I Securities markets and their agents: situation and outlook

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1 Executive summary

- The global economy has shown signs of improvement over recent months, particularly among the advanced economies. Economic activity has gained momentum in both the United States and Japan under the spur of monetary stimulus packages, while the euro area economy edged clear of recession in the year's second quarter. The emerging economies, meantime, experienced some slowing of the growth pace in the first-half period due to capacity restrictions, decelerating external demand and softening commodity prices.

- International long-term debt markets have tended to reflect both the greater relative strength of the advanced economies and lower sovereign credit risk in Europe, although some tension resurfaced around mid-year when the Federal Reserve announced that it was ready to taper its monetary stimulus ahead of time if economic activity and employment picked up sufficiently.[1] The effect of this message was to lift ten-year yields on US treasuries to almost 3%, their highest point since mid-2011, and trigger a small upswing in volatility. The sovereign risk premiums of most European economies narrowed to levels similar to those of spring 2011. In equity markets, year-to-date gains were substantial in Japan (around 40%) and the United States (around 20%), against the more modest advance of European indices (centring on 10%).

- Spanish GDP contracted 0.1% in the second quarter of 2013 (+0.3% in the euro area). This marks a trend improvement versus prior quarters and opens the door to an imminent exit from recession, possibly in the third quarter of this year. Meantime, key labour market indicators point to a slower rate of employment decline (-3.6%) and a small drop in the unemployment rate, which nonetheless remains stuck at over 26% of the active population. Against this backdrop, inflation has eased considerably year to date (from 3% to an August rate of 1.5%), while budgetary execution data place the general government deficit at 5.27% in the month of July en route for the full-year target of 6.5%.

- The Spanish financial system remains immersed in a root-and-branch restructuring that has taken it safely past the milestones set in the Memorandum of Understanding signed by the Spanish and European authorities in July 2012, the main event being the transfer to SAREB (Asset Management Company for Assets Arising from Bank Restructuring) of over 50 billion dollars in bank sector problematic loans. Although the banks continue to operate in a challenging environment, the better news is that listed financial institutions reported first-

1 The closing date for this report is 15 September.

half profits of 3.51 billion euros[2] compared to the -9.51 billion losses of the same period in 2012.

- The aggregate profits of non-financial listed companies rose by 11.2% in the first six months to 8.37 billion euros, as construction and real estate firms reined in a large portion of their losses. Companies' gross debt fell by 5.8% to 283 billion euros, while leverage held flat at 1.4.

- Prices on domestic equity markets fell sharply in the first half of 2013, but subsequently rallied on the strength of the improved economic indicators coming through and lessening perceptions of sovereign credit risk. After testing 9,000 points in mid-September 2012 (its highest point since October 2011), the Ibex 35 managed a year-to-date gain of 9.5%, which was even some way surpassed by small and medium cap indices. Market volatility spiked at 30% around mid-year after hovering near 20% for most of 2013. The liquidity conditions of the Ibex 35, as measured by the bid-ask spread, can be viewed as satisfactory given the prolonged slide in trading volumes, which thinned this year by a further 8%.

- Domestic fixed-income markets had a smoother run in 2013 as they moved further away from the disruptive climate of summer 2012. Public and corporate debt yields traced a steady downwards course with only short-lived outbreaks of tension in May and June. Spanish ten-year bond yields dropped to 4.5% in mid-September (5.3% in December 2012), while the spread over the German benchmark narrowed to 237 basis points (bp) as *bund* yields headed higher. Despite a large reduction in the perceived risk of Spanish borrowers and the cheaper funding available in consequence, the volume of issues filed with the CNMV to September 2013 was 65% down on the year-ago period at 94 billion euros. A degree of market fragility, the existence of alternative funding sources and banks' lower financing needs may go some way to explaining this hiatus in debt market issuance.

- Assets under management in investment funds rose by 4.3% to 135.93 billion euros in the first-half period, after five years of almost uninterrupted decline. Around 80% of the advance traced to purchases of fixed-income and passively managed funds to the detriment primarily of guaranteed products. This change in industry fortunes, supported by falling interest rates on bank deposits and commercial paper, allowed UCITS managers to grow their profits 11.1%, accompanied by a fall in the number of loss-making companies and the volume of their losses. In parallel, the weight of less-liquid assets in investment fund portfolios receded from 4.1% in December 2012 to 3.1% in June 2013.

- Investment firm business continued to suffer the effects of the prolonged slide in stock market trading, their main source of revenues. However, other business lines like investment fund sales and portfolio management have gained visible momentum year to date. Also, the number of firms reporting losses was

2 According to information available to the CNMV at 15 September.

lower in the period, along with the volume of the same, while sector capital adequacy remained safely in the comfort zone.

- The report contains five monographic exhibits:

  - The first exhibit describes the main characteristics of the extended Financial Education Plan signed last June by the CNMV and Banco de España, which sets new objectives for the 2013-2017 period.

  - Exhibit two summarises the discussions held on 27 June last at the First Conference on the Reform of the Securities Clearing, Settlement and Registry System, whose goal was to make public the work under way on defining the future organization of post-trade systems in Spain.

  - Exhibit three explains the preventive measures recently established by the CNMV to improve information disclosures to fund investors, in view of the growing breed of target return funds now being marketed in place of guaranteed funds.

  - The fourth exhibit discusses the latest novelties in customer reporting requirements in the frame of the appropriateness and suitability assessments to be run on prospective buyers of financial instruments (CNMV Circular 3/2013, of 12 June).

  - Finally, exhibit five summarises the report published by the European Securities and Markets Authority (ESMA) in July 2013, analysing two complex products now being extensively sold to retail investors in the euro area.

2 Macro-financial background

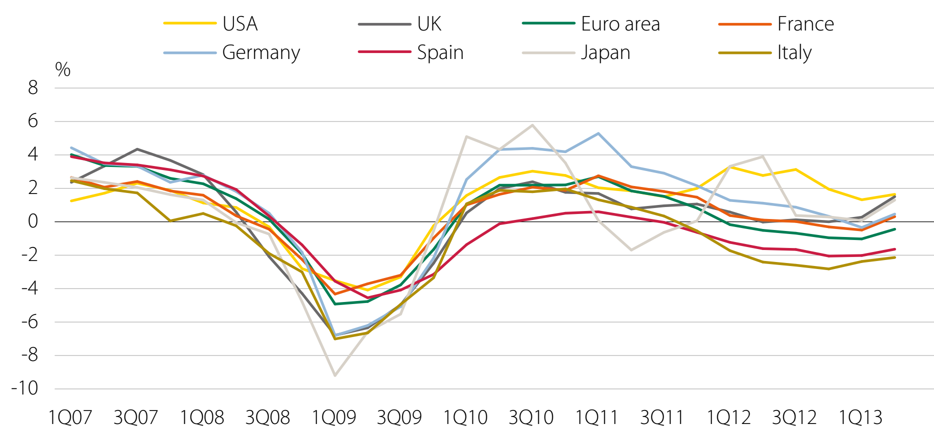
2.1 International economic and financial developments

The macroeconomic outlook has brightened among the advanced economies, while emerging market economies have seen some softening of growth.

The international macroeconomic climate has shown signs of improvement in recent months. The advanced economies have been the big beneficiaries, while emerging market economies have seen their vigorous growth eroded somewhat by capacity restrictions, decelerating external demand and softening commodity prices. In the euro area, GDP data for the second quarter signalled an end to the recession, with an overall advance in economic activity of 0.3% (0.7% in Germany, 0.5% in France, -0.3% in Italy, -0.2% in the Netherlands and -0.1% in Spain). In the United States and Japan, quarterly growth stood at 0.6% and 0.9% respectively (1.6% and 1.3% in year-on-year terms). In the case of the Japanese economy, the spurt owed partly to the monetary expansion programme announced by the central bank in April 2013.

Gross domestic product (annual % change)

FIGURE 1



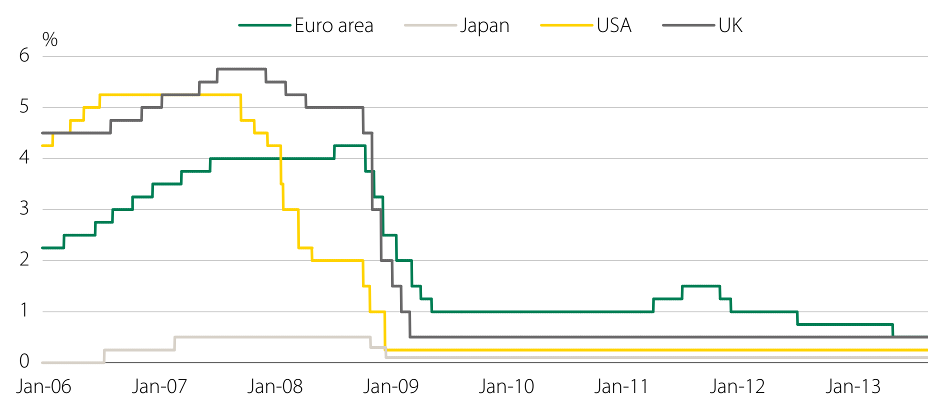
Source: Thomson Datastream.

The Federal Reserve has declared itself ready to taper its monetary stimulus.

Headline inflation has held relatively flat among the major advanced economies, at less than 2% in the United States and euro area and under 3% in the United Kingdom, while core inflation even moderated slightly. One exception was Japan, where both headline and core rates turned up strongly between March and July (from -0.9% to 0.7% and from -0.8% to -0.1% respectively) in response to the monetary expansion programme. However, the absence of any build-up in inflation pressure meant that interest rates in these economies could be kept at historical lows or even cut in the case of the euro area, where the ECB reduced its key rate last May by 25 bp to 0.5% (see figure 2). In the United States, the main event was the end-June announcement by the Federal Reserve that it was prepared to phase out the monetary stimulus measures packaged in its Quantitative Easing program in the event of a turn for the better in activity and employment data.[3]

Official interest rates

FIGURE 2



Source: Thomson Datastream. Data to 15 September.

3 Though the market consensus was that the Federal Reserve would announce the scale-back of asset purchases at its 18 September meeting, it decided, finally, to leave the program as it stands while indicating that an increase in volume was not an option (as it had been previously), and that interest rates would remain at reduced levels for the next three years. Stock markets responded with a price rise which nonetheless deflated in the next few days.

The main drivers of international long-term debt markets in the first-half period were the release of successive economic indicators, which by May were pointing the way of greater relative strength in the United States and some European economies, and the Federal Reserve's announcement that it would withdraw its quantitative easing program ahead of time if activity and employment came sufficiently back on track. The effect of this message was to lift ten-year yields on US treasuries to a fresh two-year high of around 3% not seen since mid-2011, and trigger a small upswing in volatility. Since July, debt markets have also shown some unease in response to the chain of events in Syria.

International debt markets turn somewhat more volatile in the year's middle months of the year, with yields heading higher in the United States, United Kingdom and Germany…

The ten-year bond yields of stronger economies (United States, United Kingdom and Germany) declined to the start of May, touching lows of 1.6% in the first two countries and 1.2% in Germany. They then entered a rising trend that was most marked in the case of the US treasury (see upper panel of figure 3). By mid-September ten-year bonds were yielding 2.9% in the United States and United Kingdom and 1.9% in Germany in a setting of slightly higher volatility. In the remaining economies followed, long-term sovereign yields moved steadily lower to the middle months, when a series of uncertainty factors came into play, though only the Portuguese bond experienced significant market pressures on account of political instability at home. In general, liquidity conditions on sovereign debt markets have remained comfortable year to date, even at times of heightened stress (see bottom left panel of figure 3).

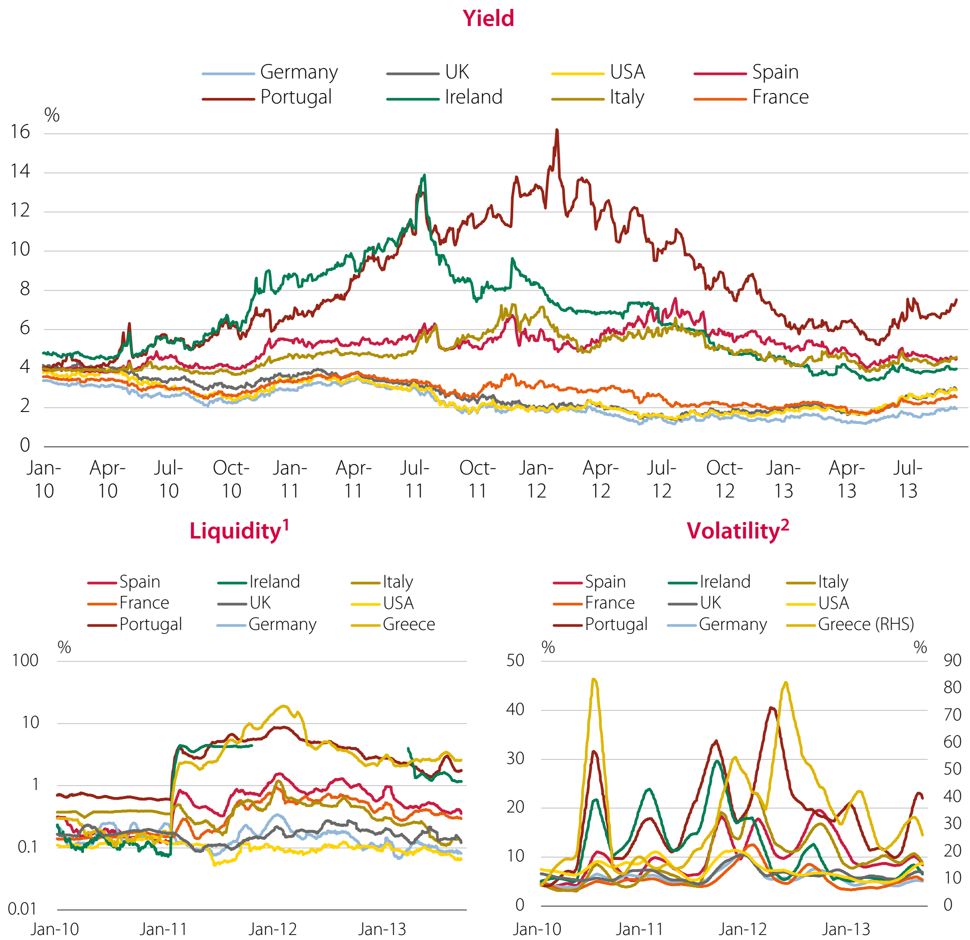
…and falling in other leading economies, albeit with some fluctuation.

On top of the run-down in sovereign spreads of last year's closing months, the improved performance of yields in the first eight months of 2013 has helped stabilise the risk premiums of most of the European economies worst hit by the sovereign debt crisis at close to the levels in place before the turmoil episode of summer 2011. In parallel, indicators of sovereign risk transmission have moved within the moderation zone, with only a temporary upswing in the middle months, most markedly in the indicator representing sovereign credit risk contagion emanating from Portugal (see figure 17). As we can see from figure 4, sovereign spreads based on five-year CDS were running at mid-September levels of 552 bp in Portugal, 251 bp in Italy, 237 bp in Spain and 145 bp in Ireland. In other, sounder European economies, equivalent spreads were comfortably below the 100 bp mark.

After a sturdy decline in second-half 2012, sovereign spreads settle near to the levels prevailing before the upsets of summer 2011.

Ten-year sovereign bond market indicators

FIGURE 3



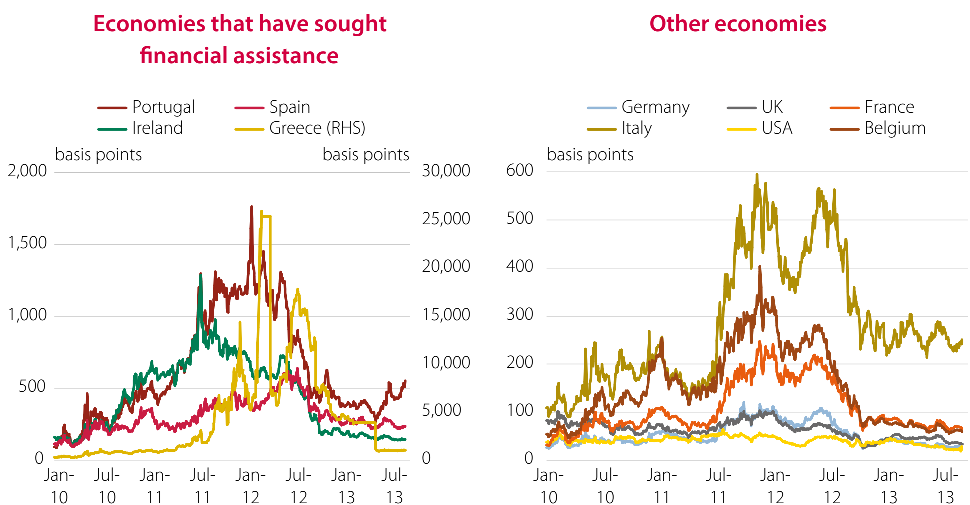
Source: Bloomberg, Thomson Datastream and CNMV. Data to 15 September.

1 Monthly average of the daily bid-ask spread of ten-year sovereign yields. Axis on a logarithmic scale.

2 Annualised standard deviation of daily changes in 40-day sovereign bond prices. Moving average of 50 periods.

Sovereign credit spreads (five-year CDS)

FIGURE 4



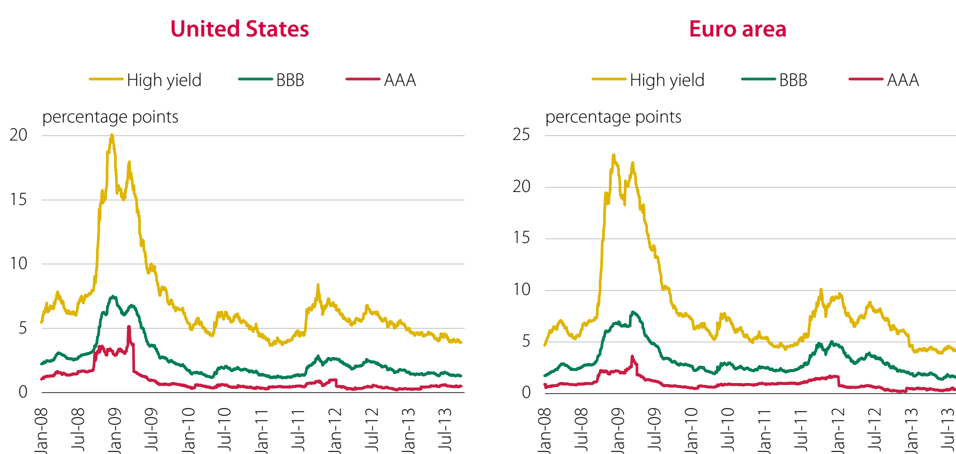
Source: Thomson Datastream. Data to 15 September.

