I Securities markets and their agents: Situation and outlook

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1 Executive summary

- The global macroeconomic environment has been characterised in recent months by the growth lead opened up by the emerging economies and United States and the decline in inflation due to falling oil prices. This scenario continues to anchor the markedly expansionary monetary policies pursued by advanced economy central banks, though divergences have recently emerged in their recourse to non-standard measures. The main event on this score was undoubtedly the ECB's announcement that it would expand its bond-buying program as far as monthly purchases of 60 billion euros, at least until September 2016. The news, released in January, was greeted with relief in financial markets, which came largely unscathed through the change of government in Greece and subsequent renegotiation of the country's debt.

- Long-term benchmark yields continued downwards[1] in most advanced economies after ending last year at record lows. Some euro-area bonds even slipped below the 0.5% mark, as investors began pricing in the first effects of the ECB's expanded asset-purchase programme. Sovereign credit risk premiums, meantime, recouped the levels in place before May 2010 and the first wave of debt market turmoil –in some cases even lower– and were barely touched by the upheavals in Greece.

- Leading world stock indices rallied strongly in 1Q 2015, except in the sideways trading US markets. Euro-area stocks were at the leading edge of the advance in contrast to the heavy losses taken in the last months of 2014. Factors in support were the improved economic outlook for Europe (helped by sharply falling oil prices) and the ECB's January announcement of its expanded asset-purchase programme. As a result, the change of government in Greece and the renegotiation of its public debt made little dent on equity prices and occasioned only brief spikes in market volatility. Finally, the majority of euro-area indices posted first-quarter gains upwards of 16%.

- Spanish GDP expanded 0.7% in 4Q 2014 (2% year on year), lifting the annual average rate to 1.4%. The increase not only signified a break with the contraction trend of recent years, but restored Spain to a growth lead vs. the euro area (1.1%) for the first time since 2008. The turnaround was accompanied by changes in the growth mix, including a strongly positive contribution (2.2 points) from the domestic demand side. The pickup in activity brought with it a small rise in employment (1.2% on average in 2014), while permitting some inroads into the jobless rate (down by two points to 23.7% of the active popula-

1 The closing date for this report is 13 March.

tion). Meantime, tumbling oil prices dragged annual inflation into negative territory, while core inflation held near zero. On the budget front, the analyst consensus is that the full-year deficit will be close to the Government's target (5.5% of GDP).

- As well as emerging successfully from the assessments run in the lead-up to the Single Supervisory Mechanism (SSM), the Spanish banking sector is enjoying a more supportive business environment, which has served to strengthen income statements and secure minor improvement in non-performing loan ratios. Lending to the private sector of the economy continued to contract, though the pace is clearly slowing with banks seemingly readier to grant new loans.

- Economic recovery also made itself felt in the results of non-financial listed companies, which grew their combined earnings 64.8% vs. 2013 to 17.51 billion euros. An encouraging note was the return to profit of the construction and real estate sector after a string of heavy losses. Also, companies cut their gross debt by 7% to 255 billion, as the private sector continued to deleverage.

- Prices pulled higher on domestic equity markets after the falls of last year's closing months, with the Ibex 35 gaining 7.3%. The bull run was punctuated by the odd spike in volatility, but was generally reflective of the improved outlook for the Spanish economy, while pricing in some of the effects of the ECB's new asset-buying programme. Equity issuance surged to over fifteen billion euros in the opening quarter (almost half the amount raised in full-year 2014), while trading volumes stood at 202.8 billion (an increase of 33.4%).

- Spanish fixed-income markets steered an even course through 1Q 2015, unperturbed as a whole by events in Greece. Government and corporate bond yields registered fresh lows at both the short and long end of the curve, anticipating in part the effects of the ECB's expanded asset purchase programme. Credit risk spreads fluctuated somewhat in the opening months, but in most cases ended the quarter below their year-end levels (under 100 bp in both the public and private sector). Cheaper financing conditions boosted the volume of fixed-income issues filed with the CNMV as far as 27.61 billion euros (68.4% more than in 2014[2]).

- 2014 was another good year for the collective investment industry, which was able to build successfully on the rebound of 2013. The thin returns of traditional products like bank deposits led investors to turn to funds for interesting alternatives. The result was a 26.8% rise in assets under management to 198.7 billion euros at the 2014 close, translating as 20.4% profits growth for UCITS management companies. Finally, investment in foreign UCITS marketed in Spain swelled to almost 79 billion (over 25% of the total distributed in Spain).

- Investment firms too fared considerably better in 2014, with a broad advance across all main business lines, particularly UCITS marketing and placement

2 Dropping to 41.8% if we exclude issuance by the SAREB.

and underwriting services. The sector's aggregate pre-tax profits climbed by more than 40% to 306 million euros, while the number of loss-making firms dropped from twelve at the outset to eight at the end of the year. Investment advisory firms also did expanding business, ending the year with 21.4 billion in assets under advice, 21.3% more than in 2013. The sector, finally, remained comfortably compliant with solvency ratios, whose calculation methods and reporting standards were amended by Regulation EU 575/2013 and CNMV Circular 2/2014.

- The report includes four monographic exhibits:

  – Exhibit one describes the results of the comprehensive assessment run on credit institutions preparatory to the launch of the Single Supervisory Mechanism (SSM) at year-end 2014.

  – The second exhibit summarises the main evidence assembled in the first report on high-frequency-trading (HFT) in Europe, prepared by securities market authority ESMA.

  – The third sets out the main characteristics of the CNMV's consultation on a classification system for financial instruments and the identification of especially complex products.

  – Finally, exhibit four looks at Spain's new venture capital law and recent changes in its collective investment scheme legislation.

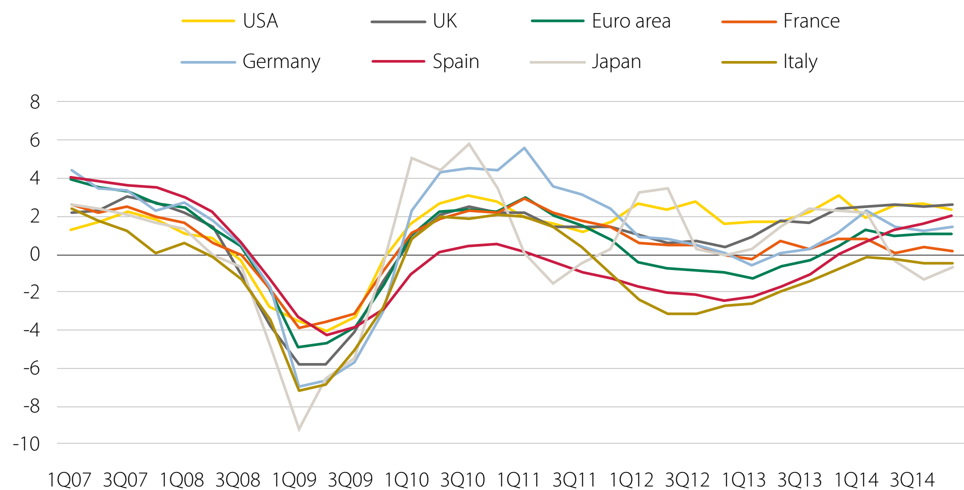
2 Macro-financial background

2.1 International economic and financial developments

World GDP expands 3.3% in a repeat of the 2013 rate, powered by the emerging economies (4.4%) with advanced economies some way behind (1.8%).

Global growth closed last year at 3.3%, a repeat of the 2013 rate, drawing on the 1.8% growth of the advanced economies and the 4.4% of the emerging market group. Among the former, points to note were the GDP increases in the United Kingdom (2.6%) and the United States (2.4%) and the mild recovery in euro-area activity, which picked up from -0.4% in 2013 to 1.1% in 2014. However, as figure 1 shows, recovery in Europe advanced along different paths and at different speeds, with Germany and Spain out in front on annual average growth nearing 1.5%, France some way behind (0.4%) and Italy still stuck in negative terrain (-0.4%). In the emerging market economies, Asia conserved its growth lead (6.5%), despite a slight weakening of activity in China (down from 7.7% in 2013 to 7.4% in 2014). Among the rest, however, growth slowed more steeply on account of their involvement in geopolitical conflicts and, in the closing stretch, the run-down in oil prices. This was the case of Russia, where growth sagged from 1.3% in 2013 to 0.6% in 2014, and certain Latin American economies.

Gross domestic product (annual % change) FIGURE 1



Source: Thomson Datastream.

Inflation races lower in main advanced economies as oil prices tumble.

Inflation fell sharply from mid-year on in most advanced economies as oil prices tumbled[3]. The lowest annual rates corresponded to the euro area, running a negative index since December last (-0.2% in December and -0.6% in January), and the United States, where the annual rate turned negative in January (-0.2%). The UK registered somewhat higher levels (0.3%), while Japanese inflation retreated from the 3.4% high of April 2014, following a VAT hike, to the neighbourhood of 2.4%. Core inflation rates, which exclude the more volatile index components, have steered a flatter though slightly downward course over the past few months.

Monetary policies remains expansionary in response to falling inflation, while non-standard measures follow divergent paths. The ECB, concretely, announced in January that it will conduct monthly bond purchases worth 60 billion euros until September 2016.

Monetary policies remained broadly expansionary across major advanced economies, albeit with growing differences in central bank decisions with regard above all to non-standard measures. These differences respond to the no less different activity, employment and inflation contexts of their respective economies. In the case of a euro area, the looming threat of deflation alongside stubbornly weak activity nudged the ECB into a January announcement the markets had been expecting for weeks: the enlargement of its 2014 package of measures[4] and specifically the extension of its asset-purchase programme to bonds issued by euro-area central governments (sovereign bonds), agencies and European institutions. According to the Bank, combined monthly purchases will amount to 60 billion euros from March 2015 to at least September 2016. The design of this quantitative easing (QE) programme, resembling other non-standard programmes launched in their day by the Federal Reserve, signals the monetary authority's resolve to meet its objective of price stability.

