate investment fund	4,377.9	6,476.9	8,595.9	7,703.9	8,072.8	8,595.9	8,781.7	8,884.5
Real estate investment companies	56.4	213.9	456.1	374.4	377.9	456.1	459.2	460.5

1 Available data: April 2007.

Foreign Collective Investment schemes marketed in Spain

TABLE 3.13

				2006				2007
	2004	2005	2006	I	II	III	IV	I
INVESTMENT VOLUME[1] (million euro)	17,785.6	33,614.7	44,102.9	41,994.5	41,655.8	41,595.1	44,102.9	45,113.8
Mutual funds	3,498.1	8,267.2	12,099.3	10,133.9	10,687.5	10,719.6	12,099.3	12,464.3
Investment companies	14,287.4	25,347.4	32,003.5	31,860.6	30,968.3	30,875.5	32,003.5	32,649.6
INVESTORS/SHAREHOLDERS	321,805	560,555	779,165	721,697	753,416	806,305	779,165	782,020
Mutual funds	51,364	104,089	144,139	135,069	140,263	141,164	144,139	158,900
Investment companies	270,441	456,466	635,026	586,628	613,153	665,141	635,026	623,120
NUMBER OF SCHEMES	238	260	340	266	280	312	340	354
Mutual funds	93	115	163	116	122	144	163	169
Investment companies	145	145	177	150	158	168	177	185
COUNTRY								
Luxembourg	164	161	189	165	175	183	189	190
France	25	47	83	48	48	68	83	90
Ireland	34	35	46	38	42	44	46	48
Germany	11	11	12	11	11	12	12	12
UK	3	5	6	3	3	3	6	9
The Netherlands	1	1	1	1	1	1	1	1
Austria	-	-	1	-	-	1	1	1
Belgium	-	-	1	-	-	-	1	2
Malta	-	-	1	-	-	-	1	1

1 Investment volume: participations or shares owned by the investors/shareholders at the end of the period valued at that moment of time.

Real estate investment schemes

TABLE 3.14

				2006			2007	
	2004	2005	2006	II	III	IV	I	II[1]
REAL ESTATE MUTUAL FUNDS								
Number	7	7	9	9	9	9	9	9
Investors	86,369	118,857	150,304	131,416	139,818	150,304	152,902	153,954
Assets (Million euro)	4,377.9	6,476.9	8,595.9	7,703.9	8,072.8	8,595.9	8,781.7	8,884.5
Return on assets (%)	6.65	5.35	6.12	1.88	1.52	0.80	1.31	0.32
REAL ESTATE INVESTMENT COMPANIES								
Number	2	6	8	6	6	8	8	8
Shareholders	121	256	749	466	466	749	754	765
Assets (Million euro)	56.4	213.9	456.1	374.4	377.9	456.1	459.2	460.5

1 Available data: April 2007. In this case, the return on assets is monthly.

VI Legislative Annex (*)

(*) This annex has been prepared by the CNMV Studies and Statistics Section.

New legislation of national scope promulgated in the second quarter of 2007 comprised:

- **Act 6/2007**, of 12 April, on reform of the Securities Market Act, 24/1988, of 28 July (*Ley 24/1988, de 28 de julio, del Mercado de Valores*), in order to modify the regime of takeover bids and the transparency of issuers.

  The purpose of this Act is to modify the Securities Market Act in order to incorporate the Takeover Directive and Directive on harmonisation of transparency requirements regarding information on issuers whose securities are admitted to listing on a regulated market.

  In the takeover field, the Act establishes the cases in which it will be mandatory for a person who achieves control of a listed company to make a takeover bid for 100% of the capital at a fair price. Other aspects which are modified relate to obligations of the management body of a company subject to a takeover bid, the possibility of introducing defensive iron-cladding measures and the concept of the compulsory sale and purchase[1].

  In relation to transparency obligations, the rules for exclusions from trading are improved by making it mandatory to promote a takeover bid for the whole of the securities affected by the exclusion. Rules are introduced covering periodic information to be prepared, published and disseminated by the issuer and the rules are adapted covering publication and dissemination of relevant information. The rules are also modified for notification to the issuer and to the CNMV of acquisition or loss of significant holdings. These rules are completed by the obligation of the issuer to give notice to the CNMV of, publish and disseminate transactions carried out in own shares.

1 For more detailed information on the new Spanish takeover legislation, section IV can be consulted, on "Regulatory novelties".