Corporate bonds spreads for all grades of issuers also stayed virtually unaltered over the first six months in both the United States and euro area. Abundant liquidity in financial markets coinciding with historically reduced levels of interest rates continued to fuel demand for higher-risk instruments in an evident quest for return that has kept corporate credit spreads running at lows. Hence the mid-September risk premiums of high-yield issuers stood at 392 bp in the United States and 399 bp in the euro area, improving on the 453 bp and 445 bp respectively of the first-quarter close. Meantime, the spreads paid by BBB issuers were 131 bp in the United States and 153 bp in the euro area (149 bp and 197 bp in the first quarter), against the 51 bp and 13 bp respectively of those rated AAA.

Corporate bond spreads continue at lows as abundant liquidity spurs investor demand for riskier instruments.

Corporate bond spreads FIGURE 5

Spread vs. the ten-year government bond[1]



Source: Thomson Datastream and CNMV.

1 In the euro area, versus the German benchmark.

Gross long-term issuance on global debt markets came to 10.2 trillion dollars year to date (in annualised terms), 13.2% less than in full-year 2012. In net terms, the decline was a steeper 43% to 2.7 trillion dollars, reflecting both the downturn in issuance and an increased volume of debt redemptions. By sector, gross sovereign issuance – again the most voluminous – came to 7 trillion dollars, a drop of 16.4% versus 2012. The stall in public debt sales was sharpest in the United States, though the effects of ongoing fiscal consolidation were also apparent in all remaining areas tracked. Financial institution issue volumes were down 9.4% versus 2012 at 1.49 trillion dollars, though note that the sector fared better in gross and net terms in both the United States and Europe compared to the difficulties encountered in the thick of the financial crisis. Finally, non-financial corporate bond issuance held on a fairly even keel at 1.71 trillion dollars compared to 1.73 trillion in 2012, maintaining a clear lead over the financial sector. Note that inter-year comparison underplays the dynamism of corporate markets, since baseline volumes for 2012 were particularly high (see bottom right panel of figure 6).

Lower gross debt issuance on international markets reflects a scale-back in public debt sales offset in part from the private sector of the economy.

Gross international debt issuance FIGURE 6

Source: Dealogic. Half-year data. Data for the second half of 2013 run to 15 September, but are restated on a semiannual basis to facilitate comparison.

Stock indices stay strongly bullish in the United States and Japan, while gains in Europe quicken from the third quarter.

Stock indices in the world's main economic areas have performed fairly divergently year to date. US and Japanese stocks took an early lead, chalking up large gains on the strength of their more buoyant activity and, in the case of Japan, the monetary stimulus program set in train by the central bank. European indices, meantime, suffered ups and downs in the first six months due to low-gear activity and, in some countries, elements of economic and political uncertainty. In the third quarter, however, European shares rallied strongly on more upbeat growth figures, which signalled the end of recession in the euro area and rekindled investors' appetite for risk (see figure 7).

Most advanced economy indices record major gains, with a volatile Japanese market in the lead.

Japanese indices have performed strongest to date with gains approaching 39%, though price volatility has also moved up a gear. US indices, meantime, have risen between 17% (Dow Jones) and 23% (Nasdaq), against the more subdued advances of their European peers, ranging from the 8.8% of the Euro Stoxx 50 to the 13.4% of the Euronext 100 (see table 1). Stock price volatility in the United States and Europe tended to hover round the 20% mark, in contrast to the second-quarter spike recorded in Japan (see right-hand panel of figure 7).

Performance of main stock indices[1] (%)

TABLE 1

	2009	2010	2011	2012	3Q12	4Q12	1Q13	2Q13	3Q13 (to 13 September) % prior qt.	% Dec	% y/y[2]
World											
MSCI World	27.0	9.6	-7.6	13.2	6.1	2.1	7.2	-0.1	7.0	14.6	15.4
Euro area											
Euro Stoxx 50	21.1	-5.8	-17.1	13.8	8.4	7.4	-0.5	-0.8	10.2	8.8	12.7
Euronext 100	25.5	1.0	-14.2	14.8	5.0	6.0	4.7	-1.3	9.7	13.4	16.4
Dax 30	23.8	16.1	-14.7	29.1	12.5	5.5	2.4	2.1	6.9	11.8	16.4
Cac 40	22.3	-3.3	-17.0	15.2	4.9	8.5	2.5	0.2	10.0	13.0	17.5
Mib 30	20.7	-8.7	-24.0	10.2	8.6	6.0	-2.6	-0.4	12.8	9.4	10.5
Ibex 35	29.8	-17.4	-13.1	-4.7	8.5	6.0	-3.0	-2.0	15.2	9.5	12.7
United Kingdom											
FTSE 100	22.1	9.0	-5.6	5.8	3.1	2.7	8.7	-3.1	5.9	11.6	13.1
United States											
Dow Jones	18.8	11.0	5.5	7.3	4.3	-2.5	11.3	2.3	3.1	17.3	13.6
S&P 500	23.5	12.8	0.0	13.4	5.8	-1.0	10.0	2.4	5.1	18.4	15.6
Nasdaq-Composite	43.9	16.9	-1.8	15.9	6.2	-3.1	8.2	4.2	9.4	23.3	17.9
Japan											
Nikkei 225	19.0	-3.0	-17.3	22.9	-1.5	17.2	19.3	10.3	5.3	38.6	60.1
Topix	5.6	-1.0	-18.9	18.0	-4.2	16.6	20.3	9.6	4.5	37.9	59.3

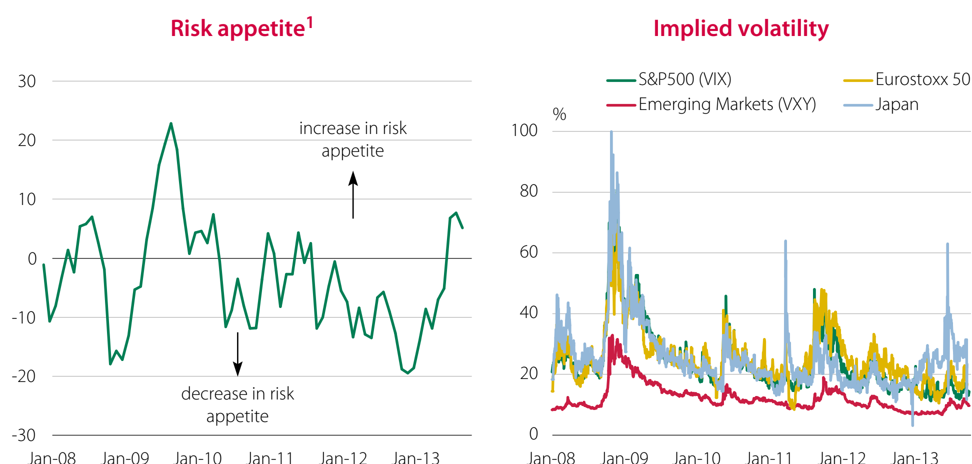
Source: Datastream.

1 In local currency.

2 Year-on-year change to the reference date.

Financial market indicators

FIGURE 7



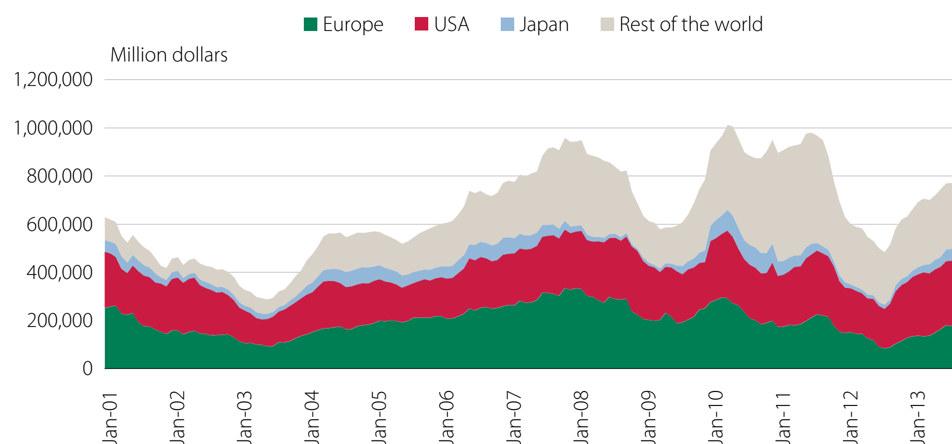
Source: Thomson Datastream and CNMV.

1 State Street indicator.

Equity issuance recovers strongly year to date in main world regions.

Equity issuance on international markets totalled 730 billion dollars to September 2013 (in accumulated twelve-month terms), easily surpassing the 583 billion dollars of the year-ago period when financial markets continued in the grip of turmoil. Issuance has picked up sharply in most regions since last summer's trough to the extent of almost doubling in Europe from the 88 billion dollars of August 2012 to 176 billion in September de 2013,[4] while volumes in the United States jumped from 181 to 249 billion (see figure 8). In Japan too companies turned increasingly to the equity market, though, as we can see from the figure, baseline levels are relatively low. Globally, equity issuance had its ten-year peak at the start of 2010, when it summed slightly over one trillion dollars.

Global equity issuance FIGURE 8



Source: Dealogic. Accumulated twelve-month data to 15 September. For comparative purposes, the figure for September is restated on a monthly basis.

2.2 National economic and financial developments

GDP contracted 0.1% in the second quarter (-1.6% year on year), 0.3 points less than in the first three months…

The latest data from Quarterly National Accounts, corresponding to the second half of 2013, show a 0.1% decline in GDP, 0.3 points less than in the preceding quarter.[5] This gives an annual contraction in GDP of 1.6% (-2.0% in the first quarter), marking a visible improvement in trend terms. In the euro area, as stated, improvement was more palpable, with GDP registering a second-quarter advance of 0.3%.

…on the slackening decline of domestic demand components.

The two main components of domestic demand lost less ground than in previous quarters. Final household consumption decreased by 3.2% in year-on-year terms against the -4.3% of the first quarter, while gross fixed capital formation receded 6.4% (-7.5% in the first quarter). It bears mention that the equipment component of gross fixed capital formation rose by 0.4% after the -4.1% of the preceding quarter, whereas the rate of decline in construction investment was again over 10%. Overall,

4 Accumulated twelve-month figures.

5 These data reflect the updated annual estimates of Spanish National Accounts for the 2009-2012 period, baseline 2008, released on 27 August, which revised down GDP growth for 2012, 2011 and 2009 by 0.2, 0.3 and 0.1 points respectively as far as -1.6%, 0.1% and -3.8%. In the same exercise, the 2010 growth rate was revised up 0.1 points to -0.2%.

domestic demand detracted from growth to the tune of 3.6 percentage points, a full point less than in the first quarter. Conversely, the growth input of net exports dropped from 2.6 percentage points in the first quarter to 2.0 in the second due to an upswing in imports (from -4.8% to 3.1%) offsetting a strong surge on the export side (from 3.6% to 9.2%).

Spain: main macroeconomic variables (annual % change) TABLE 2

					EC[1]	
	2009	2010	2011	2012	2013F	2014F
GDP[2]	**-3.8**	**-0.2**	**0.1**	**-1.6**	**-1.5**	**0.9**
Private consumption	-3.7	0.1	-1.2	-2.8	-3.1	-0.1
Government consumption	3.8	1.5	-0.5	-4.8	-3.7	-0.4
Gross fixed capital formation, of which:	-17.9	-5.5	-5.4	-7.0	-7.6	-1.1
Construction	-16.6	-9.9	-10.8	-9.7	n.a.	n.a.
Equipment and others	-24.2	5.1	5.6	-3.9	-5.8	0.1
Exports	-9.8	11.7	7.8	2.1	4.1	5.7
Imports	-16.8	9.5	0.0	-5.7	-4.0	2.0
Net exports (growth contribution, p.p.)	2.9	0.4	2.2	2.5	2.6	1.3
Employment[3]	-6.5	-2.3	-1.7	-4.4	-3.4	0.0
Unemployment rate	18.0	20.1	21.7	25.0	27.0	26.4
Consumer price index	-0.2	2.0	3.1	2.4	1.5	0.8
Current account balance (% GDP)	-4.8	-4.4	-3.7	-0.9	1.6	2.9
General government balance (% GDP)[4]	-11.2	-9.7	-9.4	-10.6	-6.5	-7.0
Public debt (% GDP)	53.9	61.5	69.3	84.2	91.3	96.8
Net international investment position (% GDP)[5]	-97.9	-91.7	-83.0	-67.5	n.a.	n.a.

Source: European Commission, Banco de España and National Statistics Office (INE).

1 European Commission forecasts published May 2013.

2 Data on GDP and components in the period 2009-2012 reflect the updated annual estimates of Spanish National Accounts, baseline 2008, released last August.

3 In full-time equivalent jobs.

4 Figures for 2011 and 2012 include government aid to credit institutions amounting to 0.5% and 3.3% of GDP respectively.

5 Ex. Banco de España.

n.a.: not available.

A slower contraction pace in all sectors except for industry.

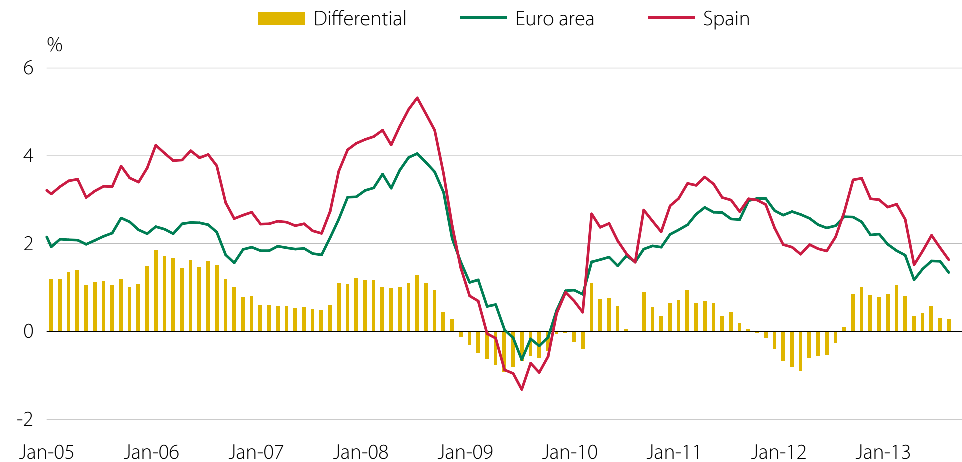
A supply side analysis shows that agriculture, hunting and forestry and most service branches clawed back some ground in the second quarter. In industry, by contrast, the rate of deceleration quickened slightly (from -3.0% to -3.1%), despite a better performance on the manufacturing side buttressed by rising demand for durable goods.

Spain's headline inflation slows from around 3% at end-2012 to 1.5% in August, lowering its differential with the euro area to 0.3 percentage points.

Spanish inflation held to a downward course, with intermittent fluctuations, that took it from near 3% at end 2012 to 1.5% in August last. The year-on-year decline in the headline rate reflects the more moderate progress of core inflation (down from 2.1% to 1.6%) and the energy component (from 7.6% to -2.2%). Spain's inflation differential vs. the euro area has also narrowed sizeably, from close to one percentage

point at the 2012 close to 0.3 in August. The absence of demand pressure and the favourable comparative effect in September figures of the VAT hike of one year before suggest this trend will persist in the short term at least.

Spain: main macroeconomic variables (annual % change) FIGURE 9



Source: Thomson Datastream. Data to August.

The latest labour-market figures indicate some very small improvement.

The latest labour-market figures also hint at a mild improvement under way. The decline in employment, specifically, was -3.6% in the second quarter compared to -4.6% in the first, while the jobless rate, still above 26% of the active population, decreased by a thin margin. The second-quarter outcome for unit labour costs (-2.3%) represents a slight containment in their adjustment path, which reflects the stabilisation of compensation per worker (-0.1%) coupled with a more modest advance in productivity (down from 2.6% to 2.2%).

The public deficit to July stands at 5.27% of GDP versus the full-year target of 6.5%.

According to advance data on budgetary execution, the general government deficit (excluding local corporations) from January to July stood at 5.27% of GDP combining the negative balances reported by central government and the autonomous communities (-4.55% and -0.77% of GDP respectively) and a slight surplus in the social security account (0.05% of GDP). Public deficit targets at the time of writing are 6.5% of GDP in 2013, 5.8% in 2014, 4.2% in 2015 and 2.8% in 2016.[6] Meantime, general government indebtedness climbed to 92.2% of GDP in the second quarter of 2013 from 90.1% in the first, placing it over six points above the level of the 2012 close[7] (85.9% of GDP).

Restructuring continues in the domestic banking sector. Individually, however, banks are still hobbled by low-gear economic activity.

These past few months, the Spanish bank sector has pressed on with a repair and restructuring process that has taken it safely past the milestones set in the Memorandum of Understanding signed by the Spanish and European authorities in July 2012. Aside from the higher provision charges taken by banks in 2012, the main

6 At the end of August, the government approved individual deficit and debt targets to 2016 for the autonomous communities, with the peculiarity that these targets are differentiated by region in 2013 (in the interval of -1% to -1.6% of GDP), and homogeneous for the 2014-2016 period (-1% of GDP in 2014, -0.7% in 2015 and -0.2% in 2016).

7 Public debt amounted to 70.4% of GDP at end-2011 and 61.7% at end-2010.

developments were the transfer to SAREB (Asset Management Company for Assets Arising from Bank Restructuring) of Group 1 entities' distressed real estate loans in December 2012, followed by the Group 2 package in February 2013, for a combined amount of over 50 billion euros. But while doubts about the quality of sector assets have been partly allayed, domestic banks are still having to cope with the stagnation of Spain's economy and the fragmentation of European financial markets, which by restricting some banks' access to funding have constrained the renewed flow of credit to the economy.