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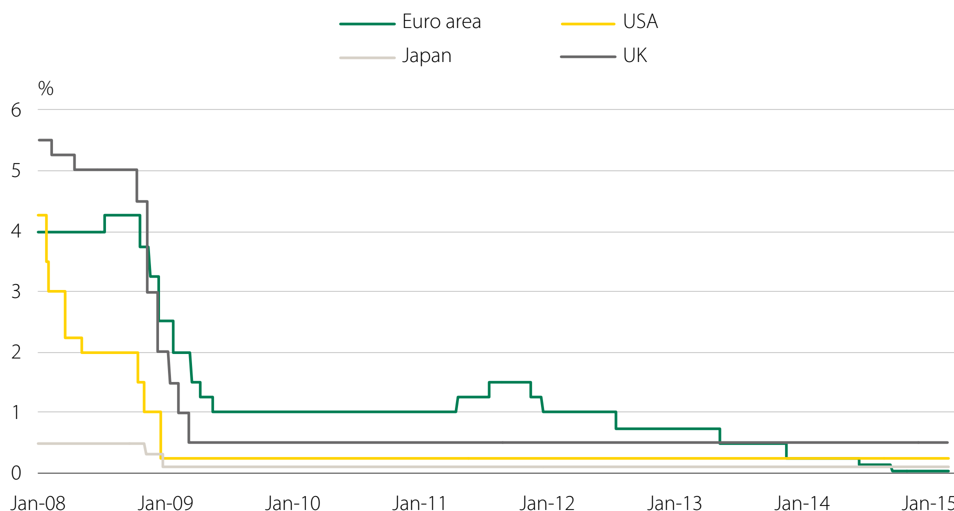
3 The price/barrel of crude dropped from around 115 dollars in mid-June 2014 to lows of 45 dollars in the middle of January 2015, equating to a cumulative drop of 60%. By mid-March, prices had inched back up to around 60 dollars/barrel.

4 In 2014, the ECB cut its benchmark rate on two occasions (in June and September) to a historical low of 0.05%, as well as adopting a set of non-standard measures, including new purchases of private assets (covered bonds and certain asset-backed securities) and targeted longer-term refinancing operations, which banks can tap as a function of their (non-mortgage) lending.

Official interest rates FIGURE 2



Source: Thomson Datastream. Data to 13 March.

The Federal Reserve ended a similar programme late in 2014 and is now calibrating the timing of an interest rate hike.

In the United States, conversely, the Federal Reserve decided to call a halt to its asset-buying programme at the FOMC (Federal Open Market Committee) meeting of end-October 2014. The Fed, which has held rates low between 0% and 0.25% since December 2008, has said it will keep them that way for some time to come, but without ruling out an earlier-than-forecast hike in light of developments in employment and inflation. The markets, naturally, will be looking out for this possibility, which analysts believe could materialise in the second half of 2015.

In global debt markets, long-term yields level off in the US and UK and decline further in the euro area against a backdrop of record lows.

After a year-long decline that took them to historic lows in most advanced economies, the yields on long-term sovereign benchmarks tended to stabilise in the US and UK over 1Q 2015 while continuing downwards in the euro area. The fall in euro-area yields presumably anticipated part of the effects of the ECB's new bond-buying programme. The result was that by mid-March, US and UK yields were running at 2.1% and 1.7% respectively, while euro-area bonds dropped to fresh lows. European economies like Germany, France, the Netherlands and Belgium saw yields slip under 0.5%, while both the Spanish and Italian bond broke below 1.2% (see upper panel of figure 3). Bond market liquidity conditions worsened slightly in the first months of 2015, but without any relevant increase in volatility (only an issue for the Greek bond). This held true even at times of maximum uncertainty, coinciding with the change of government in Greece and talks on the renegotiation of the country's debt (see lower panels of figure 3).

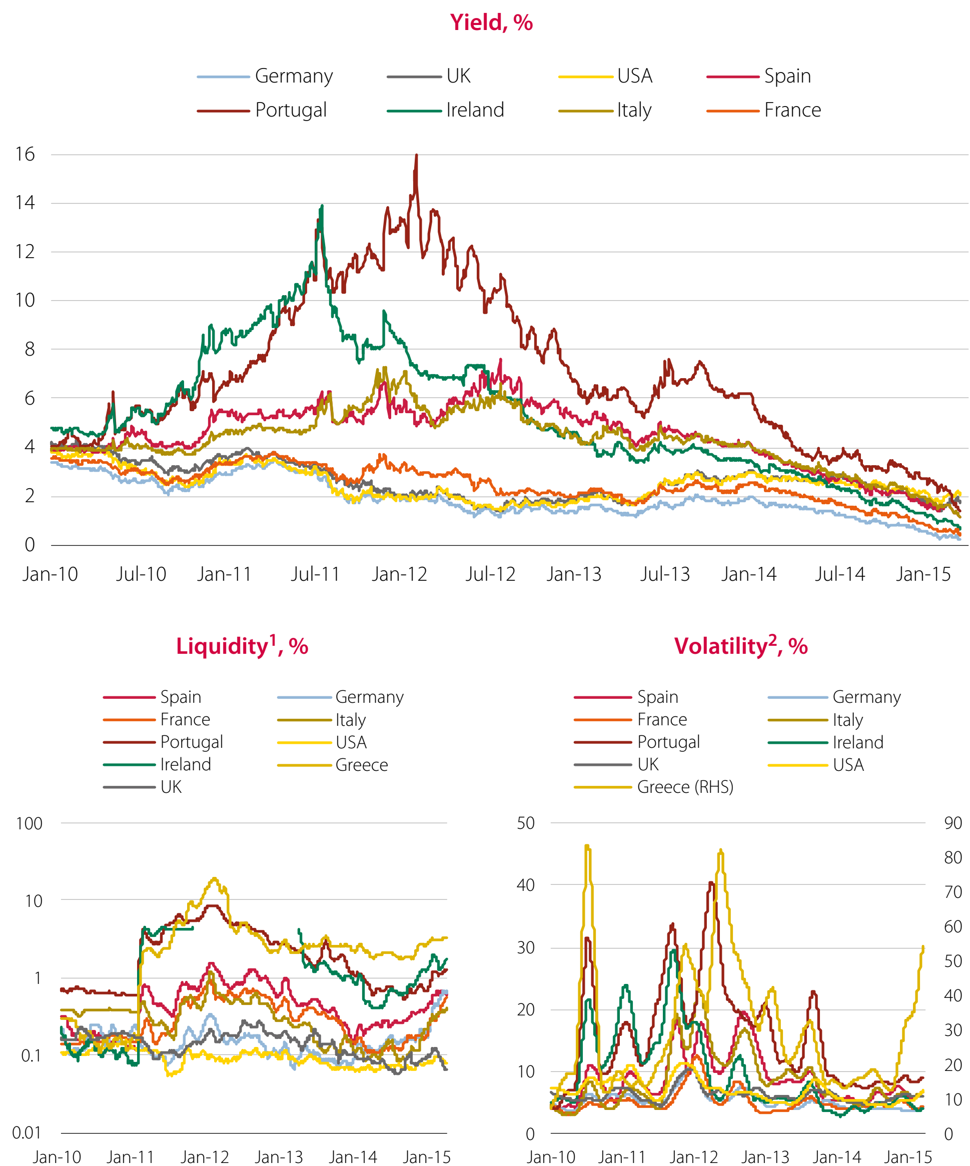
Stable sovereign spreads show that the contagion effect so powerfully present in earlier rounds of market disruption has lost much of its force.

The risk spreads of European peripherals underwent little variation in the first months of 2015 following their long descent from the peak levels of summer 2012. Their recent performance, moreover, signals a disconnect between Greek benchmarks and those of remaining euro-area sovereign issuers, in contrast to the drag exerted in earlier rounds of debt market turbulence. In effect, the instability engendered by the change of Greek government and renegotiation of the country's debt failed to drive up yields or risk premiums across the rest of Europe's economies. The only casualty was Greece itself, with sovereign spreads and long-term bond volatility escalating to two-year highs (see figures 3 and 4).

Corporate bond spreads remain at reduced levels though high-yield spreads have begun straining higher.

In corporate bond markets, reduced levels of high-yield spreads reflected the continuing predominance of "search for yield" strategies. The trend, however, reversed visibly between June and December 2014 restoring them to levels that have persisted more or less through the first quarter of 2015. As we can see from figure 5, the cumulative rise in high-yield spreads extended to around 145 bp in the United States and 180 bp in Europe. Spreads on medium-quality corporates also headed higher in the United States (63 bp). At the top of the quality scale, AAA-rated spreads held broadly flat at around 55 bp in the United States and 45 bp in Europe.

Ten-year sovereign bond market indicators FIGURE 3



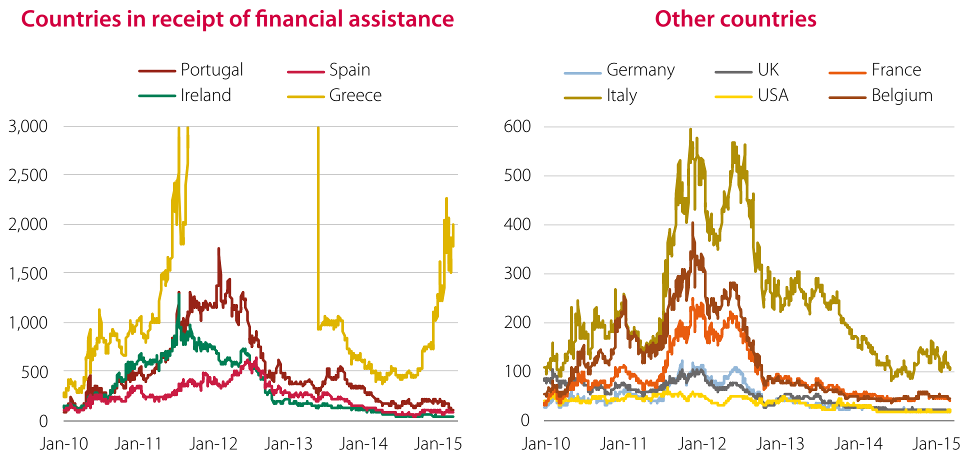
Source: Bloomberg, Thomson Datastream and CNMV. Data to 13 March.

1 Monthly average of the daily bid-ask spread of ten-year sovereign yields (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, bp)

FIGURE 4

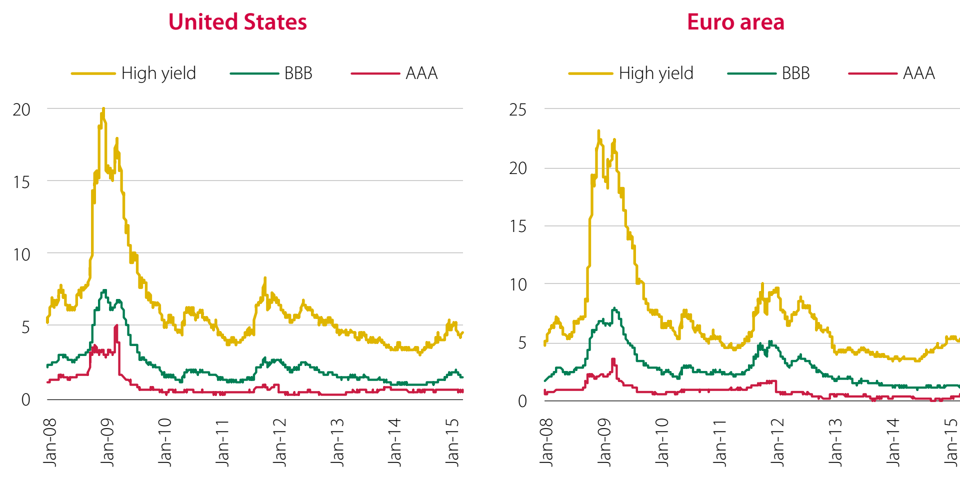


Source: Thomson Datastream. Data to 13 March.

Corporate bond spreads

FIGURE 5

Spread *vs*. the 10-year government bond, in percentage points[1]



Source: Thomson Datastream and CNMV.

1 In the euro area, versus the German benchmark.

Net debt issuance climbs in the year, with flat sovereign issuance contrasting with the dynamism of the private sector...

Net issuance on global debt markets summed 3.26 trillion dollars to the 2014 close, 8.9% more than in 2013. The advance relied on private-sector issuance, while sovereign net issuance, at two trillion dollars, was on a par with the previous year (-0.4%). Ongoing fiscal adjustment among the largest advanced economies has pushed down net issue volumes in recent years, and they are certainly a long way short of the almost six trillion dollars registered in 2010.

... particularly non-financial corporations.

In the private sector of the economy, non-financial corporations were particularly active (see figure 6), with net bond sales amounting to 756 billion dollars (23% of the total), in line with the previous year (766 billion). Non-financial issuance ran higher in the US, but also attained a sizeable sum in Europe. Meantime, financial corporations' net issuance stood at 14% of the full-year total, with divergences emerging between European institutions and the rest. Europe's banks, concretely,

held aloof from the borrowing spurt embarked on by peers in the United States and other economic areas, partly because they are still tidying up after the recent financial crisis, and partly because funding requirements are low key or can be satisfied through other channels.

The main event in 1Q 2015 has been a surge in investment-grade issuance in the United States.

These trends persisted through the opening months of 2015, when the main development was an upswing in US corporate issuance. The bonds on sale were mainly investment grade, designed to raise funds at ultra reduced rates in a context of plentiful liquidity, amplified by ECB plans to ramp up secondary-market purchasing as of this March.

Net international debt issuance FIGURE 6

Source: Dealogic. Half-year data. Data for the first quarter of 2015 run to 13 March, but are restated on a semiannual basis to facilitate comparison.

Equity indices rally in 2015 with Europe to the fore on the strength of an improved economic outlook and the stimulus from the ECB.

Leading world stock indices rallied strongly in 1Q 2015, except in the sideways trading US markets. Euro-area stocks were at the leading edge of the advance in contrast to the heavy losses taken in the last months of 2014, reasons being the improved economic prospects for Europe (supported in turn by the oil price slide) and the ECB's January announcement of an expanded asset-purchase programme, which has anchored rate expectations at ultra reduced levels. It bears mention that uncer-

tainty around the change of government in Greece and the renegotiation of its debt has had little effect on equity market prices or volatility, to the extent that a majority of euro-area indices posted first-quarter gains upwards of 16% (see table 1).

Japanese indices gain new ground, while US indices hold onto recent-year highs.

Japanese indices also pulled higher in the opening quarter by upwards of 10%, in contrast to the sideways movement that dominated US markets. The S&P 500 and Dow Jones, specifically, slipped by 0.3% and 0.4% respectively, while the Nasdaq composite managed a gain approaching 3%. These are also the indices, it should be noted, that have risen most on a longer-term perspective.

Performance of main stock indices[1] TABLE 1

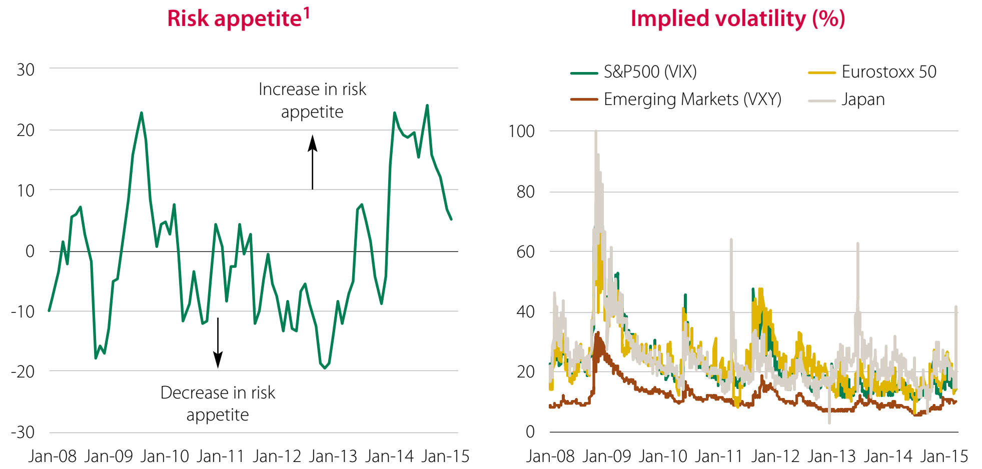
%	2011	2012	2013	2014	1Q 14	2Q 14	3Q 14	4Q 14	1Q 15 (To 13 March) %/prior qt.	1Q 15 (To 13 March) % y/y[2]
World										
MSCI World	-7.6	13.2	24.1	2.9	0.8	4.2	-2.6	0.7	0.6	4.1
Euro area										
Eurostoxx 50	-17.1	13.8	17.9	1.2	1.7	2.1	-0.1	-2.5	16.2	21.1
Euronext 100	-14.2	14.8	19.0	3.6	2.7	1.1	0.4	-0.6	17.5	22.7
Dax 30	-14.7	29.1	25.5	2.7	0.0	2.9	-3.6	3.5	21.4	32.0
Cac 40	-17.0	15.2	18.0	-0.5	2.2	0.7	-0.1	-3.2	17.3	17.9
Mib 30	-24.0	10.2	18.8	-0.4	13.6	-2.2	-3.2	-7.4	20.1	9.5
Ibex 35	-13.1	-4.7	21.4	3.7	4.3	5.6	-0.9	-5.0	7.3	10.9
United Kingdom										
FTSE 100	-5.6	5.8	14.4	-2.7	-2.2	2.2	-1.8	-0.9	2.7	2.9
United States										
Dow Jones	5.5	7.3	26.5	7.5	-0.7	2.2	1.3	4.6	-0.4	10.2
S&P 500	0.0	13.4	29.6	11.4	1.3	4.7	0.6	4.4	-0.3	11.2
Nasdaq-Composite	-1.8	15.9	38.3	13.4	0.5	5.0	1.9	5.4	2.9	14.3
Japan										
Nikkei 225	-17.3	22.9	56.7	7.1	-9.0	2.3	6.7	7.9	10.3	30.0
Topix	-18.9	18.0	51.5	8.1	-7.6	5.0	5.0	6.1	10.9	29.7

Source: Datastream.

1 In local currency.

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

Financial market indicators FIGURE 7



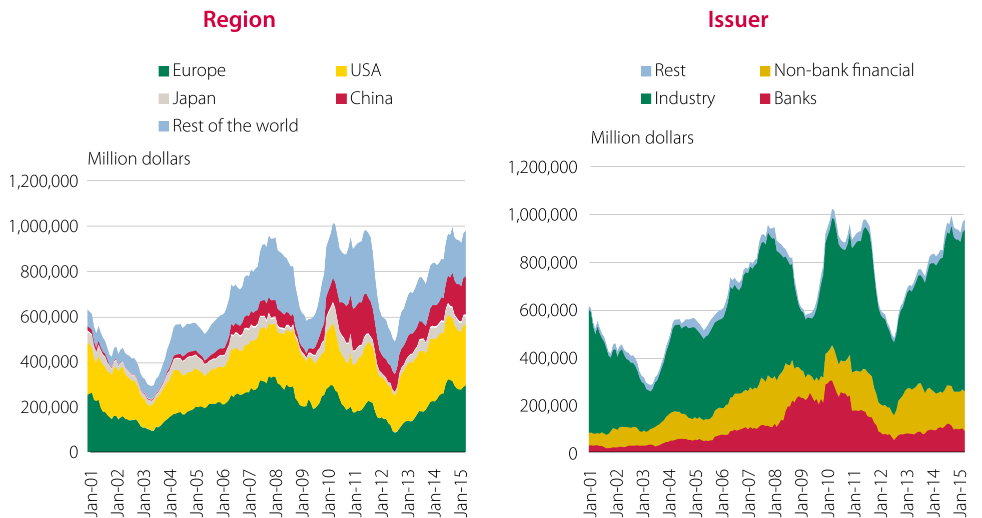
Source: Thomson Datastream and CNMV.

1 State Street indicator.

Global equity issuance reaches 936 billion dollars, 12.3% more than in 2013, with Europe and China especially dynamic.

Equity issuance on international markets summed 936 billion dollars in 2014, 12.3% more than in 2013. The most popular vehicles were public offers for subscription, which raised over 263 billion dollars (52% up vs. 2013). Increased appetite for risk and the more supportive tone of markets sent investors rushing into shares to the detriment of lower-risk instruments, above all in Europe and China, where issuance surged by 22.7% and 77.6% respectively. Industrial firms (ex. utilities) led the advance, raising 639 billion dollars in equity capital (an increase of 19.8%). And figures for the opening months of 2015 suggest share issuance has continued buoyant (see figure 8).

Global equity issuance FIGURE 8



Source: Dealogic. Cumulative twelve-month data to 13 March. For comparative purposes, the figure for this month is restated on a monthly basis.

2.2 National economic and financial developments

Spanish GDP grows by an annual 2% in 4Q 2014 for an average rate of 1.4%, opening up a lead vs. the euro area (1.1%) and breaking with the contraction trend of recent years.

Spain's GDP expanded 0.7% in 4Q 2014 (2% year on year), improving on the rates of the preceding quarters (0.3% in 1Q and 0.5% in 2Q and 3Q). The result was average annual growth of 1.4% and a clear break with the contraction trend of recent years (-1.2% in 2013, -2.1% in 2012 and -0.6% in 2011). This was also the first time since 2008 that the Spanish economy outperformed the euro-area average (1.1%).

Domestic demand contributes positively to growth (2.2 points) for the first time since the crisis broke, against a negative contribution from the net exports side.

The year also brought a significant change in the growth mix by GDP component. For the first time since the start of the crisis, domestic demand input positively to GDP growth, to the tune of 2.2 percentage points, while net exports subtracted 0.8% points. As table 2 shows, most demand components managed a sturdy year-long advance, contrasting with the setbacks of 2013. Private and government consumption rose by 2.4% and 0.1% respectively after the -2.3% and -2.9% of 2013. Gross capital formation (3.4% vs. -3.7% previously) received a two-way boost from an upswing in equipment investment (12.3% vs. 5.6%) and a slower decline in construction investment (-1.4% vs. -9.2%). In the foreign sector of the economy, exports rose by 4.2%, on a par with the previous year, while imports fought back to strength with an annual advance of 7.7% (-0.4% in 2013).