Bank sector net profits sum 621 million euros in first-quarter 2013, compared to 1.06 billion in 2012…

In this setting, sector income statements suffered added deterioration over the first quarter of 2013, albeit less intensely than in earlier periods. Gross income was down from 14.4 billion euros in the first quarter of 2012 to 13.3 billion one year later, though operating cost contention and slightly lower impairment losses on financial assets delivered a year-on-year advance at the net operating income line, from 964 million in 2012 to 1.34 billion in 2013. Finally, lower extraordinary income left the sector's net profits at 621 million euros compared to the 1.06 billion of first-quarter 2012. That said, preliminary figures for the first-half performance of listed financial institutions promise a considerable return to form, with aggregate profits of 3.51 billion euros against the 9.51 billion losses of the same period in 2012.

…in a context of still tightening credit…

Lending to the non-financial private sector has been shrinking more or less consistently at year-on-year rates from 5.5% to 6.0%. According to the latest data in the series, for the month of July, borrowings were down by 5.5% vs. the same period last year (-5.6% in the prior month). A breakdown by sector shows a decline in lending to businesses (-6.3%) and, less so, households (-4.2%). On the business side, the salient development was the divergent performance of bank credit (down by 9.8% year on year) and other kinds of debt financing (up by 8.1%). In the household sector, both home purchase and consumer lending contracted in the period, by 4.5% and 3.4% respectively. The constriction of bank lending has been less severe in the euro area than in Spain. Specifically, bank lending to non-financial corporations to the month of July was 3.7% lower year on year, while credit to households rose 0.1% due to an increase in home purchase loans (0.7%).

…and a rise in bad debt that pushed NPL ratios to a June high of 11.6%.

Bank NPL ratios resumed their ascent after the hiatus of the transfer to SAREB of Group 1 and Group 2 problematic loans in December 2012 and February 2013[8] (see figure 10). By June 2013, the ratio was running at a series peak of 11.6%. Real estate and construction were again the most delinquent sectors (28.9% and 25.4% respectively at the end of the first quarter of 2013), though the earlier asset transfers to SAREB marked a turning point for both. Meantime, the NPL ratios of remaining productive activities climbed from 8.7% at the 2012 close to 9.3% in March 2013, while the ratio for households inched up from 4.9% to 5.1%.[9]

Banks' funding conditions stay tight despite lower interest rates and the recovery of deposits.

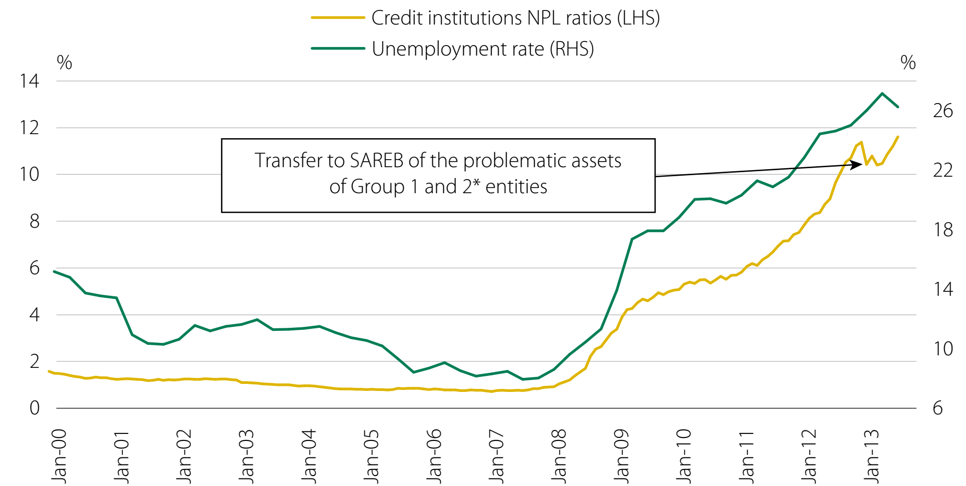
As to financial sector funding conditions, the easing of debt market tensions over the past twelve months has brought down the cost at issuance of fixed-income

8 The total amount of problematic assets transfered was 50.78 billion euros.

9 The NPL ratio of loans for home purchases and improvements rose from 4.0% to 4.2% and that of loans for the purchase of consumer durables from 6.1% to 6.2%.

securities, though note that volumes have stayed muted to date. Despite sector deleveraging and the lower funding needs brought by more restricted lending, many entities are still heavily reliant on Eurosystem finance. The latest available data, for the month of August, indicate that net Eurosystem lending to the Spanish financial system has stabilised at just under 250 billion euros. Finally, one welcome development has been the recovery of business and household deposits, which have worked their way back by more than 55 billion euros from the lows of August 2012.

Credit institution NPL ratios and the unemployment rate[1] FIGURE 10



Source: Banco de España and National Statistics Office (INE). NPL ratios and unemployment rate to June 2013, unemployment rate to December 2012.

1 Percentage of the active population.

* Group 1 transfers took place in December 2012 (36.69 billion euros) and those of Group 2 in February 2013 (14.09 billion euros).

Non-financial corporations grow their profits 11.2% to 8.37 billion euros in first-half 2013 on the receding losses of the construction and real estate sector.

The aggregate first-half profits of non-financial listed companies amounted to 8.37 billion euros, 11.2% more than in the same period in 2012. Underpinning the improvement was the notable reduction in construction and real estate sector losses, from 1.94 billion euros in the first half-year of 2012 to 516 million euros in 2013 (see table 3). Industrial firms also contributed on the upside, although their aggregate earnings are small by comparison (up from 548 million euros in 2012 to 574 million in 2013). Energy firm profits, the largest in straight-money terms, were down 0.9% vs. the year-ago period at 5.73 billion euros. The biggest fall, finally, corresponded to retail and services firms, whose profits sank 16.2% to 2.56 billion.

The sector reduces its debt by 5.8% to 283 billion euros from December 2012 to June 2013, though debt-to-equity remains unvaried.

The aggregate debt of non-financial listed companies dropped by 5.8% vs. end-2012 in the first half of 2013, to close the period at 283 billion euros. As much as 88% of this decrease traced to the retail and services and construction and real estate sectors. Aggregate leverage, defined as the ratio of debt to equity, held flat in the period at 1.40, though with some differences between sectors. Companies' debt coverage ratio, measuring the years needed to repay existing debt assuming constant EBITDA, edged up from 4.3 to 4.5, while their interest cover (EBIT/interest expenses) stayed practically unvaried in the first half-year after deteriorating through 2011 and 2012 (see table 4).

Earnings by sector:[1] non-financial listed companies

TABLE 3

	EBITDA[2]		EBIT[3]		Net profit	
Million euros	1H12	1H13	1H12	1H13	1H12	1H13
Energy	14,222	12,666	9,235	7,580	5,790	5,735
Industry	2,191	2,129	1,374	1,301	548	574
Retail and services	14,497	13,603	7,359	6,245	3,061	2,565
Construction and real estate	3,626	3,382	2,009	1,772	-1,937	-516
Adjustments	-13	-69	39	-18	65	10
AGGREGATE TOTAL	**34,523**	**31,711**	**20,016**	**16,880**	**7,527**	**8,368**

Source: CNMV.

1 Year to date.

2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

Gross debt by sector: listed companies

TABLE 4

Million euros		2009	2010	2011	2012	Jun 2013
Energy	Debt	100,572	98,283	95,853	91,233	89,323
	Debt/Equity	1.08	0.95	0.92	0.85	0.79
	Debt/EBITDA[1]	3.46	2.81	3.27	3.26	3.53
	EBIT[2]/Interest expenses	3.38	4.15	3.30	3.14	3.01
Industry	Debt	15,953	14,948	17,586	17,232	17,158
	Debt/Equity	0.69	0.58	0.63	0.63	0.95
	Debt/EBITDA	3.05	2.11	2.54	2.38	4.03
	EBIT/Interest expenses	3.15	5.00	3.90	3.82	2.27
Construction and real estate	Debt	104,762	99,917	83,716	76,236	69,629
	Debt/Equity	4.08	3.42	2.98	3.51	3.64
	Debt/EBITDA	22.48	11.18	15.00	15.17	10.29
	EBIT/Interest expenses	0.31	0.98	0.52	0.32	0.85
Retail and services	Debt	108,579	115,413	113,142	117,359	108,383
	Debt/Equity	1.78	1.60	2.01	2.00	2.08
	Debt/EBITDA	3.70	3.38	3.78	4.01	3.98
	EBIT/Interest expenses	3.28	3.94	2.45	2.02	1.97
Adjustments[3]		-1,908	-1,792	-1,404	-1,429	-1,400
AGGREGATE TOTAL	**Debt**	**327,958**	**326,769**	**308,893**	**300,633**	**283,093**
	Debt/Equity	1.63	1.43	1.44	1.41	1.41
	Debt/EBITDA	4.82	3.84	4.29	4.32	4.46
	EBIT/Interest expenses	2.42	3.12	2.30	2.06	2.03

Source: CNMV.

1 Earnings before interest, taxes, depreciation and amortisation.

2 Earnings before interest and taxes.

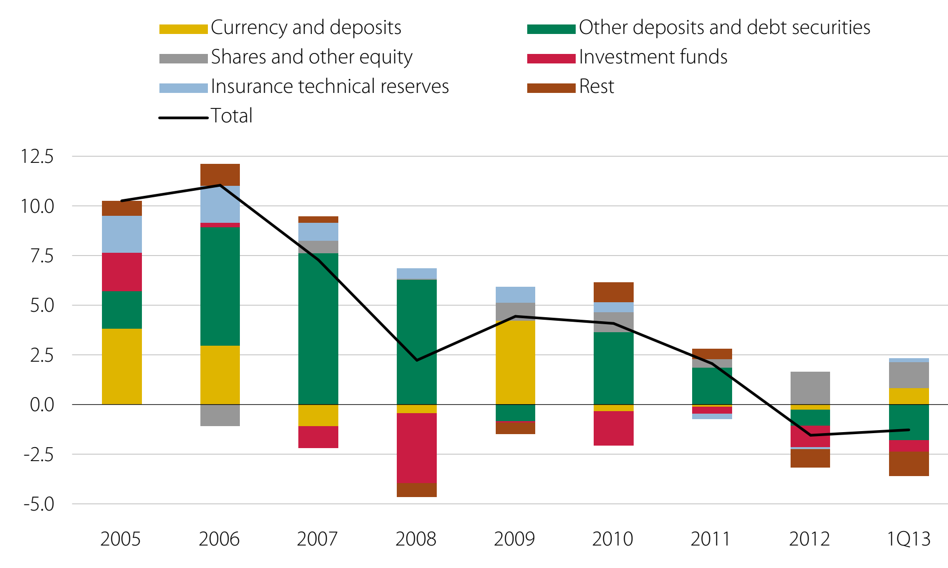
3 In drawing up this table, we eliminated the debt of issuers consolidating accounts with some other Spanish listed group. The figures in the adjustments row correspond to eliminations from subsidiary companies with their parent in another sector.

Household debt ratios head lower in the first months of 2013 hand in hand with increased investment in certain asset categories (mutual funds and insurance products).

First-quarter indicators on the net asset position of Spanish households show a drop in both indebtedness and financial burden as a percentage of gross disposable income on a combination of decreasing liabilities and lower average debt interest. Households' net wealth was largely unaltered since the increase in value of their financial assets was offset by the depreciation of real estate. Household investment decisions, meantime, were characterised by a continuing divestment of financial

assets equating in aggregate terms to 1.3% of first-quarter GDP[10] (1.5% of GDP over full-year 2012). However, some changes have emerged in household investment patterns since the closing months of 2012. In particular, disposals of financial assets in the four quarters from March 2012 to March 2013 centered on fixed-income instruments (primarily commercial paper), while time deposits came to dominance.[11] Although mutual fund investment stayed negative over the twelve months to March 2013 (-0.6% of GDP), note that the numbers turned positive in first-quarter 2013, with net inflows topping 3.40 billion euros (0.33% of GDP). Insurance and pension fund purchases also gathered speed in the same quarter as far as 0.46% of GDP.

Households: financial asset acquisitions FIGURE 11



Source: Banco de España, *Cuentas financieras*. Accumulated four-quarter data.

New Financial Education Plan EXHIBIT 1

At the G-20 summit in Los Cabos (Mexico) in June 2012, heads of state and government approved and endorsed the High-level Principles for National Strategies for Financial Education developed by the OECD and its International Network on Financial Education (INFE). These principles have been adopted by the CNMV and Banco de España in plotting their own strategy for financial education in Spain, and rolled out in the recent renovation, for the 2013-2017 period, of the Financial Education Plan that these two organizations have been promoting since 2008.

In February 2013, G-20 finance ministers and the governors of central banks reaffirmed their stance on the importance of financial education and asked the OECD to provide an update on the progress of national strategies. The resulting report devoted a full chapter to Spain's Financial Education Plan, including its objectives,

10 Accumulated four-quarter data. The figure for the first quarter of 2013 equates to an investment inflow of 0.7% of GDP.

11 Particularly in the fourth quarter of 2012.

development lines, the main results of the past edition (2008-2012) and the goals set for the incoming stage. This initiative demonstrates that the promotion of financial education has become a long-term policy priority for leading countries.

The new Financial Education Plan

In June 2013, the CNMV and Banco de España signed the renewal of the Financial Education Plan launched by the two institutions in 2008 for an initial phase ending in 2012. This second phase will extend over a further five years and signifies a renewed commitment to the plan's goal of improving citizens' financial culture.

Concretely, the Financial Education Plan targets an across-the-board improvement in Spaniards' financial knowledge, so they are better able to confront the many financial decisions they will encounter along life's path.

After a five-year period in which new groundwork has been laid for financial education and multiple objectives met (design of a financial education portal for citizens – www.finanzasparatodos.es –, production of teaching materials and resources, the start-up of learning activities for diverse collectives, partnership agreements with public and private organisations for the promotion of financial literacy, etc.), the time has come to pursue the actions that have proved most effective and set new goals for the next five years.

On the basis of the results achieved and experience gained in 2008-2012, the next phase of the plan will have the following development lines:

– *The inclusion of financial education in compulsory schooling:* this is a cornerstone of the plan. To this end, the CNMV and Banco de España concluded a framework agreement with the Ministry of Education, Culture and Sport in 2009, resulting in a series of learning initiatives in concert with regional educational authorities and sectoral associations. This development line will continue to be pursued vigorously in the second phase.

  Thanks to the work of these agents, almost 400 schools throughout Spain are running financial education programmes in the classroom in the 2012-2013 academic year. The short-term goal is to extend this programme to more centres in 2013-2014.

  Last year's teaching programme is currently being evaluated by reference to its theoretical, methodological and learning achievements as part of a broader study with the Ministry of Education, Culture and Sport to decide how these contents can best be brought within the official curriculum.

  It should be stressed that financial education in schools is now a standard practice in many countries. Recently, for instance, England and Wales declared it a compulsory subject in all plans of study.

  Testimony to the importance attached to financial education in schools at international level is the OECD's inclusion of a financial skills module in a

standard test given to 15 year olds as part of its Programme for International Student Assessment (PISA). This test will be repeated in 2015, and it is important that Spanish students are equipped for the challenge.

- *Financial education for retirement and in the insurance sphere:* in view of the need to promote the habit of long-term financial planning, and a better understanding of insurance and pension products and what they are used for, attention will go to developing materials, contents and activities that raise citizens' awareness on all these counts.

- *Consolidation of the* finanzasparatodos *brand:* work will go into establishing and publicising the *finanzasparatodos* (finance for all) brand and logo as the public image of the Financial Education Plan. This will be achieved through a presence strategy informing the public of its existence and goals through the use of social media and other instruments.

  A related objective is to get more users visiting or browsing the www.finanzasparatodos.es portal, where they can acquire new financial knowledge and pick up tips and skills.

- *Promotion and enlargement of the plan partners network:* the involvement of numerous public and private partners in the Financial Education Plan has been crucial in getting many of its activities off the ground and ensuring that it reaches a growing number of collectives.

  The goal in this second phase will be to conclude new partnership agreements and leverage existing ones. Also, contact will be made with other financial education projects under way in Spain in order to share experiences, materials and resources and by this means maximise efficiency and avoid overlap.

- *Evaluation and research:* before embarking on any financial education project, it is vital to set specific and, where possible, quantifiable objectives, so the effectiveness of actions can be properly assessed. Research is another important tool to determine where and how financial literacy needs to be improved.

  As such, an immediate objective will be to identify people's real needs through a national financial education survey. This will help pinpoint the areas where knowledge is lacking and provide a benchmark from which to assess programmes for their effectiveness in delivering progress.

2.3 Outlook

According to the latest IMF forecasts, 2013 output growth will reach 1.2% in the advanced economies and 5% in emerging market economies.

In its July forecasts, the IMF projects global growth of 3.1% in 2013 rising to 3.8% in 2014. These rates imply an 0.2 percentage points revise-down on its previous forecasts published last April. The advanced economies, it now believes, will expand 1.2% and 2.1% in 2013 and 2014 respectively, still at a distance from the emerging market economies (5% in 2013 and 5.4% in 2014).

The main risks for these projections remain tilted to the downside. Chief among them: (i) a possible thinning-out of investment flows to emerging economies when the United States gets round to withdrawing its monetary stimulus programme; (ii) delays in adopting regulatory initiatives in Europe, particularly in its progress towards the banking union crucial for uncoupling sovereign from financial risk; and (iii) the prolongation of the geopolitical instability affecting certain countries. The risks deriving from the relatively fragile state of Europe's sovereign debt markets have stabilised in recent quarters, but remain a factor of some weight, especially in a context of muted growth.

The main downside risks have to do with capital outflows from emerging economies, delays in adopting regulatory initiatives and prolonged geopolitical instability.