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

					EC[1]	
	2011	2012	2013	2014	2015F	2016F
GDP	-0.6	-2.1	-1.2	1.4	**2.3**	**2.5**
Private consumption	-2.0	-3.0	-2.3	2.4	2.7	2.6
Government consumption	-0.3	-3.7	-2.9	0.1	0.3	0.1
Gross fixed capital formation, of which:	-6.3	-8.1	-3.7	3.4	4.7	5.2
Construction	-10.6	-9.3	-9.2	-1.4	n.a.	n.a.
Equipment and others	0.9	-9.1	5.6	12.3	7.9	8.7
Exports	7.5	1.2	4.3	4.2	5.4	6.0
Imports	-0.7	-6.3	-0.4	7.7	6.9	6.7
Net exports (growth contribution, pp)	2.1	2.2	1.4	-0.8	-0.3	0.0
Employment[2]	-2.6	-4.4	-3.2	1.2	1.8	2.0
Unemployment rate	21.4	24.8	26.1	24.4	22.5	20.7
Consumer price index	3.2	2.4	1.4	-0.1	-1.0	1.1
Current account balance (% GDP)	-3.2	-0.3	1.4	0.1	0.6	0.5
General government balance (% GDP)[3]	-9.4	-10.3	-6.8	-5.6	-4.5	-3.7
Public debt (% GDP)	69.2	84.4	92.1	97.7	101.5	102.5
Net international investment position (% GDP)[4]	-81.4	-66.0	-78.9	-81.3	n.a.	n.a.

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

1 European Commission forecasts of February 2015.

2 In full-time equivalent jobs.

3 Figures for 2011, 2012 and 2013 include government aid to credit institutions amounting to 0.5%, 3.8% and 0.5% of GDP respectively. The figure for 2014, still pending at the closing date for this report, corresponds to the European Commission forecast.

4 Ex. Banco de España. 2014 data up to the third quarter.

n.a.: [data] not available.

All economic sectors, except construction, increase their value added in 2014.

On the supply side, most sector s grew their gross value added with respect to the previous year, by an average 1.5% and 1.6% respectively in industry and services (-1.1% and -1.8% in 2013), outdone by the 3.3% advance of primary activities. Only the construction sector reported a negative GVA variation, through shrinkage was less intense than in 2013 (-1.2% vs. -8.1%).

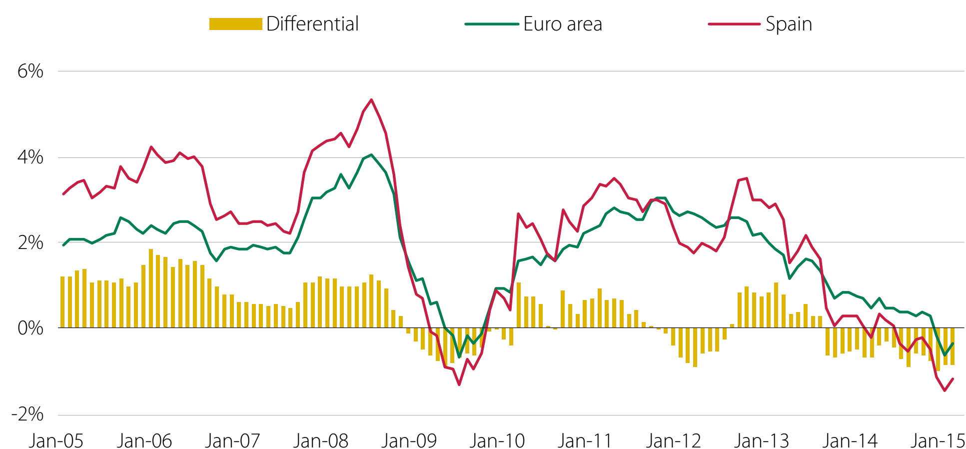
Annual inflation declines steeply on tumbling energy prices as far as -1.1% in February 2015. Core inflation rates, meantime, hold near zero.

After hovering around the zero mark over 1H 2014, Spanish inflation headed steadily downwards to a low of -1.3% in January 2015 (-1.1% in February). The decline was primarily driven by sharply falling energy prices (-11.4% year-on-year in January, -10.2% in February). Finally, the year's average headline rate was -0.1%, down from 1.4% in 2013, while core inflation, which excludes the more volatile CPI components, progressed more stably, within the narrow interval of -0.1% to 0.3%, to close at an average of near zero (1.5% in 2013). Spain's inflation differential vs. the euro area, negative since mid-2013, closed the year at -1.0 percentage points (-0.9 pp in February).

Economic recovery begins to feed through to labour market figures, in the shape of a 1.2% increase in employment and a two-point reduction in the jobless rate to 23.7%.

The gathering recovery of 2014 cut short the labour market deterioration of recent years, with an increase in the number of people in work and a small decrease in the unemployment rate. According to National Accounts data, employment in terms of full-time equivalent jobs returned to annual growth in the second quarter of 2014, after almost six years in decline. The advance, moreover, quickened to 2.4% in the closing quarter (1.2% on average in full-year 2014). The Labour Force Survey (LFS) revealed that unemployment rates had continued to retreat from their 1Q 2013 peak of 27%. By end-2014, specifically, the jobless rate was down to 23.7% of the active population (5.46 million unemployed), two points lower than at the 2013 close. The LFS put the increase in the employed population at 434,000 persons in 2014 (416,000 in the private sector and 18,000 in the public sector). Significantly, the number of households with all members unemployed fell for the first time since 2008, accompanied by an increase in households with all members in work. Finally, unit labour costs continued to fall, by a full-year average of 0.5%, with the decline drawing equally on lower compensation per worker (-0.2% in annual average terms) and an increase in apparent labour productivity (up by an average of 0.2%).

Harmonised index of consumer prices: Spain *vs.* euro area (annual % change) FIGURE 9



Source: Thomson Datastream. Data to February.

According to available budgetary execution figures, the general government deficit (excluding local authorities) to the month of November stood at 4.62% of GDP compared to 5.15% in the same period in 2013. Analyst projections for the full-year period locate the public sector deficit at 5.6%, a bare 0.1 points ahead of the Government's target and improving on the 6.8% of 2013. General government debt, meantime, closed at 97.7% of GDP, after advancing 5.6 points in the year. Budgetary targets for 2014-2017 assume a gradual reduction in the public deficit to around 1% of GDP, and debt/GDP ratios peaking in 2015 and descending thereafter.

Pending the budgetary execution figures for December, analysts project a public deficit of 5.6% for full-year 2014, a bare percentage point above the Government's target.

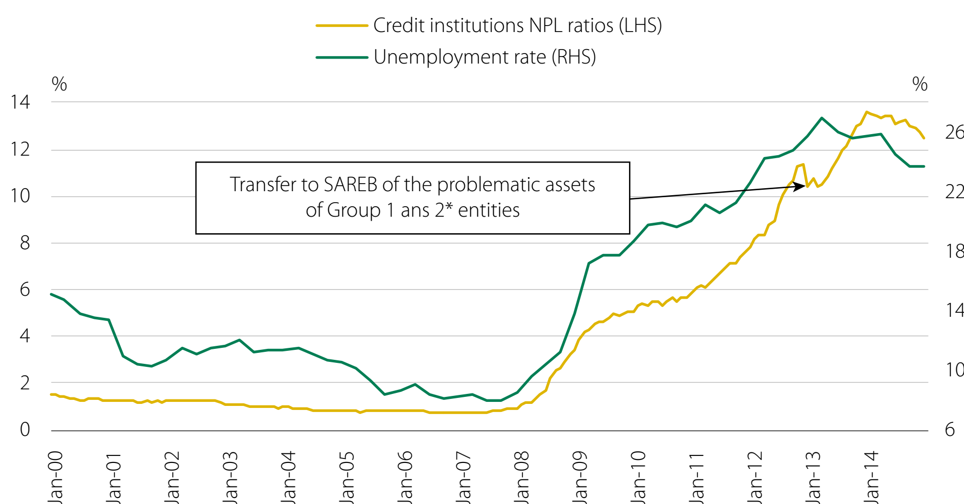
For the banking sector, the year was marked by a series of events starting with the entry to force of the capital standards known as Basel III. Also, January saw the successful conclusion of the financial assistance programme signed between the Spanish and European authorities. Finally, Spanish banks performed creditably in the sector assessment conducted by the ECB between November 2013 and October 2014 (see exhibit 1), in the run-up to the launch of the Single Supervisory Mechanism (SSM). In general, banks were able to conduct their business in a more supportive macroeconomic climate, that allowed them to boost profits while making mild inroads into non-performing loan ratios. The balance of outstanding loans continued to contract, though less so than in preceding years, with signs apparent of a slight relaxation of loan access conditions.

The banking sector, which emerged successfully from the tests applied in the run-up to the SSM, was able to conduct its business in a more supportive environment...

Bank NPL ratios receded steadily from the 13.6% high of December 2013 as far as 12.5% in December last year, while sector income statements reported profits to September of 8.33 billion euros, 41.5% more than in the first nine months of 2013. Profit growth relied heavily on reductions in impairment losses (down by 31.2% to 11.21 billion euros), while gross income dropped to 41.6 billion euros (43.07 billion in 2013) on lower inflows under net interest income and income from equity instruments.

... which facilitated income statement improvement and allowed some small inroads into still high NPL ratios.

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



Source: Banco de España and National Statistics Office (INE). Data to December 2014.

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).

Bank lending to businesses and households declines at a slower pace, with banks apparently readier to grant credit.

The decline in bank lending to the non-financial resident sector (businesses and households) lasted through all of 2014 and the first months of 2015, albeit with some slowing of the pace. Specifically, overall lending to this sector fell by 4.1% and 4.2% in annual terms to December 2014 and January 2015 respectively (-5.9% in 2013), due to a contraction in the amount of loans outstanding. Lending to non-financial corporations declined by 4.4% in December and 4.8% in January (6.6% in 2013), with lending to households down by 3.7% and 3.5% respectively (5.1% in 2013). Despite credit contracting more sharply for businesses, the increase in funds raised through other channels (principally debt) served to temper the decline. In the euro area, lending to non-financial corporations fell 1.6% year on year to the month of November, while credit flows to households thinned by a lesser 0.4%.

Easier financing conditions have not led to an increase in bank sector debt. Instead the emphasis has been kept on slimming down balance sheets and building up the equity on their balance sheets.

Despite solid improvement in the financing conditions available to Spanish banks, the sector pressed on with the process of slimming down its balance sheet[5], with declines across all main external funding channels. These included private-sector deposits (down from 1.31 to 1.29 trillion) and outstanding debt (down from 297 to 249 billion), as well as Eurosystem borrowings, which closed the year at 141 billion euros[6] (202 billion at end-2013).

Results of the comprehensive assessment conducted on credit institutions EXHIBIT 1

In November 2014, the European Central Bank (ECB) took on the direct supervision of Europe's largest credit institutions in order to favour the transparency and integration of the euro-area financial system and restore investor confidence. Between the months of November 2013 and October 2014, in the run-up to the launch of the Single Supervisory Mechanism (SSM), the banks to come under its supervision were subject to a thoroughgoing review. Comprehensive assessment, as the process is known, comprised two closely related parts: an initial examination of the quality of each bank's assets, providing an overview of sector standards, and the application of stress tests as a kind of macro-prudential exercise. Both legs were based on banks' consolidated balance sheets as at year-end 2013.

Running the assessment

The asset quality review (AQR[1]) consisted of an exhaustive examination of the figures and balance sheets of European banks (focusing on the highest-risk items) leading to the classification and measurement of their financial assets and instruments. To this end, each institution was asked to provide portfolios comprising different types of risks and exposures, European and global, for subsequent evaluation. After obtaining this snapshot, the next step was to determine how the results would impact on the bank's CET1[2] ratio, with the minimum threshold set at 8%. This process was conducted in a decentralised fashion.

5 From mid-year on, the sector-wide balance sheet has stood at three trillion euros for the first time since April 2008.

6 Reducing to 132 billion euros in February 2015.

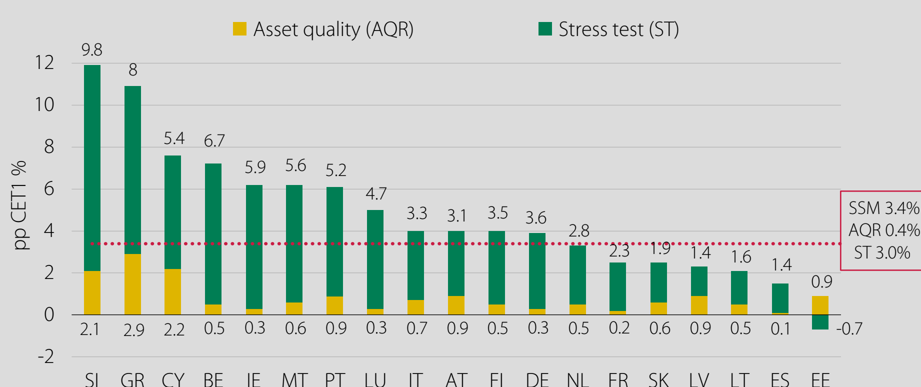
European banks were also subject to stress tests (ST[3]) to check their resilience, factoring the results of AQRs. The goal of stress testing was primarily to measure banks' capacity to absorb or withstand future losses incurred under two scenarios (baseline and adverse scenario) over a period of three years. Stress tests were devised and applied by the ECB with help from other European organisations: the European Banking Authority (EBA) for the methodology; the European Commission for the design of the baseline macroeconomic scenario; and the European Systemic Risk Board (ESRB) for the adverse scenario. Also, national competent authorities were involved in gathering data and collating the results. The minimum CET1 ratio was set at 8% under the baseline and 5.5% under the adverse scenario.

A total of 130 European institutions come under SSM supervision and assessment, including fifteen Spanish banks[4] (summing 90% of domestic bank sector assets). Between them, Spanish, French, German, Italian and Dutch banks account for 87% of the assets under supervision. An initial comparative analysis carried out by Banco de España[5] places Spain's banking sector in the top ranks of the euro-area table for 2013 by the measures of efficiency and return on equity (ROE). In terms of solvency, the Spanish institutions tested stood close to the European average despite their slightly higher leverage.

Results of the assessment

Overall, after the capital increases carried out in 2014, only 10% of the European banks analysed had a net capital shortfall with respect to the thresholds set for the AQR, the baseline ST and the adverse ST. In the case of Spain's banks, not one of the fifteen institutions analysed showed a capital shortfall in the period (see figure E.1.1).

Net impact on CET1 in the adverse scenario FIGURE E.1.1



Source: Banco de España and European Central Bank.

In Spain's case, the impact of the AQR was very limited, consuming only 14 bp of the capital ratio compared with an SSM-wide average of 42 bp. Indeed Spanish banks were found to need the least capital correction (equating to just 0.2% of risk-weighted assets). All participants, moreover, stood well clear of the required

CET1 threshold, with the exception of Liberbank whose 7.8% ratio was two basis points below (not allowing for its 2014 capital increase).

Note in regard to stress tests that the baseline scenario was based on the European Commission's forecasts[6] for each country. Also, the adverse scenario constructed for Spain was a cumulative decline in the rate of change of GDP of 1.2% over the 2014-2016 horizon (2.1% for the EU as a whole), a 2016 unemployment rate of 27.1% (13% for the EU) and long-term government bond yields in the area of 5.6% (EU average of 4.4%). Here too, the Spanish contingent did creditably well, with most banks showing a 120 bp increase in their capital ratio (30 bp for the SSM aggregate) under the more favourable scenario, and a 144 bp impact under the adverse scenario, again sizeably less than the 300 bp subtracted across the whole SSM. The resulting capital ratios of the Spanish banks stood 3.5 pp above the admissible solvency floor (9% against the 5.5% required), such that none were in the position of having to raise more equity (Liberbank again being the exception with a ratio of 7.5%, climbing to 8.2% after its capital increase).

In general, the results of the comprehensive assessment point to a more resilient banking sector suffering less impact than the European average. The reduction in the CET1 ratio amounts to 3.4 points for the SSM aggregate against just 1.6 points for the Spanish banks. The healthy margins over the minimum requirements found in the assessment reflect progress made in the clean-up and transfer of real estate assets (under the terms of royal decrees 2/2012 and 18/2012) and the sectoral restructuring measures adopted under the Financial Assistance Programme granted by the EU in summer 2012. However, the banks' apparent preparedness to ride out future macroeconomic difficulties should not distract from the task of improving sector regulation and supervision, still in its beginnings.

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1 A description of the procedures and methods developed for the Asset Quality Review (AQR) has been posted on the ECB website. For more detailed information, see http://www.ecb.europa.eu/pub/pdf/other/assetqualityreviewphase2manual201403en.pdf

2 CET1 (Common Equity Tier 1) is defined in Basel III a the highest quality form of capital.

3 Stress tests apply a standard methodology to all institutions, devised by the EBA and published on its website, along with a description of the different scenarios. See https://www.eba.europa.eu/-/eba-publishes-common-methodology-and-scenario-for-2014-eu-banks-stress-test

4 The fifteen Spanish banks evaluated were: Banco Santander, BBVA, La Caixa, BFA/Bankia, Banco Popular, Sabadell, Kutxabank, Bankinter, Unicaja-CEISS, Abanca-NCG, Ibercaja, Catalunya Bank, BNM, Liberbank and Grupo Cajamar.

5 See box 2.5 of the Financial Stability report published by Banco de España in November 2014. http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/InformesEstabilidadFinancera/14/IEF-Noviembre2014.pdf

6 The baseline scenario for 2014 and 2015 was based on the European Commission's 2014 winter forecasts; for 2016 a specific model was built.

Non-financial listed companies grow their profits 64.8% to 17.51 billion at the 2014 close…

Non-financial listed companies obtained full-year profits of 17.51 billion euros, 64.8% more than in 2013. One stand-out was the return to growth of the construction and real estate sector, which reported 755 million earnings in 2014 after a string of heavy losses. The energy sector, meantime, managed another solid performance, with profits up by 29.5% to 10.76 billion euros (8.31 billion in 2013), while industrial firms boosted their earnings from 412 million to 1.55 billion euros. Only retail and services firms lost ground in the year, with profits falling 24% to 4.39 billion euros (see table 3).

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

TABLE 3

	EBITDA[2]		EBIT[3]		Profit for the year	
Billion euros	2013	2014	2013	2014	2013	2014
Energy	17,407	18,731	9,327	10,277	8,311	10,763
Industry	3,429	4,630	2,015	3,117	412	1,550
Retail and services	28,868	26,393	15,023	13,399	5,780	4,393
Construction and real estate	3,210	4,898	354	2,586	-3,950	755
Adjustments	-58	-117	24	-40	72	47
TOTAL	**52,855**	**54,535**	**26,742**	**29,338**	**10,626**	**17,507**

Source: CNMV.

1 The table shows the earnings of firms filing information before the closing date for this report.

2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

… and trim their debt by a further 7% to 255 billion in a context of gradual deleveraging.

The aggregate debt of non-financial listed companies, at 255 billion euros, was 7% less than at end-2013 and a full 22% less than the recent-year highs of 2010. The largest reductions corresponded to the energy sector, which cut its combined debt by 14.2% to 70.49 billion euros, followed by retail and services, down 5.69 billion, and construction and real estate, down 2.17 billion (see table 4). The industrial sector bucked the trend, albeit with a moderate increase of 1.6% to 16.88 billion euros. The result has been a steady decline in the debt/equity ratio of listed firms, with construction and real estate as the most heavily leveraged of the sectors covered.

Savings rates fall as households opt to consume more despite no significant change in disposable income.

Annual indicators on the financial position of households show that the savings rate slide persisted through the year as far as 9.1% of gross disposable income compared to 10.4% at end-2013. Disposable income having held virtually flat, this lower rate signals an upswing in household consumption, in response presumably to the improved economic and employment setting. Meantime, household gross debt-to-income and the debt servicing ratio continued to recede to just over 110% and 12.5% of gross disposable income respectively, while household wealth advanced further on the rising value of assets combined with slightly decreased liabilities.

Investment funds take a growing share of household financial investments.

Salient developments with regard to household financial investments –1.7% of GDP in 2014[7]– were the continuing popularity of investment funds (2.6% of GDP) and currency and transferable deposits (2% of GDP), contrasting with a large-scale drift out of long-term deposits and debt instruments (see figure 11).

7 Cumulative four-quarter data to 3Q 2014.

Gross debt by sector: Listed companies[1]

TABLE 4

Billion euros		2010	2011	2012	2013	2014
Energy	Debt	98,283	95,853	91,233	82,146	70,488
	Debt/Equity	0.95	0.92	0.85	0.75	0.73
	Debt/EBITDA[2]	2.81	3.27	3.26	3.41	3.76
	EBIT[3]/Interest expenses	4.15	3.30	3.14	2.90	2.97
Industry	Debt	14,948	17,586	17,232	16,609	16,881
	Debt/Equity	0.58	0.63	0.63	0.62	0.92
	Debt/EBITDA	2.11	2.54	2.38	2.17	3.65
	EBIT/Interest expenses	5.00	3.90	3.82	4.56	2.98
Retail and services	Debt	115,413	113,142	117,359	111,795	106,102
	Debt/Equity	1.60	2.01	2.00	1.99	1.92
	Debt/EBITDA	3.38	3.78	4.01	3.90	4.02
	EBIT/Interest expenses	3.94	2.45	2.02	2.08	2.05
Construction and real estate	Debt	99,917	83,716	76,236	65,066	62,893
	Debt/Equity	3.42	2.98	3.51	4.46	3.44
	Debt/EBITDA	11.18	15.00	15.17	18.87	12.84
	EBIT/Interest expenses	0.98	0.52	0.32	0.09	0.64
Adjustments[4]	Debt	-1,792	-1,404	-1,429	-1,395	-1,381
TOTAL	**Debt**	**326,769**	**308,893**	**300,633**	**274,221**	**254,983**
	Debt/Equity	1.43	1.44	1.41	1.33	1.36
	Debt/EBITDA	3.84	4.29	4.32	4.29	4.68
	EBIT/Interest expenses	3.12	2.30	2.06	1.99	1.96

Source: CNMV.