Gross domestic product (annual % change) TABLE 5

					IMF[1]	
	2009	2010	2011	2012	2013F	2014F
World	-0.7	5.3	3.9	3.1	3.1 (-0.2)	3.8 (-0.2)
United States	-3.0	2.4	1.8	2.2	1.7 (-0.2)	2.7 (-0.2)
Euro area	-3.8	2.0	1.5	-0.6	-0.6 (-0.2)	0.9 (-0.1)
Germany	-5.1	4.0	3.1	0.9	0.3 (-0.3)	1.3 (-0.1)
France	-3.0	1.6	2.0	0.0	-0.2 (-0.1)	0.8 (=)
Italy	-5.5	1.8	0.4	-2.4	-1.8 (-0.3)	0.7 (+0.2)
Spain[2]	-3.8	-0.2	0.1	-1.6	-1.6 (=)	0.0 (-0.7)
United Kingdom	-3.9	1.8	1.0	0.3	0.9 (+0.3)	1.5 (=)
Japan	-5.5	4.7	-0.6	1.9	2.0 (+0.5)	1.2 (-0.3)
Emerging economies	2.8	7.5	6.2	4.9	5.0 (-0.3)	5.4 (-0.3)

Source: IMF, Thomson Datastream and Eurostat.

1 In brackets, change vs. the previous forecast. IMF, forecasts published July 2013 with respect to April 2013.

2 GDP growth rates for Spain in the period 2009-2012 reflect the updated annual estimates of Spanish National Accounts, baseline 2008, released on 27 August.

The IMF's projections for the Spanish economy point to a 1.6% contraction in 2013 followed by zero growth in 2014. The 0.7 percentage points cut in its 2014 forecast with respect to April last was among the largest downward revisions dealt out to any country. Among the plus points in its macro scenario we can cite the improved performance of domestic financial markets since the closing months of 2012, which has helped reduce financing costs across the economy, the tentative improvement in labour-market data, and advances made in financial sector restructuring. However, the growth rates being forecast are still too low to deliver solid progress in employment, in the short term at least, and doubts persist over the real health of the banking sector in a context of credit constriction that is barring the way to a more dynamic recovery.

Spanish GDP is forecast to decline 1.6% in 2013 followed by zero growth in 2014. Although improvement symptoms are appearing on the macro front, downside risks are material.

3 Spanish markets

3.1 Equity markets

Share prices slide to mid-year and later rally on more evidence of economic improvement and lessening perceptions of sovereign credit risk.

Prices on domestic equity markets fell significantly in the first six months of 2013 on sluggish activity and the persistence of uncertainty factors in some economies. The moment of maximum tension on international markets came at the end of June, when the Federal Reserve announced that it was ready to withdraw its monetary stimulus ahead of time if activity and employment data accompanied. In the third quarter, however, the bear trend gave way to a sizeable rally in most sectors in response to more upbeat news on the economy and employment and a lessening perception of sovereign risk. After staying contained for most of the year, stock market volatility spiked at 30% during the tension episode of late June, though this was mild compared to the experience of past turbulence outbreaks. Liquidity conditions remained in the comfort zone while trading was generally thin except for a short-lived upturn in the middle months.

The Ibex 35's year-to-date gain of 9.5% was surpassed by small and medium cap indices.

The Ibex 35 followed up its 3% and 2% losses in the first and second quarter with a third-quarter gain of 15.2% which placed it 9.5% ahead of its start-out value (see table 6). By mid-September, in effect, the Spanish benchmark was testing 9,000 points, its highest level since October 2011. Meantime, Spanish small and medium cap indices progressed strongly for most of the year, with the latter rising 28.1% from January to September ahead of the former's 20.5%. The performance of domestic stock indices contrasted with that of the Latin American shares traded on Latibex, as evidenced by year-to-date slides of 15.1% in the FTSE Latibex All-Share and 10.5% in the FTSE Latibex Top.

Consumer services, basic materials, industry and construction, and, in third place, technology and telecoms, are the best performing sectors year to date.

A look at the different sectors making up the Madrid General Index (IGBM) reveals some starkly contrasting performances. Financial and real estate services initially came out worst with losses of 9.4% and 6.1% in the first and second quarter respectively, compared to the 12.6% and 5.2% gains of consumer services. The third-quarter rally, however, extended to all sectors, with rises ranging from the 5.3% of oil and energy to the 23.5% of financial and real estate services (see table 6). Year to date, the top performers are consumer services (34.2%), basic materials, industry and construction (17.9%) and technology and telecommunications (13.3%), while oil and energy (9.5%), consumer goods (7.0%) and financial and real estate services (5%) all lag the IGBM average. The slide in bank sector quotes in the first and second quarters (-10.1% and -6.5% respectively) was decisive in this last case.

The P/E of the Ibex 35 rebounds to 12.4 after a first-half fall, placing it at the upper end of the European table…

The price/earnings ratio[12] (P/E) of the Ibex 35, which had dropped from 11.7 in December 2012 to 11.3 in March and 11.0 in June, resumed an upwards path in the third quarter as share prices rallied. By mid-September the multiple of Spain's benchmark index was up to 12.4, placing it at the upper end of the European table (on a par with the Euronext 100 and ahead of the British and Italian indices), but below the top US and Japanese indices, with ratios from 13.6 to 13.9.

12 On one-year forward earnings.

Performance of Spanish stock market indices and sectors (%) TABLE 6

Index	2009	2010	2011	2012	1Q13[1]	2Q13[1]	3Q13 (to 13 September) % prior qt.	% Dec	% y/y
Ibex 35	29.8	-17.4	-13.1	-4.7	-3.0	-2.0	15.2	9.5	12.7
Madrid	27.2	-19.2	-14.6	-3.8	-3.2	-2.1	15.9	9.9	12.8
Ibex Medium Cap	13.8	-5.6	-20.7	13.8	2.2	7.9	16.1	28.1	43.9
Ibex Small Cap	17.6	-18.3	-25.1	-24.4	7.3	-3.1	15.9	20.5	12.9
FTSE Latibex All-Share	97.2	9.0	-23.3	-10.7	-1.2	-18.8	5.8	-15.1	-21.0
FTSE Latibex Top	79.3	9.7	-17.1	-2.6	5.2	-19.0	5.1	-10.5	-13.7
Sector[2]									
Financial and real estate services	**47.3**	**-31.7**	**-18.9**	**-4.7**	**-9.4**	**-6.1**	**23.5**	**5.0**	**4.6**
Banks	50.0	-33.1	-20.3	-4.8	-10.1	-6.5	24.0	4.2	3.3
Insurance	18.9	-26.4	12.5	-2.0	8.5	3.0	13.7	27.0	32.6
Real estate and others	-31.8	-53.3	-47.5	-14.4	-7.8	-2.1	15.2	4.0	30.6
Oil and energy	**-2.7**	**-8.6**	**-2.7**	**-16.0**	**-3.0**	**7.2**	**5.3**	**9.5**	**18.4**
Oil	12.4	10.2	14.9	-35.4	3.4	2.3	14.2	20.7	17.9
Electricity and gas	-8.4	-14.2	-10.8	-5.4	-5.7	9.5	1.1	4.4	18.6
Basic materials, industry and construction	**22.5**	**-15.2**	**-14.3**	**-8.0**	**-0.9**	**3.7**	**14.7**	**17.9**	**27.8**
Construction	17.7	-14.9	-6.9	-9.3	-0.7	4.0	15.5	19.3	37.5
Manufacture and assembly of capital goods	9.9	-29.2	-12.2	-8.8	-2.1	17.8	15.8	33.6	42.9
Minerals, metals and metal processing	36.4	-9.1	-33.7	-8.7	-9.6	-7.3	17.0	-1.9	-3.4
Engineering and others	92.7	-0.1	-29.0	3.8	-0.1	-6.8	6.7	-0.6	-6.7
Technology and telecommunications	**22.8**	**-12.8**	**-20.9**	**-18.3**	**3.9**	**-2.9**	**12.3**	**13.3**	**5.1**
Telecommunications and others	23.3	-12.8	-20.8	-23.0	3.2	-6.0	14.4	10.9	0.4
Electronics and software	3.0	-12.0	-21.3	39.4	8.0	15.1	3.5	28.7	40.9
Consumer goods	**26.3**	**17.0**	**5.7**	**55.6**	**0.2**	**-5.9**	**13.6**	**7.0**	**26.3**
Textiles, clothing and footwear	38.3	28.6	12.7	66.2	-2.0	-8.3	16.0	4.2	26.0
Food and drink	7.0	25.3	-6.3	25.0	-3.7	-1.4	6.2	0.8	14.8
Pharmaceutical products and biotechnology	14.5	-22.2	-7.3	68.3	12.5	0.9	9.2	23.9	37.9
Consumer services	**32.3**	**-0.1**	**-24.2**	**12.7**	**12.6**	**5.2**	**13.3**	**34.2**	**44.9**
Motorways and car parks	36.2	-10.1	-3.7	5.7	5.6	2.2	6.5	14.9	19.4
Transport and distribution	3.8	55.3	-34.9	29.7	34.3	2.8	21.8	68.1	96.1

Source: BME and Thomson Datastream.

1 Change vs. previous quarter.

2 IGBM sectors. Under each sector, data are provided for the most representative sub-sectors.

…while the equity risk premium narrows to 3.6%, near its historical average, after pulling higher in the first six months.

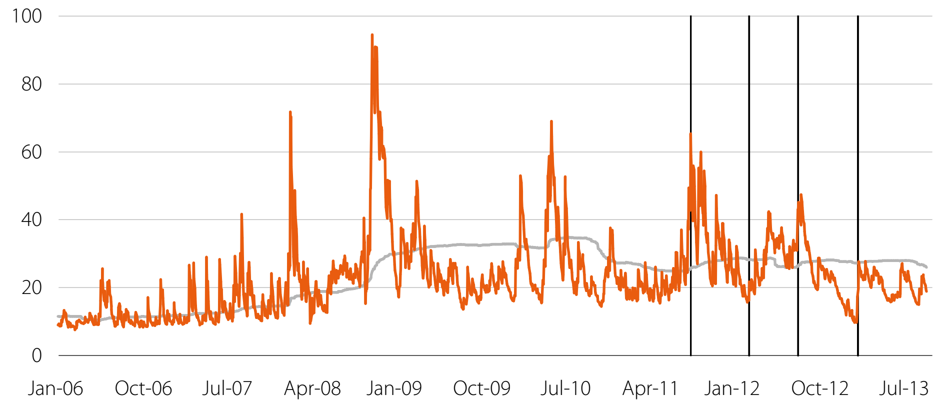
The earnings yield gap, which reflects the return premium required to be invested in equity versus long-term government bonds, widened from 3.3% to 4.5% over the first six months, reflecting both the decrease in the P/E and the falling yields of Spanish sovereigns. In the third quarter, however, sharply rising stock markets boosted P/E enough to offset the run-down in bond yields, restoring the gap to 3.6% in line with its historical average.[13]

13 This indicator's historical average since 1999 stands at 3.3%.

Ibex 35 volatility has hovered near 20% all year except for a second-quarter spike (at 30%) as markets briefly tensed.

Ibex 35 volatility has been moving around the 20% mark for most of this year after easing from 50% to just 10% in the second half of 2012. Its mid-year spike, coinciding with a degree of market agitation, was short-lived only and contained at under 30% (see figure 12), compared to the heights reached in earlier outbreaks.

Historical volatility of the Ibex 35 FIGURE 12

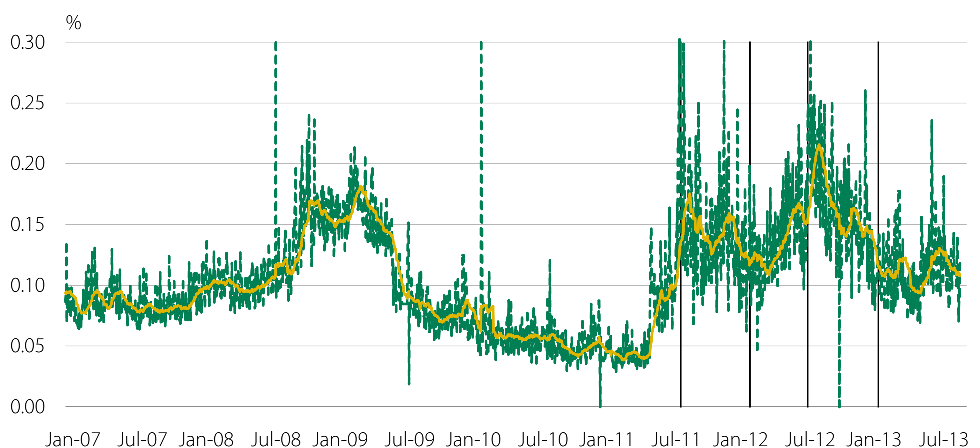


Source: Thomson Datastream and CNMV. Data to 15 September. The red line shows conditional volatility and the grey line unconditional volatility. The vertical lines refer to the introduction and lifting of the previous short-selling ban on 11 August 2011 and 16 February 2012 respectively, and the new ban starting on 23 July 2012 and ending on 1 February 2013.

Liquidity conditions remain comfortable over the first three quarters of 2013…

The second-half 2012 improvement in Ibex 35 liquidity conditions (measured through the bid/ask spread) carried over into this year's opening months albeit with some fluctuations (see figure 13). After deteriorating briefly in June and July, spreads narrowed once more to 0.11% in mid-September, in line with their average since 2003.

Ibex 35 liquidity. Bid-ask spread FIGURE 13



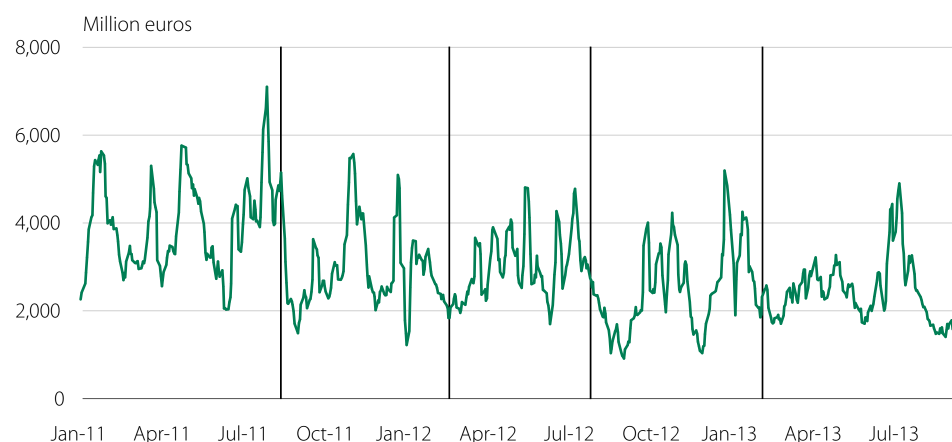
Source: Thomson Datastream and CNMV. Data to 15 September. The curve represents the bid-ask spread of the Ibex 35 along with the average of the last month. The vertical lines refer to the introduction and lifting of the previous short-selling ban on 11 August 2011 and 16 February 2012 respectively, and the new ban starting on 23 July 2012 and ending on 1 February 2013.

Trading volumes on Spanish stock markets shrank by 455.9 billion euros in the first three quarters of 2013 (to 15 September), equivalent to an 8.2% decrease vs. the same period last year. Daily averages held more or less stable at around 2.60 billion euros then surged to just under 5 billion in the year's central weeks, coinciding with a period of mild turbulence on international financial markets. Since then, volumes have tailed off anew to a multi-year low of 2.35 billion.[14]

…but stock market trading conserves its muted tone.

Daily trading on the Spanish stock market[1]

FIGURE 14



Source: CNMV. Data to 15 September 2013. The vertical lines refer to the introduction and lifting of the previous short-selling ban on 11 August 2011 and 16 February 2012 respectively, and the new ban starting on 23 July 2012 and ending on 1 February 2013.

1 Moving average of five trading sessions.

Turnover on the Spanish stock market

TABLE 7

Million euros

	2009	2010	2011	2012	1Q13	2Q13	3Q13[1]
All exchanges	**886,135**	**1,037,284**	**925,667**	**698,987**	**162,136**	**164,346**	**129,393**
Electronic market	880,544	1,032,447	920,879	694,294	160,793	163,071	128,304
Open outcry	73	165	48	50	6	4	28
of which SICAVs[2]	20	8	6	0	0	0	0
MAB[3]	5,080	4,148	4,380	4,330	1,238	1,171	993
Second Market	3	3	2	0	0	0	0
Latibex	435	521	358	313	99	100	67
Pro memoria: non-resident trading (% all exchanges)							
	64.5	75.2	81.2	78.7	n.a.	n.a.	n.a.

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

1 Accumulated data from 1 July to 15 September.

2 Open-end investment companies.

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

n.a.: Data not available at the closing date for this report.

14 Taking average daily volumes in the year, the low point comes in 2012 (2.61 billion euros), compared to the higher levels of 2008 to 2011 (4.89 billion in 2008, 3.49 billion in 2009, 4.05 billion in 2010 and 3.62 billion in 2011).

Equity issue volumes, at 24 billion euros, surpass the 2012 total, but are strongly concentrated in a small number of banks.

Equity issuance on domestic markets summed almost 24 billion euros in the first three quarters of 2013, surpassing the full-year figure for 2012 (21.14 billion). The peak moment came in the second quarter when capital increases at one nationalised bank raised a total of 15.5 billion euros. So far no POS have been launched compared to the three in 2012, for a combined amount of 1.23 billion euros (see table 8).

Capital increases and public offerings[1] TABLE 8

	2009	2010	2011	2012	1Q13	2Q13	3Q13[2]
CASH AMOUNTS[3] (million euros)	**11,391**	**16,017**	**17,146**	**21,142**	**4,996.0**	**16,372.3**	**2,580.4**
Capital increases	11,389	15,407	17,019	19,911	4,996.0	16,372.3	2,580.4
Of which, through IPO	17	959	6,239	2,457	0.0	1,054.8	0.0
National tranche	15	62	5,827	2,457	0.0	1,054.8	0.0
International tranche	2	897	412	0	0.0	0.0	0.0
Public offering of shares	2	610	127	1,231	0.0	0.0	0.0
National tranche	2	79	125	1,231	0.0	0.0	0.0
International tranche	0	530	2	0	0.0	0.0	0.0
NUMBER OF FILINGS[4]	**53**	**69**	**92**	**105**	**28**	**37**	**32**
Capital increases	53	67	91	103	28	37	32
Of which, through POS	2	12	8	7	0	3	0
Of which, bonus issues	11	15	22	22	9	9	10
Public offering of shares	1	3	2	3	0	0	0

Source: CNMV.