1 Data up to and including 2013 correspond to all non-financial listed companies, while data for 2014 are confined to those filing information before the closing date for this report.

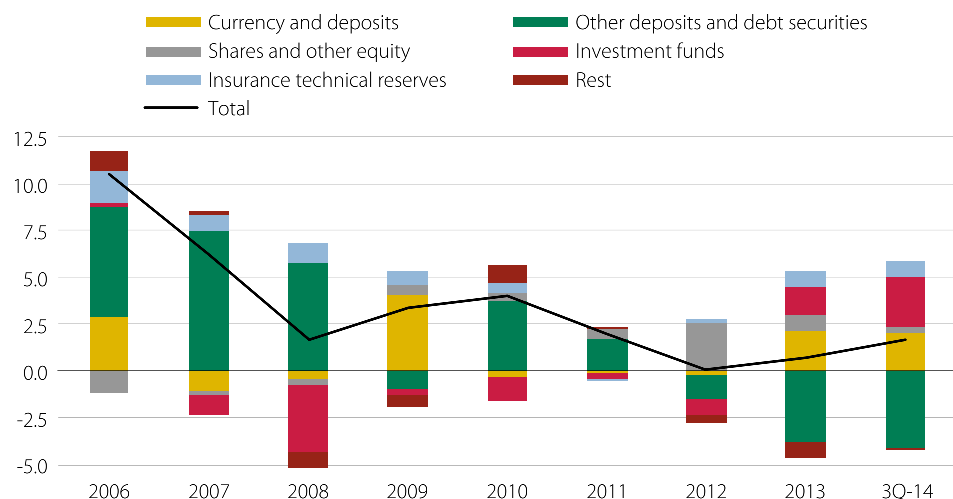
2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

4 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 include eliminations corresponding to subsidiary companies with their parent in another sector.

Households: Net financial asset acquisitions

FIGURE 11



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

2.3 Outlook

In its latest forecasts, the International Monetary Fund (IMF) projects global growth quickening from 3.3% in 2014 to 3.5% in 2015 and 3.7% in 2016, a mark-down of 0.3 points with respect to the previous round (see table 5). The revision owes exclusively to the somewhat worse prospects of emerging market economies, which will nonetheless conserve their solid growth lead. Specifically, the emerging group is expected to expand by 4.3% in 2015 and 4.7% in 2016, ahead of the flat 2.4% of the advanced economies.

Global growth will edge up from 3.3% in 2014 to 3.5% in 2015 and 3.7% in 2016, according to the IMF.

Gross domestic product (annual % change) TABLE 5

					IMF[1]	
	2011	2012	2013	2014	2015F	2016F
World	4.1	3.4	3.3	3.3	3.5 (-0.3)	3.7 (-0.3)
United States	1.6	2.3	2.2	2.4	3.6 (+0.5)	3.3 (+0.3)
Euro area	1.8	-0.7	-0.5	1.1	1.2 (-0.2)	1.4 (-0.3)
Germany	3.7	0.6	0.2	1.6	1.3 (-0.2)	1.5 (-0.3)
France	2.1	0.4	0.4	0.4	0.9 (-0.1)	1.3 (-0.2)
Italy	0.7	-2.3	-1.9	-0.4	0.4 (-0.5)	0.8 (-0.5)
Spain	-0.6	-2.1	-1.2	1.4	2.0 (+0.3)	1.8 (=)
United Kingdom	1.6	0.7	1.7	2.6	2.7 (=)	2.4 (-0.1)
Japan	-0.4	1.8	1.6	0.0	0.6 (-0.2)	0.8 (-0.1)
Emerging economies	6.2	5.1	4.7	4.4	4.3 (-0.6)	4.7 (-0.5)

Source: Thomson Datastream and IMF.

1 In brackets, change vs. the previous forecast. IMF forecasts published January 2015 with respect to October 2014.

Among the upside risks to this outlook we can cite, first and foremost, the oil price slide, which will boost the growth rates of importing countries. It is also reasonable to assume that the monetary expansion launched by the ECB will impact positively on euro-area activity. However certain downside risks are also present in the shape of fresh bouts of financial market turmoil in response to the political uncertainties emanating from Greece and the process of renegotiating the country's debt. A further risk dimension relates to geopolitical conflict in other world areas. And then there is the prospect of the US bringing forward its rates upcycle, and the resulting knock-on effect on risk premiums, particularly damaging to emerging market economies that rely on maintaining stable capital flows. In Europe, doubts persist about the threat of deflation and the strength of economic recovery, though in the latter case the ECB's latest decisions have gone some way to restoring confidence.

Although a series of factors could boost growth in some world regions, projection risks are tilted to the downside.

The IMF projects that the Spanish economy will grow 2% in 2015 (an upgrade of 0.3 points vs. its previous estimate) and 1.8% in 2016. Both forecasts are slightly lower than the rates forecast by other institutions and analysts, for 2015 particularly, which in some cases approach or exceed 2.5%. Although falling oil prices and the improved economic climate have undoubtedly boosted domestic activity, risks persist related to the need to press on with fiscal consolidation and the fact that unemployment will remain high for some time to come. A third risk dimension comes in

In Spain's case, the IMF is looking for 2% growth in 2015, although other institutions augur rates upwards of 2.5%. The oil price tumble will boost growth in the economy, but risks related to fiscal consolidation and labour market deterioration have not gone away.

the form of a deflation scenario, here and in the euro area, which would hurt the economy's most heavily indebted sectors. However, the more vigorous private consumption augured for this year and the fact that most of the slowdown in the CPI has its origin in the energy component (oil) make it less likely that this risk will materialise.

3 Spanish markets

3.1 Equity markets

Spanish shares rally strongly in 1Q 2015, after the price falls of end-2014 and despite the events unfolding in Greece.

Equity markets shook off the losses of the closing months of 2014 to start the new year with a strong price rebound. The rally, also experienced in other European markets, went through moments of heightened volatility, but overall reflected the improved prospects for the Spanish economy while pricing in some of the effects of the ECB's new asset-buying programme. The buoyant mood of the opening quarter also proved an incitement to issuers, with over 15 billion raised in equity capital (almost half last year's amount), while market turnover rose 33.4% in annual terms to 202.8 billion euros. On this last score, trading in Spanish shares continued to drift from home exchanges to other venues, whose market share is already over 20%[8]. Ibex 35 liquidity conditions remained satisfactory in the opening months.

The ECB's announced asset-purchase programme sends share prices soaring: the Ibex 35 gains 7.3% and other domestic indices fare even better.

Against this backdrop, the Ibex 35 gained 7.3% after losing ground in the second half of 2014 (-0.9% and -5% in the 3Q and 4Q respectively). Other Spanish indices fared even better, with small and medium cap indices advancing 18.1% and 28.5% respectively year to date (see table 6). In year-on-year terms, increases topped 10% across the board, the sole exception being the small cap index, which shed over 2% due to heavy losses in 2H 2014. Conversely, the indices tracking the Latin American stocks traded on domestic platforms began the year in bearish mood, with losses of 8% and 4.9% respectively on the FTSE Latibex All-Share and the FTSE Latibex Top.

Stock market sectors perform more evenly with across-the-board increases stretching in some cases to nearly 20%.

The mixed fortunes of 4Q 2014 gave way to a broad front advance in 2015 (see table 6). The largest gains corresponded to basic materials, industry and construction (19.4%), consumer goods (19.1%), consumer services (16.7%) and technology and communications (11.6%), in contrast to oil and energy (4.1%) and financial and real estate services (1.5%), both of which underperformed the index. In annual terms, all sectors shared in the advance except financial and real estate services, whose flat performance vs. 1Q 2014 evidences the drag effect of bank sub-sector shares.

The P/E ratio edges higher in 1Q 2015 to just above its historical average.

The price-earnings ratio (P/E) of the Ibex 35 broke out of the downtrend lasting through the second half of 2014 (from 16.3 in June to 14.8 in December) and rose slightly to 15.7 in line with the run-up in share prices. As figure 12 shows, the earnings multiples of all leading indices, except Japan's Topix, closed the first-quarter period ahead of the average values for 2000-2015.

8 Estimate based on CNMV and Bloomberg data from 1 January 2015 to 13 March 2015.

Performance of Spanish stock market indices and sectors (%)

TABLE 6

Index	2011	2012	2013	2014	3Q 14[1]	4Q 14[1]	1Q 15 (to 13 March) %/prior qt.	% y/y
Ibex 35	-13.1	-4.7	21.4	3.7	-0.9	-5.0	7.3	10.9
Madrid	-14.6	-3.8	22.7	3.0	-1.0	-5.6	7.5	10.0
Ibex Medium Cap	-20.7	13.8	52.0	-1.8	-8.6	-1.7	18.1	10.2
Ibex Small Cap	-25.1	-24.4	44.3	-11.6	-13.6	-14.0	28.5	-2.3
FTSE Latibex All-Share	-23.3	-10.7	-20.0	-16.1	5.0	-20.8	-8.0	-7.5
FTSE Latibex Top	-17.1	-2.6	-12.4	-11.1	3.8	-14.7	-4.9	0.6
Sector[2]								
Financial and real estate services	**-18.9**	**-4.7**	**19.9**	**1.4**	**0.8**	**-10.8**	**1.5**	**0.0**
Banks	-20.3	-4.8	18.8	1.6	1.3	-11.4	0.6	-0.7
Insurance	12.5	-2.0	47.3	-9.2	-6.0	1.0	12.3	2.6
Real estate and others	-47.5	-14.4	38.3	36.3	-5.8	-8.2	17.2	14.5
Oil and energy	**-2.7**	**-16.0**	**19.0**	**11.8**	**1.6**	**-6.8**	**4.1**	**12.2**
Oil	14.9	-35.4	19.5	-15.1	-2.4	-17.3	4.7	-7.6
Electricity and gas	-10.8	-5.4	18.7	21.7	2.7	-4.1	3.9	18.4
Basic materials, industry and construction	**-14.3**	**-8.0**	**28.9**	**-1.8**	**-8.2**	**-9.7**	**19.4**	**9.8**
Construction	-6.9	-9.3	26.5	8.9	-8.4	-3.7	14.1	13.4
Manufacture and assembly of capital goods	-12.2	-8.8	55.4	-18.3	-14.9	-7.2	30.3	7.0
Minerals, metals and metal processing	-33.7	-8.7	11.5	4.5	-1.3	-8.2	16.3	19.2
Engineering and others	-29.0	3.8	7.6	-17.0	-7.0	-33.3	29.0	-7.4
Technology and telecommunications	**-20.9**	**-18.3**	**22.8**	**2.5**	**-1.5**	**-0.8**	**11.6**	**20.0**
Telecommunications and others	-20.8	-23.0	17.1	2.6	-1.1	-2.7	10.6	19.7
Electronics and software	-21.3	39.4	56.8	2.3	-3.2	7.9	16.3	21.8
Consumer goods	**5.7**	**55.6**	**17.1**	**-1.5**	**-5.5**	**6.0**	**19.1**	**28.0**
Textiles, clothing and footwear	12.7	66.2	13.5	-1.1	-2.7	8.4	18.8	37.9
Food and drink	-6.3	25.0	4.7	-5.2	-3.4	-3.1	26.9	29.7
Pharmaceutical products and biotechnology	-7.3	68.3	39.6	-1.0	-14.2	1.1	16.4	2.1
Consumer services	**-24.2**	**12.7**	**58.9**	**10.0**	**-3.6**	**12.6**	**16.7**	**26.6**
Motorways and car parks	-3.7	5.7	36.5	6.8	-6.9	5.1	-0.5	6.4
Transport and distribution	-34.9	29.7	116.4	27.9	1.8	31.3	28.3	53.0