1 Incorporating issues admitted to trading without a prospectus being filed.
2 Data to 15 September.
3 Excluding amounts recorded in respect of cancelled transactions.
4 Including all transactions registered, whether or not they eventually went ahead.

First Conference on the Reform of the Securities Clearing, Settlement, and Registry System EXHIBIT 2

On 27 June, the National Securities Markets Commission (CNMV) held its First Conference on the Reform of the Securities Clearing, Settlement and Registry System. The event was an opportunity for market participants to catch up with work under way and discuss the future shape of post-trade systems in the Spanish market. In calling the conference, the CNMV fulfilled its pledge to keep the sector informed of progress in the reform process initiated in 2010, when it set up a Steering Committee chaired by the CNMV Vice President with members from the Banco de España, the Spanish Banking Association (AEB), the Spanish Confederation of Savings Banks (CECA), the Investors Compensation Scheme (FOGAIN), Bolsas y Mercados Españoles (BME), and the main actors in the settlement cycle.

The opening address was delivered by the Vice President of the CNMV, who pointed to the strides made in the reform process, as detailed in the report published 13 May, 2013 with the title "Reforma del Sistema de Registro, Compensación y

Liquidación".[1] She also underlined that the heavy workload ahead would require a sustained and coordinated effort in order to keep the reform on schedule.

The next speaker was the CNMV's Director-General of Markets, who stressed that time was very tight for the reform to be concluded by deadline. Among the main tasks pending, he signalled, were the design of participating entities' communications with the Post Trading Interface (PTI), the detailed protocol for the optional settlement model, and the settlement of OTC trades involving a central counterparty. He also stressed the need to complete detailed planning for migration to the new system and an assessment of its risks before end-2013, and to get the required regulatory amendments in place in as short a time as possible.

The meeting then broke up into four themed workshops. The first focused on the practical aspects of the new opportunities yielded by the reform, a crucial point given its potential impact on bank sector strategic business. At the heart of the debate were certain still undefined features of the reform project which could limit banks' decision-making power over their own business model. Doubts were raised on issues like the requirements to be met by clearing members of the central counterparty (CCP), which, it was agreed, should be cleared up as a matter of urgency. Participants also analysed the steps banks should take in designing their positioning strategies and setting in train their changeover plans. The consensus was that the entry conditions for each infrastructure would influence the decision to become an individual clearing member or, alternatively, to sign a contract with a general clearing member, and that this, in turn, would affect the number of entities and the organisation of the market.

On the topic of the reform's advantages and drawbacks for end investors, participants in this workshop were adamant that it should proceed smoothly enough for retail investors not to notice the changes, and that it was important to keep an eye on costs and to ensure that final customers were properly informed with maximum disclosure. Finally, they felt that the flexible design of the reform would give entities more operational scope and allow them to choose which services to offer, with some opting to extend their existing suite while others specialise.

The second workshop turned on the functionalities of CCPs in the context of Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, known as EMIR. The introduction of a CCP would, it was felt, contribute to optimising settlement procedures and the detailed information sent to participants.

The following novelties of CCP design were mentioned in discussions: the possibility of netting trades before settlement instructions are generated; the implementation of transaction management procedures in order to delimit the scope of netting; the option for trading members to be either ordinary or segregated; and the option of assigning a trade to a particular account from the time of execution, or else sending a give-up (transfer of trade), likewise upon execution, to another clearing or non-clearing member. This facilitates the transfer of risk and subsequent calculation of the margin required by the CCP from the definitive clearing member.

Participants were agreed that the cost of the reform should be considered as a whole, and did not rule out the need to make investments, while admitting that netting in the CCP should provide some offset. Interoperability was seen as vital, and it was felt that the EMIR should encourage the trend of providing cash collateral to the CCP. International investors, they said, had welcomed the reform and were hopeful that it would improve what they see as the sub-optimal procedures now in place for the settlement of trades originating in other, non-resident CCPs. Finally, care should be taken to keep failed trades to a moderate level, as they have been to date.

Discussions in the third workshop ranged over aspects of the new settlement by balances system envisaged in the reform. Participants were keenly aware of the challenges involved in the eventual shortening of the settlement cycle from three to two business days counting from the trade date, and Iberclear's integration within T2S. They stressed that T+2 settlement, while aiding harmonisation with Europe, could cause a short-term spike in failed trades, particularly for non-resident institutional investors, though it would also cut collateral requirements by a third in tandem with the reduction in the settlement period and, therefore, in default risk.

Another subject of debate was how the reform would affect the timing of when a transaction becomes final. Iberclear currently dates finality from the moment the transaction is accepted, in accordance with the principle of assured delivery. But the nascent CCPs will need to be recognized as systems pursuant to Directive 98/26/EC of the European Parliament and of the Council, of 19 May 1998, on settlement finality in payment and securities settlement systems. With the CCP, trades will become final on being accepted from the market, while with Iberclear, finality will shift to the settlement environment once the principle of assured delivery has disappeared.

Participants also welcomed the flexibility of the account structure mooted for the CCP and central securities depository (CSD) at the preparatory stage of the reform, with particular regard to the following points: (i) the possibility of opening individual accounts in the name of member's clients, so their collateral is kept separate from that of the clearing member's other accounts; (ii) the possibility that transactions can be recorded in accounts on a gross or net basis, determining, in turn, both the gross or net calculation of margin requirements and the application or otherwise of cleared balances when processing settlement instructions; and (iii) the possibility for financial intermediary orderers to open individual accounts supporting the entry of operations in the CSD in the name of the final owner for whom they are operating, within the space of the settlement cycle and in the terms permitted by CSD and CCP internal regulations.

Finally, the point was made that the settlement by balances which is a feature of the reform will remove the need to use registry information in the market phase, which will simplify processes and foreseeably encourage more trading going forward, especially from the non-resident investors who account for 60% of stock exchange trading volumes.

The fourth and last workshop dealt with aspects of the new securities registry arrangements. Regarding the new registry and settlement system managed by Iberclear, it was explained that there will be a single system for all securities (equities and fixed-income, public and corporate debt), to be implemented in two phases according to the project timeline. The registry system will be in two tiers and will be based on balances or aggregated positions. On the matter of how accounts are organized, participants were told that they could have one or more proprietary or general client accounts or individual accounts per client, and even financial intermediary special individual accounts for use in the optional order settlement procedure.

Discussion then moved on to the changes in legal relations (including finality) that would ensue from the reform, and its fit with other changes in the European regulatory framework touching on the rights attached to securities. Finally, after analysing how these developments would affect participants in different platforms, attention turned to the new standardised system of reporting participants' entries in the detailed register. It was stressed that for supervisory purposes its features are equivalent to those of the current system based on register references (RR).

The Conference was closed by the Director-General of General Operations, Markets and Payment Systems at Banco de España and the General Secretary for the Treasury and Financial Policy of the Ministry of Economy and Competitiveness. The former talked of the usefulness of having this kind of event and the interest it had generated. He stressed that the reform was a flagship project for the Spanish financial industry in the light of the harmonising legal measures being developed in the European post-trade environment, and that entities should make every effort to adapt their operations. Two points, he said, merited special attention: the shortage of time available for the huge amount of work that still needs doing, and the coming onstream of T2S, whose start-up and migration will require an enormous and concerted effort from the market as a whole. And the next challenge, he concluded, would be the shortening of the settlement cycle from three to two days envisaged in the new regulation for Central Securities Depositories currently under consideration by the European Parliament and the Council.

The General Secretary of the Treasury and Financial Policy began his address saying that efficient markets rely on the proper functioning of all the processes involved concluding with payment and transfer of ownership. He added that the post-trade stage encompassing securities clearing, settlement and registry is the cornerstone of any financial system, supporting the exchange of securities and cash. Europe is on the brink of major changes in the post-trade sector comparable to the shake-up in the trading landscape brought by the first MiFID a decade ago. And Law 32/2011 amending the Securities Market Law acknowledged this fact by launching the reform of the clearing, settlement and registry system in which we are now immersed. In closing, the General Secretary expressed his confidence that the determination of regulators, supervisors and the financial industry would bring the reform to a successful conclusion and ensure that migration to the new system went through as smoothly as possible.

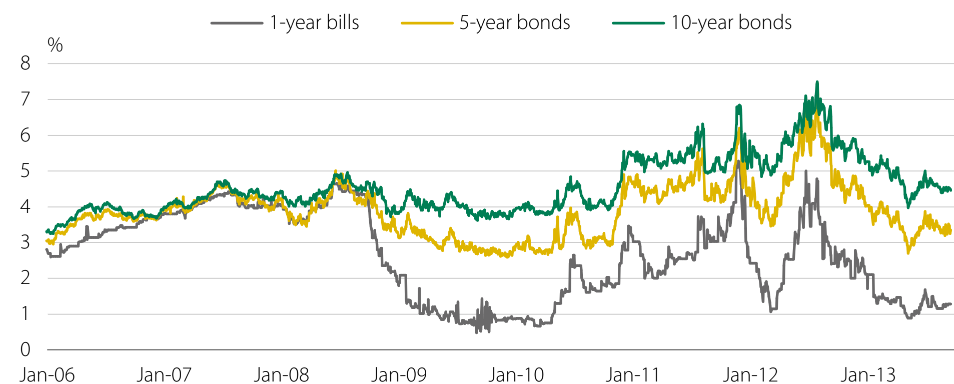
1 Available at http://www.cnmv.es/docportal/aldia/SituacionReforma090513.pdf

3.2 Fixed-income markets

Spanish fixed-income markets reflect the calmer mood prevailing in European sovereign debt markets since summer 2012, though certain elements of fragility remain.

The easing of European debt market tensions meant domestic fixed-income markets had an altogether smoother run in 2013, only briefly interrupted by minor stress episodes in the months of May and June. Public and, less so, corporate debt yields traced a firm downwards course which restored risk premiums to levels unseen since spring 2011. However, fixed-income markets are still looking less than robust, and the hefty decrease in agents' financing costs has so far failed to translate as an upswing in issuance. One cause of the fading popularity of this kind of instrument could be the availability of other, cheaper funding sources at a time when ongoing deleveraging coupled with low-gear economic activity have sizeably eroded the borrowing needs of the resident private sector.

Spanish government debt yields FIGURE 15



Source: Thomson Datastream. Data to 15 September.

Short-term treasury yields have fallen from 75 to 96 bp year to date depending on the maturity, with occasional rises in May and June.

Against this backdrop, short-term treasury yields continued their downward path from the 1.1%, 1.7% and 2.2% of last year's close in three, six and twelve-month tenors respectively, broken only by rises in the spring months coinciding with moments of market unease. At the closing date for this report (15 September), three, six and twelve-month bills were yielding 0.2%, 0.9% and 1.3% respectively (in average monthly terms), between 75 bp and 96 bp down on their end-2012 rates (see table 9). Commercial paper yields, meantime, experienced a sharp reduction in the first quarter that tended to level off in subsequent months. The decline, finally, took them to mid-September levels of 1.2%, 1.6% and 1.6% at three, six and twelve-month maturities, between 162 bp and 224 bp down on the equivalent levels at the 2012 close (2.8%, 3.6% and 3.8% respectively).

Long-term government yields have also come down substantially; from 5.3% at end-2012 to 4.5% in mid-September in the case of the ten-year bond.

Long government bonds followed a similar path to short-term treasuries, namely a run-down in yields breaking off only in May and June. As we can see from table 10, average monthly yields of three, five and ten-year bonds stood at 2.6%, 3.4% and 4.5% respectively in September 2013, around 80 bp lower than at the 2012 close.[15] Long-term corporate bond yields also fell sharply to April and turned flatter thereafter, as far as mid-September averages of 2.9%, 3.7% and 5.3% in three, five and ten-year tenors, between 93 bp and 146 bp down vs. year-end 2012.

15 Already a long way short of the historical highs of summer 2012.

Short-term interest rates[1] (%)

TABLE 9

	Dec 10	Dec 11	Dec 12	Mar 13	Jun 13	Sep 13[3]
Letras del Tesoro						
3 month	1.60	2.20	1.14	0.29	0.58	0.22
6 month	2.71	3.47	1.68	0.85	0.79	0.93
12 month	3.09	3.27	2.23	1.37	1.34	1.27
Commercial paper[2]						
3 month	1.37	2.74	2.83	1.49	1.25	1.21
6 month	2.52	3.52	3.58	1.72	1.43	1.61
12 month	3.49	3.77	3.83	1.90	1.67	1.59

Source: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Interest rates at issue.

3 Data to 15 September.

Medium and long bond yields[1] (%)

TABLE 10

	Dec 10	Dec 11	Dec 12	Mar 13	Jun 13	Sep 13[2]
Government bonds						
3 year	3.87	4.01	3.40	2.85	2.86	2.62
5 year	4.65	4.65	4.22	3.65	3.47	3.36
10 year	5.38	5.50	5.33	4.93	4.67	4.49
Corporate bonds						
3 year	4.39	5.43	4.19	2.81	3.00	2.90
5 year	4.96	5.91	4.66	3.45	3.81	3.73
10 year	6.28	8.06	6.79	5.40	5.38	5.33

Source: Thomson Datastream, Reuters and CNMV.

1 Monthly average of daily data.

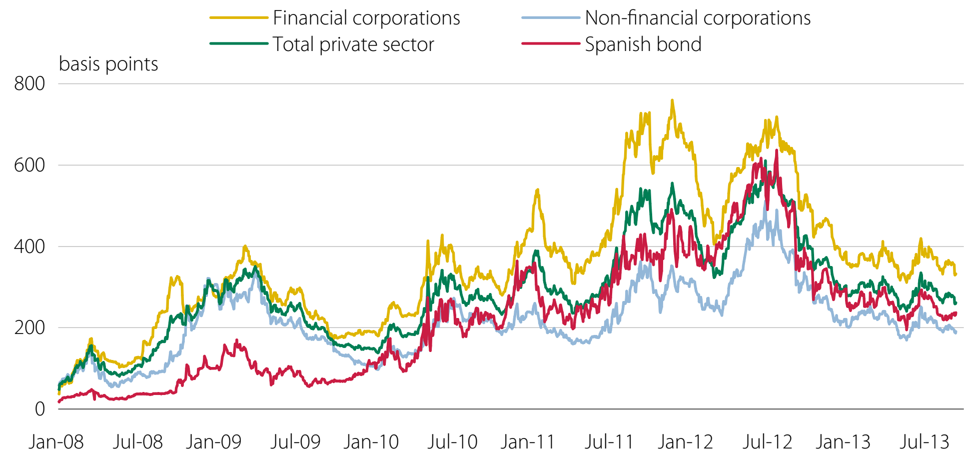
2 Data to 15 September.

After an uncertain start, sovereign spreads head steadily lower to reach 255 bp in mid-September vs. 396 bp at the 2012 close.

Spain's sovereign risk premium, as derived from five-year CDS spreads and the yield spread between the Spanish and German benchmark, has held to a narrowing trend, with some ups and downs, in tune with the drop in tensions on European debt markets. The CDS spread, specifically, decreased to 237 bp in mid-September from the 295 bp of last year's close (see figure 16), while the Spanish/German spread narrowed to 255 bp from 396 bp. This downward movement was strongest in the third quarter as *bund* yields edged higher. The decline in perceived sovereign risk extended to practically all of Europe[16] (with Portugal as sole exception). And indicators of sovereign risk contagion have moved in the moderation zone despite straining temporarily higher in the summer months. The only blip we can point to is the higher rise in the contagion indicator for Portuguese sovereign credit risk (see figure 17).

16 It bears mention that Spanish sovereign spreads declined faster than their Italian equivalents over the reference period, to the extent that Spanish/German spreads dipped below Italian/German spreads on 10 September 2013, the first such occasion since March 2012.

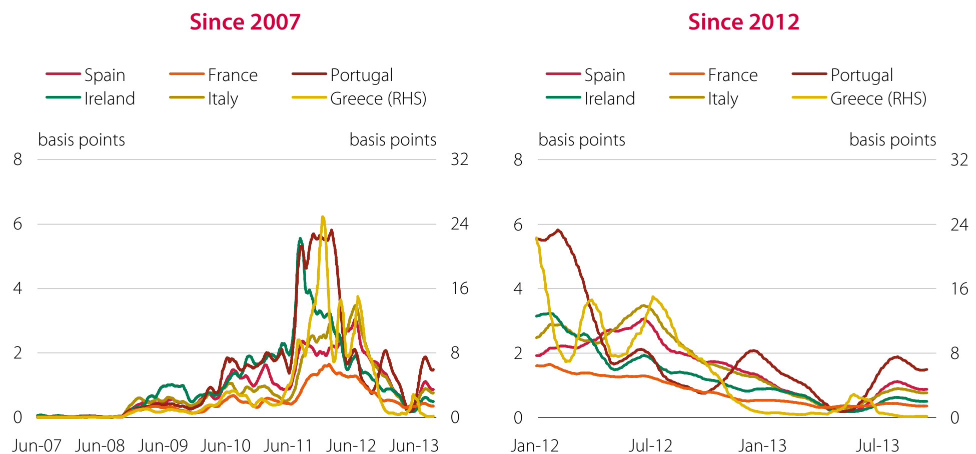
Aggregate risk premium[1] based on the five-year CDS of Spanish issuers FIGURE 16



Source: Thomson Datastream and CNMV.

1 Simple average. Data to 15 September.

Indicators of sovereign credit risk contagion in the euro area[1] FIGURE 17



Source: Thomson Datastream and CNMV. Data to 15 September 2013.

1 Defined as the impact on German sovereign CDS of contemporaneous shocks in the CDS of Spain, Italy, Ireland, Portugal, Greece and France equivalent to 1% of the CDS spread at that point in time. Results are the product of two components. The first measures the degree of contagion from one country to another, taken as the percentage change in the CDS of the German sovereign bond that is exclusively explained by a contemporaneous variation in the CDS spread of one of the above six countries. This percentage is based on the decomposition of the variance of the estimated prediction error using an autoregressive vector model (ARV) with two variables – the impacted variable (change in the German sovereign CDS) and the shock-generating variable (change in the sovereign CDS of Spain, Italy, Ireland, Portugal, Greece or France) – and two retardations. Estimates are implemented through a moving window of the one hundred periods prior to the first prediction period. The second component measures the credit risk of the shock emitter, as approximated from its CDS. Finally, the resulting series is smoothed using a moving average of thirty trading sessions.