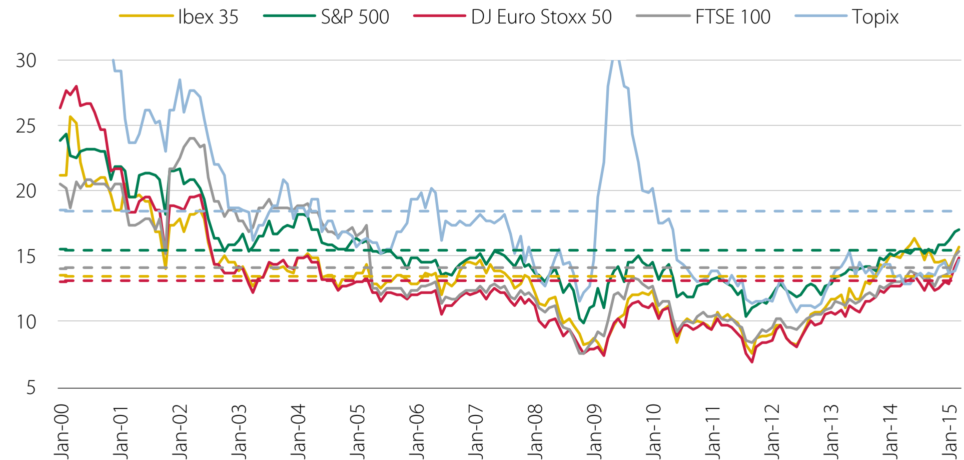
Source: BME and Thomson Datastream.

1 Change vs. the previous quarter.

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

Price-earnings ratio[1] (P/E)

FIGURE 12



Source: Thomson Datastream. Data to 13 March.

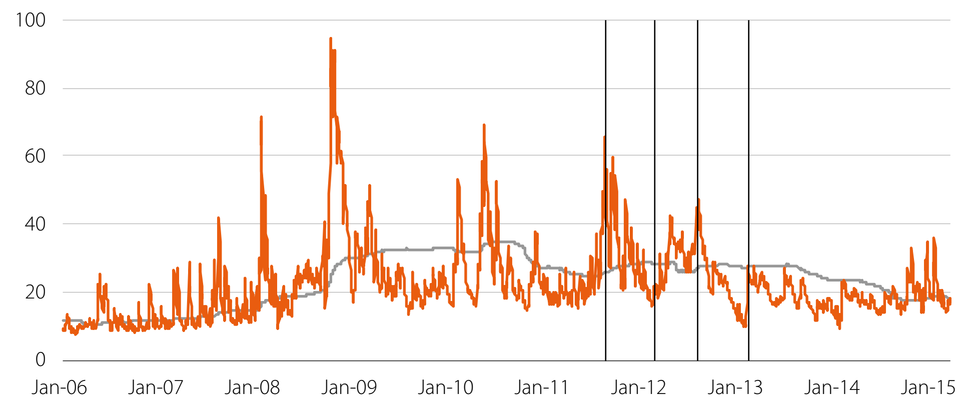
1 Twelve-month forward earnings.

Issues in Greece trigger brief volatility upswings in January, with peaks of over 35%, though levels ease subsequently to under 20%.

Ibex 35 volatility spiked on various occasions in the first weeks of 2015 in response to political uncertainty in Greece, just before the ECB's 22 January announcement of its quantitative easing program. Readings peaked briefly at over 35% before settling back below 20% (see figure 13) on a par with the average for 2014 (18.2%). The pattern was broadly similar to that of other European indices and some in the United States, though note that index volatility was considerably more muted in this last country (holding below 20% even at times of heightened instability).

Historical volatility of the Ibex 35

FIGURE 13

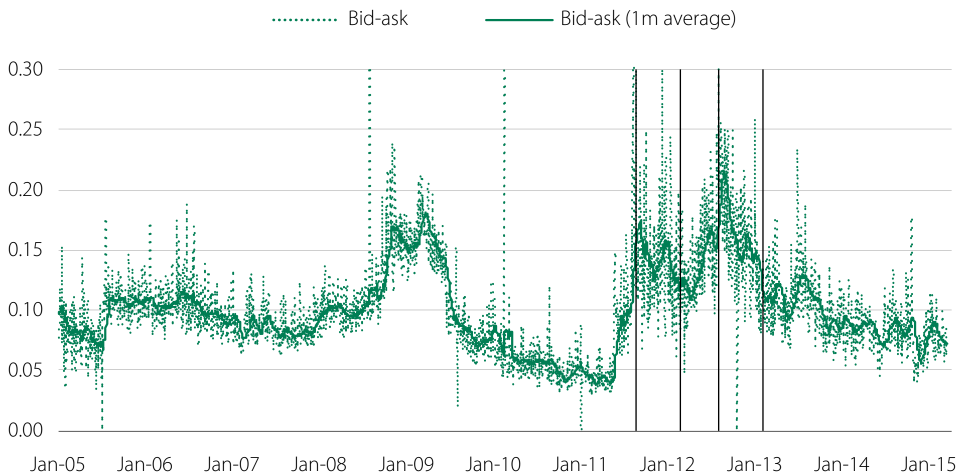


Source: Thomson Datastream and CNMV. Data to 13 March. The red line indicates conditional volatility and the grey line unconditional volatility. The vertical lines refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

Ibex 35 liquidity conditions remain satisfactory…

The slight deterioration in Ibex 35 liquidity conditions observable since late November 2014 gave way to a new improvement trend in January 2015 (see figure 14). Specifically, the bid-ask spread rebounded from the 0.056% low of last November to 0.09% at end-January 2015, before narrowing back to 0.07% at the closing date for this report. The historical average for this indicator stands at 0.10%.

Ibex 35 liquidity. Bid-ask spread (%) FIGURE 14

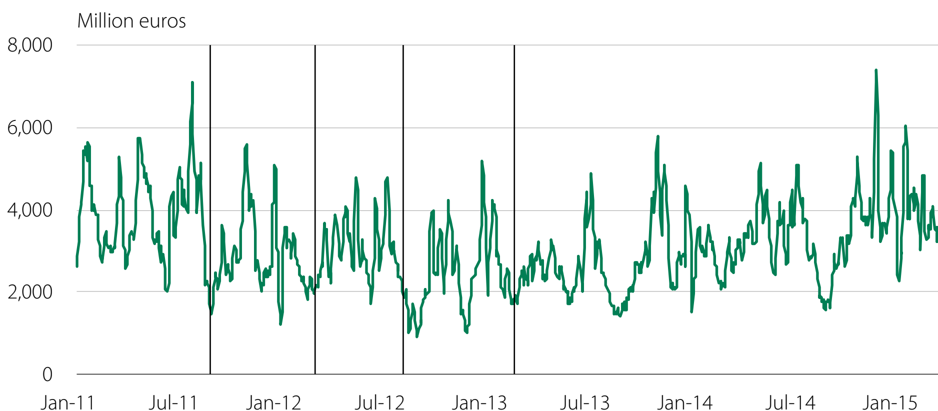


Source: Thomson Datastream and CNMV. Data to 13 March. The curve represents the bid-ask spread of the Ibex 35 along with the average of the last month. The vertical lines refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

Trading on Spanish stock markets swelled by 24.7% in 2014 to over 864 billion euros[9]. Falling bond yields contributed to the upswing, which was replicated on other leading world markets. The trend, moreover, has lasted through the opening months of 2015, with trading volumes upwards of 202 billion, 33.4% more than in 1Q 2014. Average daily volume, meantime, stood at 3.38 billion euros in 2014 and 4.06 billion in 1Q 2015, improving by a large margin on the 2.72 and 2.70 billion euros respectively of 2013 and 2012 (see figure 15).

… while trading in Spanish shares expands significantly on domestic markets…

Daily trading on the Spanish stock market[1] FIGURE 15



Source: CNMV. Data to 13 March. The vertical lines refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

1 Moving average of five trading days.

9 Ex. trading volumes on MAB and Latibex and in ETFs.

… and other European regulated markets and MTFs.

Trading in Spanish listed shares on other European regulated markets and MTFs continued to augment. Business on these foreign markets has topped 55 billion euros[10] year to date, with the Chi-X platform particularly turning over more than 31 billion euros in Spanish shares (see table 7). On the basis of these figures, non-domestic venues now command a market share exceeding 20% of total value traded (15.2% in 2014 and 10.1% in 2013).