The risk premium of the private sector of the economy has tended to mirror the progress of sovereign spreads, though note that financial institutions are still paying more.

Corporate bond spreads performed similarly to their sovereign equivalents, namely a descending trend as of end-2012 broken off occasionally in the second quarter. As figure 16 shows, the average credit spreads of resident private-sector issuers tended to align with sovereign risk premiums, reaching mid-September levels of 262 bp and 237 bp respectively. But despite this notable reduction in the perception of risk

attached to domestic borrowers, we still find a large gap between the (average) spreads of financial institutions (332 bp in the month of September) and the 191 bp of the non-financial sector.

The gross volume of fixed-income issues registered with the CNMV between January and September 2013[17] came to 94.12 billion euros, 65% less than in the same period last year (see table 11). The largest reductions in straight-number terms corresponded to commercial paper (-77.66 billion euros), mortgage covered bonds (-64.55 billion) and, in smaller measure, non-convertible bonds (-26.73 billion). Various factors underlie the slump in primary activity in these instruments, precisely the most popular in 2012, though the common denominator is issuers' more modest financing needs.

The amount of fixed-income issues filed with the CNMV from January to September drops 65% to 94 billion euros…

In the case of commercial paper – up by 28% in 2012 – sales plunged by 71% vs. the year-ago period to a lowly 32.5 billion euros. Direct causes here can be presumed to include the recovery of bank deposit levels in the household and business sectors and the increased inflows registered by certain lower-risk categories of investment funds.

…due to falling sales of commercial paper amid stiff competition from deposits and investment funds,…

Meantime, sales of mortgage covered bonds shrank by 75% in year-on-year terms to 21.8 billion euros, and those of non-convertible bonds by 57% to a September total of just under 19.9 billion. These large percentage reductions reflect both lighter funding needs and the abnormally high comparative baseline of 2012, when financial institutions engaged in heavy selling of these instruments to ensure themselves a stock of high-quality assets for use in Eurosystem financing operations.

…and lower issuance of mortgage and non-convertible bonds.

The exception to this widespread slowdown was asset-backed securities. Issuance of these instruments climbed by 10% to around 14 billion euros, without of course coming anywhere near to recouping their pre-crisis levels. Sales of territorial covered bonds summed 5.61 billion between January and September, 37% less than in 2012. Again, no preference share issues were reported in the period.

Asset-backed securities buck the trend with a 10% increase, although the baseline is low.

Foreign debt financing also tailed off considerably between January and July 2013. As table 11 shows, the amount placed abroad by Spanish fixed-income issuers was 43% lower than in the year-ago period at 32.89 billion euros. Most of this decline corresponded to short-term sales, down by 73% to 8.39 billion, against an 8% decline to 25 billion for longer-dated instruments.

International issuance sinks back in 2013.

17 Data to 15 September.

Gross fixed-income issues

TABLE 11

filed[1] with the CNMV	2009	2010	2011	2012	2013 1Q	2013 2Q	2013 3Q[2]
Number of ISSUES	**512**	**349**	**353**	**334**	**61**	**74**	**47**
Mortgage bonds	75	88	115	94	15	14	5
Territorial bonds	1	9	42	18	1	2	2
Non-convertible bonds and debentures	244	154	87	134	27	47	31
Convertible/exchangeable bonds and debentures	6	3	9	7	3	1	0
Asset-backed securities	76	36	45	35	11	5	3
Commercial paper facilities	73	59	53	46	4	5	6
Securitised	2	2	2	1	0	0	0
Other commercial paper	71	57	51	45	4	5	6
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	37	0	2	0	0	0	0
NOMINAL AMOUNT (million euros)	**387,476**	**226,449**	**288,992**	**357,830**	**44,462**	**30,406**	**19,255**
Mortgage bonds	35,574	34,378	67,227	102,170	9,195	7,340	5,265
Territorial bonds	500	5,900	22,334	8,974	95	1,520	4,000
Non-convertible bonds and debentures	62,249	24,356	20,192	86,442	15,595	4,136	166
Convertible/exchangeable bonds and debentures	3,200	968	7,126	3,563	425	15	0
Asset-backed securities	81,651	63,261	68,413	23,800	8,052	4,942	904
Domestic tranche	77,289	62,743	63,456	20,627	6,965	4,309	904
International tranche	4,362	518	4,957	3,173	1,087	633	0
Commercial paper[3]	191,342	97,586	103,501	132,882	11,100	12,453	8,920
Securitised	4,758	5,057	2,366	1,821	180	390	440
Other commercial paper	186,583	92,529	101,135	131,061	10,920	12,063	8,480
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	12,960	0	200	0	0	0	0
Pro memoria:							
Subordinated issues	20,989	9,154	29,199	7,633	1,557	978	92
Covered issues	4,794	299	10	0	0	193	0

abroad by Spanish issuers	2009	2010	2011	2012	2013 1Q	2013 2Q	2013 3Q[4]
NOMINAL AMOUNT (million euros)	**149,686**	**127,731**	**120,043**	**91,882**	**19,246**	**11,506**	**2,133**
Long-term	47,230	51,107	51,365	50,312	16,076	7,793	628
Preference shares	3,765	0	0	0	0	1,500	0
Subordinated debt	2,061	0	242	307	0	0	0
Bonds and debentures	41,404	50,807	51,123	50,005	16,076	6,293	628
Asset-backed securities	0	300	0	0	0	0	0
Short-term	102,456	76,624	68,677	41,570	3,170	3,713	1,505
Commercial paper	102,456	76,624	68,677	41,570	3,170	3,713	1,505
Securitised	108	248	322	11,590	0	0	0

Source: CNMV and Banco de España.

1 Incorporating issues admitted to trading without a prospectus being filed.

2 Data to 15 September.

3 Figures for commercial paper issuance correspond to the amount placed.

4 Data for the month of July. No data are available for foreign sales of securitised commercial paper in this month.

4 Market agents

4.1 Investment vehicles

Financial UCITS[18]

After five years of non-stop decline, assets under management in investment funds climbed by 4.3% in the first half of 2013 as far as 135.93 billion euros (see table 13). Around 80% of the increase, moreover, owed to net subscriptions in these two quarters summing over 9 billion euros (see table 12). The most copious inflows found their way into fixed-income and passively managed products. Conversely, guaranteed fixed-income and equity, absolute return and global funds registered net redemptions in the period. These investment and divestment flows represent a switch in the pattern that has dominated for several years, in which guaranteed fixed-income and equity categories were the main subscription beneficiaries to the detriment of fixed-income funds.

Five years of decline are brought to a halt in the first half of 2013 by a 4.3% increase in investment fund assets to nearly 136 billion euros.

Investment fund returns were a positive 2% over the first six months of 2013, but lagged some way behind the returns obtained in 2012 (see table 13). The best performing categories in the first half-year were euro and international equity (4.4% and 7% respectively), while all categories, generally speaking, fared better in the first than in the second quarter. Despite this improved tone, fund numbers continued to dwindle as far as 2,117 at the end of June. This was 68 fewer than at end-2012, with the biggest losses (46) in the fixed-income category.

The long-awaited increase owes 80% to net subscriptions and the remainder to fund returns (2%).

Net investment fund subscriptions TABLE 12

				2012		2013	
Million euros	2010	2011	2012	3Q	4Q	1Q	2Q
Total investment funds	**-25,580.9**	**-10,839.0**	**-11,495.4**	**-3,176.6**	**-3,570.7**	**4,224.4**	**5,205.5**
Fixed income[1]	-27,150.0	-10,427.7	-5,662.5	-1,880.9	-1,273.4	1,729.5	3,934.9
Mixed fixed income[2]	-1,416.9	-1,925.7	-651.6	-173.6	-116.5	419.0	668.7
Mixed equity[3]	-90.1	-320.5	-281.6	-68.3	-53.3	349.0	315.7
Euro equity	-696.9	152.0	-109.7	-2.1	-23.9	275.0	104.6
International equity	1,151.9	-817.6	-370.2	-55.9	-186.5	122.3	133.3
Guaranteed fixed-income	4,716.0	7,228.3	-334.5	58.5	-974.5	537.8	-602.6
Guaranteed equity[4]	-2,500.1	-3,061.6	-3,353.1	-805.1	-1,115.8	-651.9	-952.7
Global funds	323.7	945.3	-7.8	-101.1	7.5	-61.0	-197.9
Passively managed	-790.3	-274.5	572.1	67.8	360.4	1,477.0	1,851.1
Absolute return	871.8	-2,337.0	-1,296.5	-215.9	-194.7	27.7	-49.5

Source: CNMV. Estimates only.

1 Includes: Euro and international fixed income and money market funds (as of 3Q 2011, money market funds encompass those engaging in money market and short-term money market investments, Circular 3/2011).

2 Includes: Euro and international mixed fixed income.

3 Includes: Euro and international mixed equity.

4 Includes: Guaranteed and partial protection equity funds.

18 Although this classification includes hedge funds and funds of hedge funds, we make no separate reference to them here, since they are the subject of their own sub-section further ahead.

Main investment fund variables*

TABLE 13

				2012		2013	
Number	**2010**	**2011**	**2012**	**3Q**	**4Q**	**1Q**	**2Q**
Total investment funds	**2,408**	**2,310**	**2,185**	**2,197**	**2,185**	**2,185**	**2,117**
Fixed income[1]	537	508	454	459	454	448	408
Mixed fixed income[2]	160	140	125	128	125	126	129
Mixed equity[3]	138	128	117	119	117	120	124
Euro equity	172	148	127	129	127	126	116
International equity	232	220	211	214	211	209	198
Guaranteed fixed-income	276	351	398	393	398	409	402
Guaranteed equity[4]	499	420	361	369	361	348	336
Global funds	192	203	192	194	192	182	174
Passively managed	61	59	85	75	85	103	126
Absolute return	141	133	115	117	115	114	104
Assets (million euros)							
Total investment funds	**143,918.2**	**132,368.6**	**124,039.9**	**125,108.2**	**124,039.9**	**130,295.4**	**135,933.5**
Fixed income[1]	56,614.6	46,945.5	40,664.6	41,512.2	40,664.6	42,690.3	46,736.8
Mixed fixed income[2]	7,319.0	5,253.6	5,500.9	5,512.9	5,500.9	5,965.6	6,618.4
Mixed equity[3]	3,470.5	2,906.1	3,179.9	3,116.2	3,179.9	3,593.6	3,911.9
Euro equity	5,356.8	4,829.2	5,270.2	4,891.7	5,270.2	5,691.8	5,867.8
International equity	8,037.3	6,281.2	6,615.0	6,663.2	6,615.0	7,224.0	7,297.3
Guaranteed fixed-income	26,180.2	35,058.0	36,445.0	36,489.9	36,445.0	37,653.1	37,316.1
Guaranteed equity[4]	22,046.5	18,014.5	14,412.7	15,383.0	14,412.7	13,925.5	13,032.2
Global funds	4,440.3	5,104.7	4,358.6	4,288.4	4,358.6	4,366.9	4,157.3
Passively managed	2,104.8	1,986.2	2,991.2	2,456.2	2,991.2	4,511.4	6,402.4
Absolute return	8,348.1	5,989.7	4,601.9	4,794.4	4,601.9	4,673.3	4,593.4
Unit-holders							
Total investment funds	**5,160,889**	**4,835,193**	**4,410,741**	**4,531,940**	**4,410,741**	**4,523,140**	**4,646,619**
Fixed income[1]	1,622,664	1,384,946	1,261,634	1,297,686	1,261,634	1,283,052	1,347,295
Mixed fixed income[2]	270,341	206,938	188,574	193,992	188,574	194,084	203,705
Mixed equity[3]	171,336	145,150	138,096	140,387	138,096	140,132	141,715
Euro equity	266,395	237,815	220,433	220,342	220,433	231,881	239,309
International equity	501,138	448,539	398,664	417,276	398,664	409,552	427,789
Guaranteed fixed-income	790,081	1,042,658	1,075,852	1,082,897	1,075,852	1,114,875	1,124,209
Guaranteed equity[4]	1,065,426	912,298	727,867	783,203	727,867	703,587	655,760
Global funds	105,720	127,336	101,321	105,824	101,321	104,718	111,567
Passively managed	90,343	100,416	125,003	110,678	125,003	170,399	224,481
Absolute return	277,445	229,097	173,297	179,655	173,297	170,860	170,789
Return[5] (%)							
Total investment funds	**0,35**	**-0,08**	**5,50**	**2,72**	**2,08**	**1,64**	**0,37**
Fixed income[1]	0,11	1,56	3,54	1,35	1,12	0,76	0,31
Mixed fixed income[2]	-0,54	-1,34	4,95	2,41	1,75	0,83	-0,19
Mixed equity[3]	-0,98	-5,64	7,83	4,12	3,30	2,02	0,17
Euro equity	-2,94	-11,71	12,31	8,16	7,28	3,05	1,32
International equity	14,22	-10,83	13,05	5,27	2,32	7,49	-0,45
Guaranteed fixed-income	-0,67	3,28	4,85	2,42	2,27	1,72	0,68
Guaranteed equity[4]	-1,79	0,14	5,07	3,89	1,99	1,16	0,42
Global funds	3,22	-4,64	7,44	2,95	2,03	1,75	-0,26
Passively managed	-2,36	-7,33	7,10	5,50	4,04	0,96	0,77
Absolute return	1,53	-1,87	3,84	1,81	1,36	1,01	-0,57

Source: CNMV.

* Data for funds that have filed financial statements (i.e., not including those in the process of winding-up or liquidation).

1 Includes: Euro and international fixed income and money market funds (as of 3Q 2011, money-market funds encompass those engaging in money market and short-term money market investments, Circular 3/2011).

2 Includes: Euro and international mixed fixed income.

3 Includes: Euro and international mixed equity.

4 Includes: Guaranteed equity and partial protection equity funds.

5 Annual return for 2010, 2011 and 2012. Quarterly data comprise non-annualised quarterly returns.

The number of fund unit-holders expanded by more than 200,000 vs. December last year to 4,646,619 at the June close. As with assets under management, the increase of fund unit-holders was greatest in fixed-income and passively managed funds, with 86,000 and 99,000 respectively. Only guaranteed equity and absolute return funds lost members in the reference period (72,000 and 2,500 respectively).

200,000 more unit-holders in the first six months of 2013.

Preliminary data for July 2013 suggest that the expansion trend in assets and unit-holders numbers has not let up. They also suggest, to judge by the number of mergers, that sector rationalisation still has some way to go.

The expansion trend continues through July, according to preliminary data.

The liquidity conditions of fund fixed-income portfolios continued to improve to mid-year 2013, with the amount of less-liquid assets down by 25% from 5.39 billion in December 2012 to 4.05 billion in June 2013 (see table 14). On this showing, the ratio of less-liquid assets dropped from 4.3% of total fund assets at end-2012 to 3.1% at the first-half close. The composition of these less-liquid holdings was largely unchanged except for a small rise in the weight of non-financial fixed income, though note that a continuing characteristic is the large balance of financial fixed-income instruments rated below AA.

A renewed decline in the balance of less-liquid assets as far as 3.1% of the industry total in June.

Estimated liquidity of investment fund assets TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	**Dec 12**	**Mar 13**	**Jun 13**	**Dec 12**	**Mar 13**	**Jun 13**
Financial fixed income rated AAA/AA	348	330	210	23	29	21
Financial fixed income rated below AAA/AA	4,120	4,018	3,114	19	20	17
Non-financial fixed income	148	175	186	5	7	8
Securitisations	774	605	541	42	35	30
AAA-rated securitisations	44	37	35	97	98	99
Other securitisations	730	568	506	40	34	28
Total	**5,390**	**5,127**	**4,051**	**20**	**21**	**17**
% of investment fund assets	**4.3**	**3.9**	**3.1**			

Source: CNMV.

Real estate schemes

The downturn in Spanish construction and real estate continued to make life hard for this category of funds, and the bottom of the market has still to be reached. That said, a small performance gap has recently opened up between funds and companies, with the former's main variables still in retreat and the latter's experiencing a small advance.

Real estate schemes again have to cope with a difficult environment…

In the case of real estate investment funds, the first thing to note is that of the six funds registered at end-June (an identical number to December 2012), only five were active, while the sixth was being wound up. Meantime, unit-holder numbers contracted 10.3% more to 21,563, and managed assets shrank by 2.9%. Fund returns, finally, closed the first-half period in negative territory with losses on a similar scale to those of past years (-1.86% in the first quarter and -0.76% in the second).

…which has made further inroads into main fund variables.

Figures for real estate companies were bolstered by the entry of two new competitors.

The number of real estate investment companies rose from eight to ten between January and June 2013. The three-fold increase in sub-sector assets in the first quarter of the year (from 284 to over 800 million) was down exclusively to one new entrant, which changed its form in January from that of a public limited company. Shareholder numbers, finally, increased by 80 to an end-June total of 1,017.

Main real estate scheme variables TABLE 15

					2012		2013	
	2009	2010	2011	2012	3Q	4Q	1Q	2Q
FUNDS								
Number[1]	8	7	6	6	6	6	6	6
Unit-holders	83,583	75,280	29,735	25,218	27,587	25,218	24,048	21,541
Assets (million euros)	6,465.0	6,116.0	4,495.0	4,202.0	4,314.0	4,202.0	4,071.4	3,985.5
Return (%)	-8.31	-4.74	-3.23	-5.96	-1.83	-2.17	-2.59	-1.88
COMPANIES								
Number	8	8	8	8	8	8	9	10
Shareholders	928	943	943	937	935	937	1,021	1,017
Assets (million euros)	309.0	322.0	313.0	284.1	294.7	284.1	843.8	854.0

Source: CNMV.

1 Schemes filing financial statements.

Hedge funds

Another divergent performance within the hedge fund industry…

The hedge fund landscape continued to be dominated by two main trends originating in the crisis, with the fund of hedge funds segment deep in depression, and the hedge fund segment continuing to perform well, albeit less so than last year. Note also that a significant number (eight hedge funds and one fund of hedge funds) were being liquidated at the end of the second quarter of 2013.

…with funds of hedge funds losing assets…

Funds of hedge funds shed 2% of their assets as far as 529 million euros between December 2012 and May 2013, while unit-holder numbers reduced by 153 to 3,185 (see table 16). Redemptions outstripped subscriptions in the opening quarter, repeating the pattern of all of last year (no second-quarter data were available at the closing date for this report).

…and further progress for pure hedge funds.

By way of contrast, hedge funds grew their assets 8.3% in the first five months of 2013 to a May total of 995 million euros (against over 26% growth in the twelve preceding months). This advance drew on both unit-holder subscriptions and portfolio gains, which extended to 6.1% between the same months of January and May. Unit-holder numbers, however, fell by 81 to 2,346, marking an end to two years of solid growth.

Main hedge fund and fund of hedge fund variables

TABLE 16

	2009	2010	2011	2012		2013	
				3Q	4Q	1Q	2Q[2]
FUNDS OF HEDGE FUNDS							
Number[1]	38	28	27	26	24	24	22
Unit-holders	5,321	4,404	3,805	3,513	3,338	3,211	3,185
Assets (million euros)	810.2	694.9	573.0	561.3	540.0	536.2	529.2
Return (%)	7.85	3.15	-1.70	1.38	0.60	2.73	0.72
HEDGE FUNDS							
Number[1]	29	33	36	36	36	33	33
Unit-holders	1,917	1,852	2,047	2,305	2,427	2,384	2,346
Assets (million euros)	652.0	646.2	728.1	828.7	918.6	964.8	995.3
Return (%)	14.94	5.37	-2.60	2.85	3.03	3.72	2.34

Source: CNMV.

1 Funds filing financial statements.

2 Data to May 2013.

Foreign UCITS marketed in Spain

This segment kept up the strong expansion begun in 2012 in terms of both investment and unit-holders. Investment volumes, concretely, rose 26.9% in the first six months to 48 billion euros. Both funds and companies shared in the advance with growth of 25.6% and 27.2% to 8 billion and over 40 billion respectively, while investor numbers rose by 16.4% to 950,000. The first-half period also brought changes in the mix, with the addition of 14 companies, making 347, and 15 fewer funds, making 406.

Foreign UCITS marketed in Spain enjoy another strong run in first-half 2013 in terms of both investment and unit-holder numbers.

Outlook

Assets under management in the collective investment industry have slumped to almost half since the crisis broke, due to a continuous outpouring of investor funds. However, these first-half data suggest the tide may be turning. The growth trend, moreover, could firm in the coming months due to the fading attractiveness of alternatives like bank deposits or commercial paper, and investors' renewed confidence in this type of product after the financial market turbulence of previous years. The stabilisation of household disposable income may also free up some investment capacity, and indeed savings rates pulled a little higher in the first months of 2013.

The improved industry outlook will foreseeably consolidate thanks to less competition from alternative investment products.

The industry outlook is also partly conditioned by banks' product policies and marketing strategies. One development of note here is the recent selling spurt in non-guaranteed funds with a target return. It is important that investors are properly apprised of how these products operate, so they can make informed decisions in keeping with their risk profile and expectations and in full awareness of their rights. On this score, exhibit 3 describes recent measures taken by the CNMV to strengthen transparency in the marketing of certain types of investment fund.

Full disclosure of investor-relevant information is vital not only to individual decision-making but also to the sustainability of the financial industry.

Strengthening transparency in the selling of target funds

EXHIBIT 3

The cost of securing guarantees for investment funds alongside management companies' need to keep up a stream of new fund launches to compete with the returns offered by other financial products – particularly deposits – have fuelled the recent trend towards the phasing out of guaranteed funds in favour of others incorporating a non-guaranteed target return. The risk is that investors will not pick up on this change of policy, since their formal acceptance will not be sought (quite simply, their tacit acceptance will be presumed if they do not exercise the associated exit right). And the experience of the past suggests that such concerns are fully justified. In effect, what usually happens when a fund guarantee expires is that some investors either sell or switch to another fund, while others leave their money in and find themselves holding a fund which resembles its forerunner but without any third-party guarantee.

For preventive purposes, therefore, the CNMV has taken steps to strengthen investor disclosure requirements in respect of the transformation of guaranteed into non-guaranteed funds. Some of these measures, moreover, have been extended to target funds (guaranteed or otherwise) in certain situations.

On 12 July, the CNMV posted a communication on its website stating that entities should, where possible, refrain from replacing guaranteed funds with non-guaranteed target funds, and, failing this, make every reasonable effort to ensure that unit-holders of the pre-existent fund are aware that the new product carries no guarantee.

The measures taken are set out below:

– Prospectuses and key investor information (KII) documents in respect of non-guaranteed target funds should bear the following warning in capital letters:

  "THIS FUND CARRIES NO THIRD-PARTY GUARANTEE SO NEITHER THE CAPITAL INVESTED NOR THE LEVEL OF INCOME ARE GUARANTEED".

– A statement that the target return is not guaranteed should figure in the prospectus, KII document and, where relevant, the communication sent to unit-holders. Whenever the APR is cited, it should come with the warning (in capital letters) NOT GUARANTEED.

– The correspondence sent to investors in funds whose guarantee is due to expire and which will be switching to a new, non-guaranteed policy should draw their attention to the fact that THIS FUND IS NO LONGER GUARANTEED (in capital letters), with copies of the corresponding draft furnished to the CNMV.

  Also, the following warning should appear (in capitals) at the end of the letter:

  "IF YOU CHOOSE NOT TO REDEEM BUT TO MAINTAIN YOUR INVESTMENT, YOU ARE AGREEING TO STAY ON AS A UNIT-HOLDER WITH THE CHANGES DESCRIBED ABOVE".

  This same warning should be displayed in standard letters to investors detailing their information and exit rights, whether or not the fund in question is guaranteed.

– Existing funds which are planning to change their investment policy to pursue a specific target return (guaranteed or otherwise) should accompany the letter notifying investors with a copy of the new KII document filed with the CNMV. This represents a change of practice in prospectus and KII registration, in that both documents must henceforth be filed before the notification letter is sent out. By this means, investors in the existing fund will have more complete information at their disposal.

– Finally, in the case of funds with a set target return (guaranteed or otherwise) which accept subscriptions and/or redemptions after the marketing period has concluded, management companies must:

  (i) Adopt measures to avoid potential conflicts of interest between investors acquiring or redeeming holdings and those remaining in the fund.

  (ii) Adopt measures to ensure that those subscribing to the fund after the marketing period is over receive appropriate post-sale information about the investment's expected return.

4.2 Investment firms

Investment firms reported aggregate first-half profits 15.3% down on the year-ago period, due primarily to a stall in revenues from order processing and execution, their main business line. Note however that the profits slide was confined to the broker-dealer segment accounting for 95% of sector earnings, while both brokers and portfolio management companies managed to grow their profits in the opening half. The number of loss-making firms reduced substantially, along with the volume of their losses, while capital adequacy remained within the comfort zone.

Investment firms again had to negotiate a challenging market landscape. Sector earnings decreased 15%, but the number of loss-making firms was sizeably lower and capital adequacy remained satisfactory.

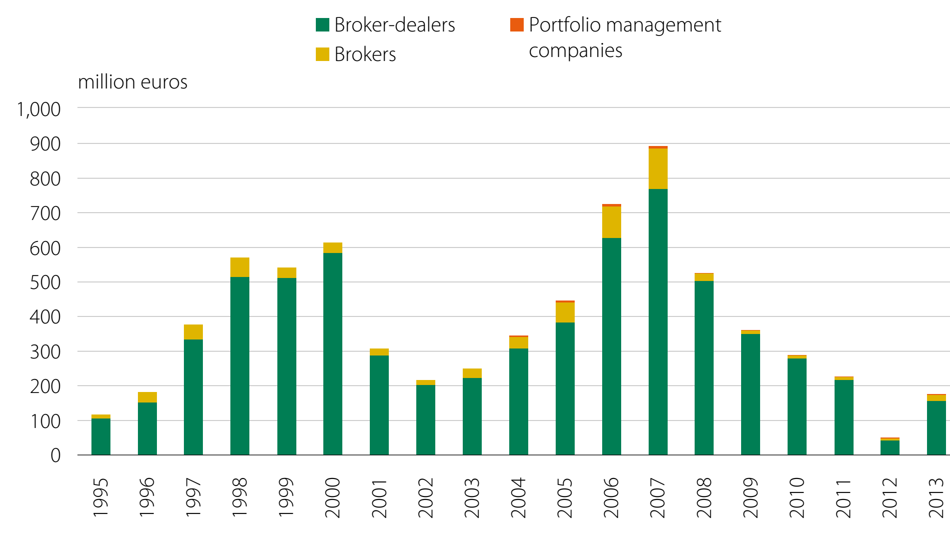
Broker-dealers, as stated, lost further business in the first half of 2013, as evidenced by a 15.8% fall in fee income from investment services vs. the same period last year. The result was a 22.5% decline in pre-tax profits to 78 million euros (see table 17). Income from order processing and execution, which brings in around two-thirds of fees, dropped by 15.8% to 175.7 million euros. Other captions suffering reverses were investment advisory income, down from 23.7 to 4.5 million euros, and other fee income. UCITS marketing fees, meantime, edged up slightly to 24.4 million euros, reflecting the improved performance of the investment fund industry in first-half 2013. Continuing down the income statement, the results of financial investments almost doubled in the period, while exchange losses swelled by 116.2% to 132.7 million, translating as gross income of 271.1 million, 10.7% less than in the same period in 2012.

Broker-dealer profits contracted 22% in the first-half period on a combination of falling fee income and spiralling exchange losses.

Despite this notable year-on-year contraction in first-half earnings, these same figures, extrapolated to the full-year period (i.e., annualising their amount) would stand significantly above the 2012 total (see figure 18). This is because one firm posted heavy losses in December last year which made a large dent in broker-dealer aggregate earnings. Stripping out this effect, aggregate 2013 profits (with June figures annualised) would stand around 6% lower than those of last year.

These same figures, on an annualised basis, compare favourably with 2012 due to heavy losses at one firm.

Investment firm pre-tax profits[1, 2] FIGURE 18



Source: CNMV.

1 Except IAFs.

2 2013 earnings on an annual basis.

Brokers post a sturdy advance in pre-tax profits driven by rising fee income and operating cost contention.

Brokers, meantime, grew their pre-tax profits to 9.1 million euros from the 2.7 million of first-half 2012. Underpinning the advance was the fact that many firms reporting heavy losses in 2012 either entered profit or reduced their scale. Fee income, as table 17 shows, rose by 10.4% year on year to 59.2 million euros on the strength of gathering inflows from order processing and execution and UCITS marketing (up by 12% to 20.2 million and 56% to 15.4 million respectively). Gross income in this sub-sector climbed 8.7% to 51.6 million euros, while operating expenses kept to a descending path (down by 4.3% to 41.9 million).

Portfolio managers grow their pre-tax profits to over one million euros in the first half of 2013.

Finally, the aggregate pre-tax profits of **portfolio management companies** rose by 60.9% to just over one million euros. This improvement drew on both income and expense headings, with gross income up by 5.2% to 4.4 million euros on strongly performing fee income, and operating costs down by 4.3% to 3.4 million euros.

The ROE of all industry segments expands to the month of June, though note that among broker-dealers the advance owes to one firm's heavy losses in 2012.

Sector-wide return on equity (ROE) jumped from 3.0% to 12.2% between December 2012 and June 2013, remembering though that the ROE reading for December last year was depressed by heavy losses at one broker-dealer. By sub-sector, the ROE of broker-dealers rose from 2.9% to 11.8%, although without the impact of this one firm it would have dropped from 12.8%. Other intermediaries performed better by this measure in line with their earnings performance to June 2013, with an increase of 14 percentage points (to 20.3%) in the case of brokers and a more modest 4.2% (to 5.9%) among portfolio management companies (see left-hand panel of figure 19).

The number of loss-making firms and the scale of their losses dwindle in 2013…

Against this sector-wide backdrop, the number of firms in losses fell to 25 in June 2013, compared to 38 one year before and 31 at the 2012 close. The scale of losses, at 11.5 million euros, was also 10.6% less in year-on-year terms. Of the total of loss-making firms as at June 2013, 13 were broker-dealers (15 in December 2012), ten were brokers (14 in December), and two were portfolio management companies (the same number as in December).

Aggregate income statement (June 13)

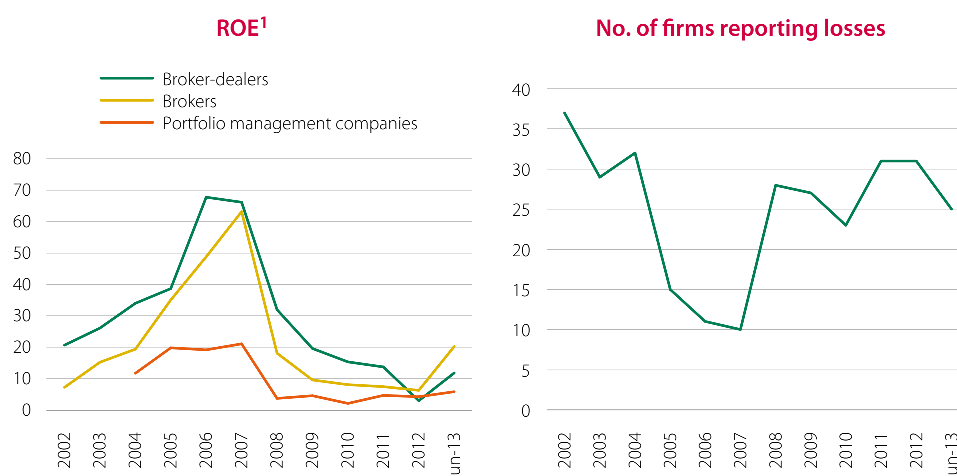
TABLE 17

Thousand euros	Broker-dealers Jun 12	Broker-dealers Jun 13	Broker-dealers % var.	Brokers Jun 12	Brokers Jun 13	Brokers % var.	Portfolio managers Jun 12	Portfolio managers Jun 13	Portfolio managers % var.
1. Net interest income	32,651	26,865	-17.7	946	924	-2.3	390	341	-12.6
2. Net fee income	234,842	187,136	-20.3	46,665	51,267	9.9	3,832	4,102	7.0
2.1. Fee income	331,330	278,910	-15.8	53,625	59,204	10.4	8,864	9,384	5.9
2.1.1. Order processing and execution	200,721	175,651	-12.5	17,993	20,178	12.1	–	–	–
2.1.2. Issue placement and underwriting	4,089	8,366	104.6	1,620	1,957	20.8	–	–	–
2.1.3. Securities custody and administration	10,091	8,944	-11.4	311	306	-1.6	–	–	–
2.1.4. Portfolio management	6,881	6,960	1.1	5,487	6,341	15.6	8,115	8,564	5.5
2.1.5. Investment advising	23,684	4,508	-81.0	2,445	1,800	-26.4	749	819	9.3
2.1.6. Search and placement	25	30	20.0	0	55	–	–	–	–
2.1.7. Margin trading	6	84	1,300.0	14	11	-21.4	–	–	–
2.1.8. UCITS marketing	23,113	24,433	5.7	9,881	15,401	55.9	0	0	–
2.1.9. Others	62,720	49,934	-20.4	15,874	13,155	-17.1	0	1	–
2.2. Fee expense	96,488	91,774	-4.9	6,960	7,937	14.0	5,032	5,282	5.0
3. Result of financial investments	92,439	184,105	99.2	786	35	-95.5	-52	-11	78.8
4. Net exchange income	-61,398	-132,712	-116.2	25	-33	–	23	7	-69.6
5. Other operating income and expense	5,043	5,737	13.8	-978	-643	34.3	25	-2	–
GROSS INCOME	**303,577**	**271,131**	**-10.7**	**47,444**	**51,550**	**8.7**	**4,218**	**4,437**	**5.2**
6. Operating expenses	205,085	194,152	-5.3	43,785	41,906	-4.3	3,528	3,378	-4.3
7. Depreciation and other charges	5,705	6,405	12.3	1,022	902	-11.7	53	34	-35.8
8. Impairment losses	501	447	-10.8	45	9	-80.0	0	0	–
NET OPERATING INCOME	**92,286**	**70,127**	**-24.0**	**2,592**	**8,733**	**236.9**	**637**	**1,025**	**60.9**
9. Other profit and loss	8,348	7,843	-6.0	129	390	202.3	0	0	–
PROFITS BEFORE TAXES	**100,634**	**77,970**	**-22.5**	**2,721**	**9,123**	**235.3**	**637**	**1,025**	**60.9**
10. Corporate income tax	22,174	15,870	-28.4	361	580	60.7	200	337	68.5
PROFITS FROM ONGOING ACTIVITIES	**78,460**	**62,100**	**-20.9**	**2,360**	**8,543**	**262.0**	**437**	**688**	**57.4**
11. Profits from discontinued activities	0	0	–	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**78,460**	**62,100**	**-20.9**	**2,360**	**8,543**	**262.0**	**437**	**688**	**57.4**

Source: CNMV.

Pre-tax ROE of investment firms and loss-making entities

FIGURE 19



Source: CNMV.

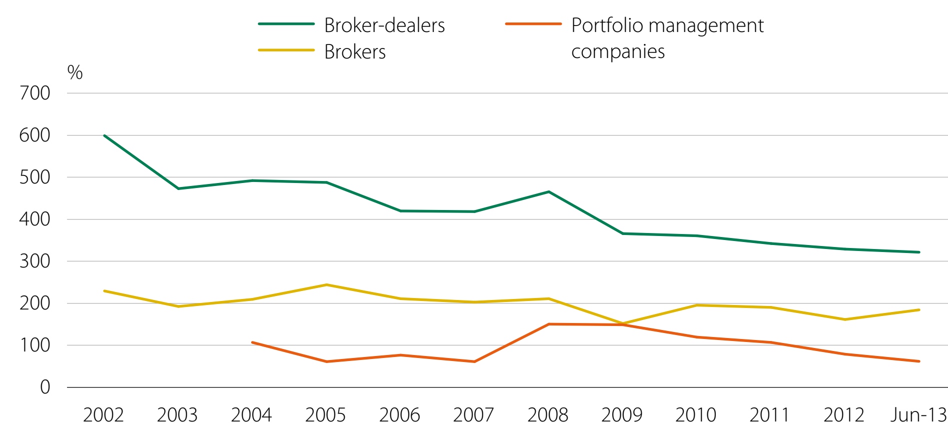
1 ROE based on annualised pre-tax profits.

...while capital ratios remain comfortably clear of minimum requirements.

Investment firms remained comfortably compliant with capital standards. The slight narrowing movement observable in the first six months of 2013 (see figure 20) refers only to broker-dealers and portfolio management companies, whose surplus to the minimum requirement dropped from 3.3 to 3.2 and 7.9 to 6.2 respectively, against the 1.6 to 1.8 increase in the securities broker segment.

Investment firm capital adequacy FIGURE 20

(surplus of qualifying equity to the minimum requirement)



Source: CNMV.

IAF business resumes growth in first-half 2013 after a slow 2012.

Investment advisory firms (IAF), which have been operating in Spain since 2009 and the transposition of the MiFID, have shaken off the slowdown symptoms of 2012 year and turned in a healthy performance year to date (see table 18). A total of 112 IAFs were registered in June 2013, 11 more than at end-2012 and 15 more than in June last year. Meantime, assets under advice expanded by 5.1% (to 15.44 billion euros) and the number of contracts by 12.3% (to 3,680 million). Approximately half the amount of assets under advice (52% to be exact) corresponded to eligible counterparties[19] (the "others" heading), with a further 22% and 26% drawn from professional and retail clients respectively. It is also in this last group where assets under advice have grown most (62.6%) vs. the first half of 2012. Against this more upbeat backdrop, sector fee income rose by 6% year on year to 14.7 million euros, while profits advanced by 5% to 3 million euros.

The prospects for the investment firm sector remain complicated while stock market trading continues to languish, but help could be forthcoming from other business lines.

The outlook for investment firms remains muddied in view of the prolonged slide in stock market trading, their main source of income. But signs of recovery are showing though in other business lines, particularly the collective investment industry and, to a lesser extent, issue placements, and this should hopefully boost income statements going forward. The rollout of bank sector restructuring measures has so far had little impact on the number of firms in operation. Only one retiral in 2012 was due to merger of the parent entity, while the three retirals to August this year resulted from changes in corporate form. Note finally that four firms joined the register in this same period, comprising three brokers and one broker-dealer.

19 Eligible counterparty is the classification the MiFID typically assigns to banks, other financial institutions and governments. It is also the category requiring the lowest level of protection.

Main investment advisory firm variables

TABLE 18

Thousand euros	2010	2011	2012	2012 1H	2012 2H	2013 1H	% annual change
NO. OF FIRMS	**52**	**82**	**101**	**97**	**101**	**112**	**15.5**
ASSETS UNDER ADVICE[1]	**16,114,880**	**16,033,108**	**14,776,498**	**14,694,319**	**14,776,498**	**15,437,210**	**5.1**
Retail customers	1,710,385	2,181,943	3,267,079	2,443,271	3,267,079	3,973,782	62.6
Professional customers	3,854,641	3,151,565	3,594,287	3,396,260	3,594,287	3,472,835	2.3
Others	10,549,854	10,699,600	7,915,132	8,854,788	7,915,132	7,990,593	-9.8
NO. OF CONTRACTS[1]	**2,431**	**3,673**	**3,484**	**3,276**	**3,484**	**3,680**	**12.3**
Retail customers	2,345	3,540	3,285	3,097	3,285	3,455	11.6
Professional customers	70	117	175	157	175	194	23.6
Others	16	16	24	22	24	31	40.9
FEE INCOME[2]	**20,745**	**31,053**	**26,177**	**13,915**	**26,177**	**14,685**	**5.5**
Fees received	20,629	30,844	26,065	13,833	26,065	14,660	6.0
From customers	17,132	26,037	20,977	11,642	20,977	12,058	3.6
From other entities	3,497	4,807	5,088	2,191	5,088	2,601	18.7
Other income	116	209	112	82	112	25	-69.5
EQUITY	**10,062**	**12,184**	**13,402**	**13,123**	**13,402**	**12,153**	**-7.4**
Share capital	3,014	3,895	4,365	4,328	4,365	4,820	11.4
Reserves and retained earnings	247	950	4,798	5,912	4,798	4,306	-27.2
Profit/loss for the year[2]	6,801	7,338	4,239	2,883	4,239	3,027	5.0

1 Period-end data at market value.
2 Cumulative data for the period.

New customer information requirements with regard to appropriateness and suitability assessment in the realm of financial services

EXHIBIT 4

On 19 June 2013, the CNMV published its Circular 3/2013, of 12 June, implementing certain obligations to provide information to investment services customers in relation to the assessment of the appropriateness or suitability of determined financial instruments.

The Circular sets out the terms in which entities must advise their clients of the non-appropriateness of a transaction or that no assessment has been performed in its regard, the specific wording of the handwritten statements to be provided and signed by the customer, and the requirement to keep a register of the products found to be unsuitable, pursuant to the amendments made to article 79 *bis* numbers 6 and 7 of the Securities Market Law (LMV for its initials in Spanish) by the third final provision of Law 9/2012 on restructuring and resolution of credit institutions.

The purpose of the handwritten statement, as envisaged in the new text, is to ensure that when a product is not suitable for a customer or cannot be properly assessed due to insufficient information, he or she is fully aware of that fact. And the idea of keeping a register of assessed clients and inappropriate products is so

customers are not later approached with personalised offers of products whose appropriateness has already been tested with negative results.

The main changes introduced by Circular 3/2013 are set out below:

- Information disclosures during suitability testing. The description envisaged in article 79 *bis* (6) of the LMV justifying that the recommendation matches the characteristics and objectives of the investor must at least include the terms in which the investment product or service has been classified from the point of view of market, credit and liquidity risk, and its complexity, and the corresponding customer suitability assessment. The description, it adds, can be abridged in the event of repeated recommendations on the same type or family of instruments. The entity must also establish mechanisms to corroborate its compliance with this requirement.

- Information disclosures during appropriateness testing.

  (i) Delivery to the customer of a document with the results of the test. The Circular specifies that entities must demonstrate compliance with the obligation to supply customers with the results of the test referred to in article 79 *bis* (7) of the LMV, and that this assessment must be consistent with all the information available to the entity or provided by the customer and used in the test.

  (ii) Content of cautionary notices specifying non-appropriateness or lack of assessment, and handwritten statements in the case of transactions involving complex instruments. The Circular specifies the wording of the cautionary notice to be delivered to the customer in the event that the assessment cannot be performed or that it has found the product to be inappropriate, and also of the handwritten statement to be procured from customers when the transaction involves a complex instrument, as referred to in article 79 *bis* (7) of the LMV.

  (iii) Unadvised transactions. When the entity wishes to include a statement to the effect that no advisory services have been given in connection with a transaction in the documentation the customer is to sign, it must obtain his or her signature together with a handwritten statement that they have not been given advice.

- Up-to-date register of assessed customers and unsuitable products. The Circular specifies that the up-to-date register referred to in article 79 *bis* (7) of the LMV, should reflect the date from which the entity deemed each type of instrument unsuitable for each customer individually, and, if relevant, the date as of which this limitation ceased to exist. Entities must also furnish customers with this information on request, free of charge.

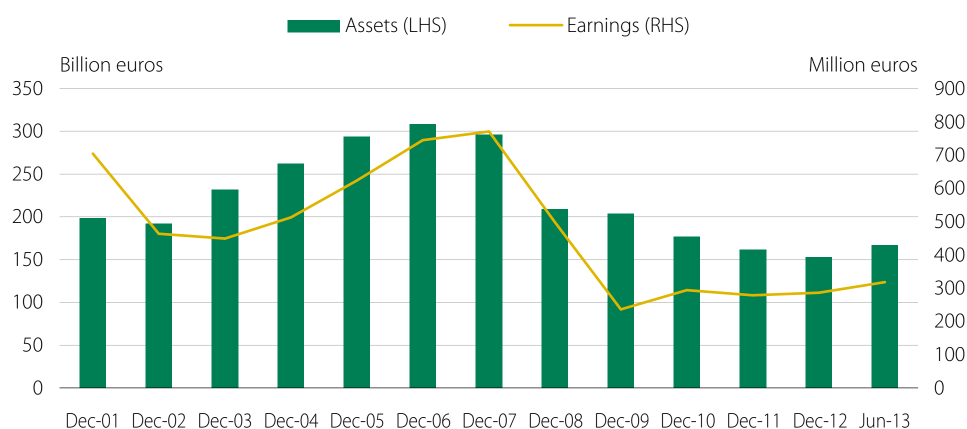
  All these requirements will come into force two months from the Circular's publication date, except those referring to the wording of cautionary notices and the up-to-date register of assessed customers and unsuitable products, which will do so five months from the same date.

4.3 UCITS management companies

Assets under management in UCITS management companies summed almost 166.7 billion euros in June this year, an increase of 9% over the 2012 close. As we can see from figure 21, this is the first rise in assets managed since the start of the crisis in mid-2007. As much as 83% of the advance was drawn from mutual funds, though the investment company segment also contributed on the upside.

Assets under management in UCITS management companies climb by 9% in the first half of 2013 (the first rise since the crisis broke in mid-2007)…

UCITS management companies: assets under management and pre-tax profits[1] FIGURE 21



Source: CNMV.

1 The profits figure for June 2013 has been restated on an annual basis.

UCITS management companies: assets under management, management fees and fee ratio TABLE 19

Million euros

	Assets under management	UCITS management fee income	Average UCITS management fee (%)	Fee ratio (%)[1]
2006	308,476	3,281	1.06	71.5
2007	295,922	3,194	1.08	70.5
2008	209,014	2,302	1.10	70.8
2009	203,730	1,702	0.84	68.6
2010	177,055	1,622	0.91	68.1
2011	161,481	1,479	0.90	66.6
2012	152,644	1,416	0.93	64.6
June 13[2]	166,669	1,446	0.87	63.9

Source: CNMV.

1 Ratio of fee expenses for fund marketing to fee income from UCITS management.

2 Figures for fee income and average management fees have been restated on an annual basis.

The recovery in managed assets was reflected in the main captions in sector income statements. Income from management fees, specifically, was 1.45 billion euros (in annualised terms), 2.1% more than in 2012, while annualised pre-tax profits grew by 11.1% to almost 318 million euros (see figure 21). Sector-wide return on equity

…delivering an advance in sector income and profits, along with a reduction in the number of loss-making companies.

(ROE) inched up from 23.1% at the 2012 close to 23.7% in June 2013, while the number of loss-making entities shrank from 28 to 19, generating combined red numbers of just 3.7 million compared to the 10 million euros of end-2012.

The ranks of management companies thin once more, due in part to the ongoing restructuring of the Spanish banking sector.

Sector reorganisation continued to progress albeit at a rather slower pace, with bank sector restructuring as the main driver. In the first eight months of 2013, one company joined the register while five more withdrew, two of them due to movements in the banking sector. This left the sector ranks at 101 entities as of 31 August this year.

ESMA report on the selling of complex products to retail investors EXHIBIT 5

The sale of complex financial products to retail investors has increased significantly in the past few years. As a result, these investors are exposed to a series of risks of which they have no previous experience. It is accordingly important to be able to identify and analyse these risks.

The European Securities and Markets Authority (ESMA) published a report on July 2013 examining two classes of complex products which, by their nature, have been marketed extensively among retail investors in the euro area; namely, structured products and UCITS pursuing alternative investment strategies.[1]

Structured products

The sale of structured products involves specific risks which must be borne in mind when analysing them from the standpoint of investor protection. In particular, many such products have risk profiles that are difficult to grasp without a degree of expertise and access to specific tools. Also, they often have implicit costs embedded in the selling price which are hard to quantify.

In order to investigate these risks, the ESMA report presents the results of a risk/reward analysis run on a sample of structured products at the date of issuance and assuming the investment is held to maturity:

– *Analysis at date of issuance:* The ESMA report analyses a sample of 76 structured products, comparing each one's notional value with the price at which it is sold to retail investors. The conclusion they reach is that structured products are sold with an average issuance premium of 4.6%. However, if we also factor issuer credit risk, this average premium increases to 5.5%. In other words, in the case of a product sold at 100% of its nominal value, its intrinsic value would stand on average at between 94.5% and 95.4% of the sale price, according to whether or not we consider issuer credit risk.

– *Analysis at date of maturity:* The ESMA report also looks at the performance of a sample of 2,760 structured products incorporating capital protection on the assumption that investors hold them in their portfolio to maturity. Its findings, in this case, are that the annual return on these products would have been 0.5% less than the "risk-free" rate (Euribor or Libor) available at the time of sale.

This analysis, in which the CNMV was an active partner, was conducted on structured products issued in the euro area between 1996 and 2011.

UCITS pursuing alternative investment strategies

The ESMA report also examines the returns obtained by a sample of 623 UCITS (Undertakings in Collective Investments in Transferable Sectruities)[2] pursuing similar investment strategies to hedge funds. Specifically, it compares the returns of these alternative UCITS to those of various hedge funds and market indices in the same period.

The results indicate that alternative UCITS outperformed equity indices over the 2006-2011 period while underperforming hedge funds. However, when we calculate return in relation to risk, as measured by volatility and Conditional Value-at-Risk (CVaR), we find that the alternative UCITS had a risk-adjusted return close to zero, slightly lower than the return obtained by various equity and bond indices in the same period.

The report's conclusions

The main conclusions ESMA draws from its study are summarised below:

– Understanding complex financial products requires significant knowledge of quantitative tools and valuation methods as well as access to market inputs. To ensure their proper supervision it is vital that the competent authorities have specific means at their disposal to analyse their performance mechanisms and associated risks.

– The intrinsic value, expected return and risk drivers of structured products are challenging concepts for a majority of retail investors. This being so, it is essential that they are supplied with all the information needed to judge each product appropriately. Information disclosure to investors can be improved by including: (i) a higher degree of transparency regarding the total costs of structured products, including the implicit costs embedded in the selling price, and (ii) detailed information regarding the specific risks of each product, in particular issuer credit risk and its possible quantification.

1 The report can be consulted or downloaded from the ESMA website: http://www.esma.europa.eu/system/files/2013-326_economic_report_-_retailisation_in_the_eu_0.pdf

2 UCITS are collective investment schemes established in conformity with European legislation, such that a single authorisation from one Member State allows them to be sold freely throughout the European Union.

4.4 Other intermediaries: venture capital

The number of venture capital entities remains unvaried vs. 2012, but with some changes in the mix (more funds and fewer managers).

Of the 340 venture capital entities (VCEs) in operation at end-August 2013, the same number as at end-2012, 137 were venture capital companies (VCCs), 124 venture capital funds (VCFs) and 79 VCE management companies (see table 20). Twelve entities joined the register during the first eight months of 2013 (six VCCs, five

VCFs and one VCE manager) with the same number of retirals (eight VCCs and four VCE managers).

Movements in the VCE register in 2013

TABLE 20

	Situation at 31/12/2012	Entries	Retirals	Situation at 31/08/2013
Entities	340	12	12	340
Venture capital funds	119	5	0	124
Venture capital companies	139	6	8	137
Venture capital management companies	82	1	4	79

Source: CNMV.

VCE assets rose by 0.7% in 2012 with growth in funds contrasting with a degree of shrinkage in the company segment.

In 2012, VCE assets expanded a bare 0.7% to close the year at just over 8.50 billion euros. VCFs and VCCs enjoyed unequal fortunes, with the former growing their assets 9.7% to 4.74 billion euros, against the 8.6% contraction to 6.78 billion reported by the latter group (see table 21). The jump in VCF assets owed mainly to increased investment by foreign entities (whose assets rose in consequence by 64.5% to 927 million euros) and, to a smaller extent, domestic VCEs (whose assets rose 126% to 227 million). By contrast, the principal investors in VCCs – banks and non-financial corporations – cut back their investments by 27.7% and 14.9% respectively.

Venture capital entities: assets by investor group

TABLE 21

	VCF		VCC	
Million euros	2011	2012	2011	2012
Natural persons				
Residents	212.7	209.3	80.8	73.7
Non-residents	2.8	4.0	0.8	1.2
Legal persons				
Banks	526.4	524.6	1,265.4	915.1
Savings banks	281.8	198.8	102.7	41.5
Pension funds	417.6	422.0	23.6	14.2
Insurance corporations	111.2	130.2	26.0	30.4
Broker-dealers and brokers	0.0	0.0	0.0	0.1
UCITS	27.2	34.9	10.7	6.6
Domestic VCEs	100.0	225.7	56.1	32.3
Foreign VCEs	394.0	328.1	3.7	1.1
Public authorities	588.4	574.5	165.2	237.0
Sovereign funds	38.2	27.1	0.0	0.0
Other financial corporations	309.1	358.6	676.0	997.9
Non-financial corporations	594.1	586.3	1,541.1	1,311.9
Foreign entities	563.3	926.5	46.8	40.0
Others	157.3	191.7	134.8	73.8
TOTAL	**4,324.1**	**4,742.2**	**4,133.8**	**3,776.8**

Source: CNMV.

According to preliminary data furnished by industry association Asociación Española de Entidades de Capital Riesgo (ASCRI), venture capital investment in Spain in the first six months of 2013 was a lowly 508 million euros, compared to 2.53 billion in the same period last year. It bears mention, however, that investment in early-stage companies has held up well, accounting for 63% of the total amount (10% in seed and start-up transactions and 53% in expansion projects). This also explains why 73% of funds went on transactions of under one million euros. Lack of ready credit, meantime, drove down the volume of leveraged buyouts, as far as 21% of the total versus 54% in the year-ago period. International funds were again prominent, as the source of 47% of first-half investment (60% to June last year).

The shortage of bank finance has eroded sector assets in the first half of 2013.

The short-term outlook for the venture capital sector remains hard to judge, since there are various factors which could help or hinder its development. On the one hand, the dearth of bank lending, which will foreseeably persist until sector restructuring is complete, means VCEs are missing out on investment opportunities. And nor is the domestic economy especially supportive. However, other factors could serve to energise the sector, among them the imminent transposition to Spanish law of the AIFM Directive, which pursues an improved climate for industry growth, or the creation of the FOND-ICO Global fund of funds, a public initiative that will inject large sums into promoting private equity funds to invest in Spanish companies at all development stages.

The sector's near-term prospects remain hazy while the credit shortage persists, though certain factors could help energise business in the medium term.