Trading in Spanish shares listed on Spanish exchanges[1] TABLE 7

Million euros	2011	2012	2013	2014	3Q 14	4Q 14	1Q 15[2]
Total	**926,873.7**	**709,902.0**	**764,986.6**	**1,002,189.0**	**221,436.2**	**308,216.9**	**255,953.0**
Listed on SIBE (electronic market)	**926,828.6**	**709,851.7**	**764,933.4**	**1,002,095.9**	**221,396.8**	**308,191.3**	**255,944.5**
BME	912,176.9	687,456.1	687,527.6	849,934.6	188,289.5	260,645.9	199,980.0
Chi-X	11,120.3	16,601.3	53,396.7	95,973.0	19,414.9	31,253.0	31,718.3
Turquoise	707.7	3,519.6	11,707.9	28,497.5	8,321.7	9,576.8	9,999.6
BATS	1,276.4	2,261.9	10,632.1	18,671.0	4,202.0	5,142.8	7,454.0
Others[2]	1,547.3	12.8	1,669.2	9,019.8	1,168.7	1,572.8	6,792.6
Open outcry	**42.8**	**49.9**	**51.4**	**92.4**	**39.1**	**25.6**	**8.0**
Madrid	16.1	3.0	7.3	32.7	27.1	0.8	0.7
Bilbao	0.1	8.5	0.1	14.3	0.0	0.1	2.8
Barcelona	26.4	37.7	44.1	45.2	12.0	24.6	4.4
Valencia	0.3	0.7	0.0	0.3	0.0	0.1	0.0
Second market	**2.3**	**0.4**	**1.7**	**0.7**	**0.2**	**0.1**	**0.5**
Memorandum item							
BME trading of foreign shares[3]	5,206.0	4,102.0	5,640.0	14,508.9	3,681.8	5,123.2	2,800.1
MAB	4,379.9	4,329.6	5,896.3	7,723.2	1,704.3	1,828.7	1,483.2
Latibex	357.7	313.2	367.3	373.1	76.6	82.5	67.6
ETFs	3,495.4	2,736.0	4,283.9	9,849.4	2,476.1	2,781.9	2,303.3
Total BME trading	925,661.3	698,987.5	703,768.7	882,482.3	196,267.6	270,487.8	206,642.7
% Spanish shares on BME vs. total Spanish shares	98.4	96.8	89.9	84.8	85.0	84.6	78.1

Source: Bloomberg and CNMV.

1 Spanish shares listed on Spanish exchanges are those with a Spanish ISIN that are admitted to trading in the regulated market of Bolsas y Mercados Españoles, i.e., not including alternative investment market MAB. Foreign shares are those admitted to trading in the regulated market of Bolsas y Mercados Españoles whose ISIN is not Spanish.

2 Data to 13 March.

3 Difference between the turnover of the EU Composite estimated by Bloomberg for each share and the turnover of the markets and MTFs listed in the table, i. e., including trading on other regulated markets, MTFs and OTC systems.

Share issuance moves up a gear, with 15.1 billion raised in 1Q 2015 (almost half of last year's total).

Equity issuance on domestic markets summed 15.1 billion euros in the first quarter, almost half of the total issued in the whole of 2014 (see table 8) and a full 11.41 billion more than in 1Q 2014, with growth drawing on both capital increases and public offerings (up by 7.10 and 4.31 billion respectively). Although the step-up in issuance extended to all sectors, two placements by one Spanish banking major stand out above the rest, accounting for 61% of the quarterly total. As regards the

10 On the basis of Bloomberg data.

issuance mix, capital increases without trading warrants and public offerings tended to dominate to the detriment of scrip dividends (17% of the total raised in 1Q 2015 compared to 38% in full-year 2014).

Capital increases and public offerings

TABLE 8

	2012	2013	2014	2Q 14	3Q 14	4Q 14	1Q 15
NUMBER OF ISSUERS[1]							
Total	**30**	**39**	**55**	**27**	**25**	**22**	**22**
Capital increases	30	39	53	27	24	21	20
Of which, through public offer for subscription	3	5	6	4	2	0	0
Public offering of shares	3	0	4	2	1	1	2
NUMBER OF ISSUES[1]							
Total	**95**	**145**	**147**	**43**	**39**	**33**	**28**
Capital increases	92	145	140	40	37	31	26
Of which, through public offer for subscription	3	5	8	4	2	0	0
Public offering of shares	3	0	7	3	2	2	2
CASH AMOUNTS[1] (billion euros)							
Total	**29,521.6**	**39,126.2**	**32,762.4**	**9,069.9**	**5,863.5**	**13,009.8**	**15,095.8**
Capital increases	28,290.2	39,126.2	27,875.5	7,833.7	5,345.8	9,876.9	10,786.3
Public offers for subscription	2,450.5	1,742.8	2,951.5	1,650.0	401.5	0.0	0.0
Bonus issues	8,424.2	9,932.8	12,650.8	2,439.6	3,008.7	4,335.0	2,616.2
Of which scrip dividend[2]	8,357.9	9,869.4	12,573.8	2,439.5	2,931.7	4,335.0	2,616.2
Capital increase by conversion[3]	10,982.4	7,478.8	3,757.9	1,470.0	1,227.5	35.1	411.5
Capital contribution in kind[4]	1,867.5	231.6	2,814.5	0.5	314.7	2,497.3	242.4
With preferential subscription right	4,560.6	11,463.1	2,790.8	1,738.2	50.5	1,002.1	6.2
Without trading warrants	5.0	8,277.1	2,909.9	535.4	342.9	2,007.4	7,509.8
Public offering of shares	1,231.4	0.0	4,886.9	1,236.2	517.7	3,132.9	4,309.5
Memorandum item: MAB transactions[5]							
Number of issuers	9	7	10	3	5	1	4
Number of issues	11	14	15	3	5	4	4
Cash amounts (million euros)	35.8	45.7	130.1	43.4	53.3	23.5	7.6
Million euros	35.8	45.7	130.1	43.4	53.3	23.5	7.6
Of which, through public offer for subscription	6.8	1.8	5.0	5.0	0.0	0.0	0.0
Public offering of shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: BME and CNMV. Data to 13 March.

1 Transactions registered with the CNMV. Not including data from MAB, ETFs or Latibex.

2 In scrip dividends, the issuer grants shareholders the right to collect a monetary dividend or to have it converted into shares as part of a bonus issue.

3 Includes capital increases to meet the conversion of bonds and debentures into shares, the conversion of employee options or the execution of warrants.

4 Capital contributions in kind are stated at their market value.

5 Transactions not registered with the CNMV.

First ESMA report on high frequency trading (HFT) in Europe EXHIBIT 2

At end-2014, the European Securities Market Authority (ESMA) unveiled the results of a study into high-frequency trading activity in EU equity markets, as published in the report of the same name[1].

The first step in the review was to decide which trading practices come within this definition. Two main approaches have been used in the literature: i) the direct approach, which involves identifying investment firms engaging in high-frequency trading and/or using services of a related nature, of types such as colocation (a service offered by organised trading platforms that allows market participants to locate their devices in close proximity to the platform's matching engine so they can access their order books without latencies), and ii) the indirect approach which judges an activity to be high-frequency training on the basis of participants' trading patterns (the lifetime of orders, the number of orders sent to the market, order-to-trade ratios, etc.). ESMA has chosen to employ a mixture of the two: direct, via analysis of the trading activity of investment firms tagged as high-frequency traders; and indirect, utilizing the time orders remain in the system before being cancelled or filled.

The study sample comprises one hundred shares, twelve of which are traded in Spain, while the observation period was May 2013. The choice of shares from each country was arrived at using a statistical tool known as stratified sampling. ESMA then set out to assess the extent of HFT activity in Europe by reference to the value traded of shares, the number of orders and the number of trades.

Applying the direct approach, flagged investment firms engaging in HFT activity accounted for 24% of value traded in the study period. Meantime, the indirect approach based on the lifetime of orders found that high-frequency trading represented 43% of value traded. This last percentage coincides with the findings of similar studies conducted on a single-country basis.

For the number of trades, estimates of HFT activity stand at 30% under the direct and 49% under the indirect approach, while for the number of orders the corresponding percentages are a considerably higher 58% and 76% respectively.

Among the study's conclusions is that the size of HFT trades is smaller than that of other trades. Further, their use of multiple submissions (a hallmark of this type of trading) gives HFT firms a notably higher market share by number of orders than other market participants.

Results also show that the level of HFT activity varies widely between trading venues, being higher on entrant MTFs like BATS Europe, Chi-X Europe and Turquoise that traditional regulated markets. Moreover, investment firms flagged as HFT traders belong to more trading platforms than other participants, suggesting that many of them engage in cross-venue price arbitrage.

ESMA now plans to conduct further studies to elucidate:

– The extent of HFT's actual contribution to market liquidity.

– The factors driving the emergence and growth of HFT.

– The potential risks and benefits attached to HFT activity.

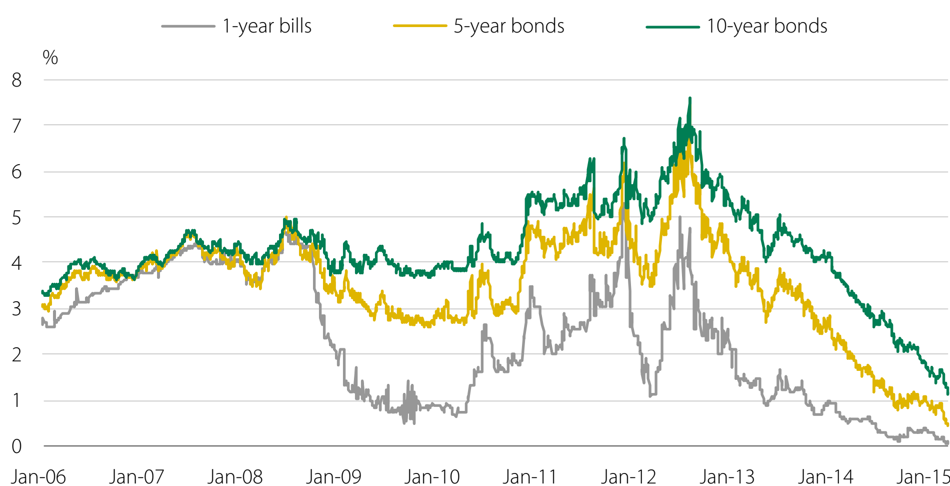
1 http://www.esma.europa.eu/system/files/esma20141_-_hft_activity_in_eu_equity_markets.pdf

3.2 Fixed-income markets

Spanish bond markets begin 2015 as they ended 2014, and experience little fallout from upheavals in Greece.

Domestic fixed-term markets steered a firm course in the opening quarter, with barely a ripple in response to the uncertainties surrounding Greece. Sovereign and corporate bond yields headed lower in the period in both short and long maturities as investors began to price in the effects of the ECB's new bond-buying programme. By mid-March, most of these yields were at record lows, creating an environment supportive of companies' investment decisions. Credit risk premiums had a few shaky moments in the opening months of 2015, but by the end of the quarter had settled back to around 90 bp for both public-sector[11] and corporate borrowers (averaging financial and non-financial spreads). Easier financing conditions prompted a sizeable increase in the amount of fixed-income issues filed with the CNMV, as far as 27.61 billion euros (68.4% more than in 2014[12]).

Spanish government debt yields FIGURE 16



Source: Thomson Datastream. Data to 13 March.

11 There are small differences between the sovereign risk premium as measured by the spread between the Spanish ten-year bond and equivalent German benchmark and by the five-year CDS of the Spanish sovereign bond.

12 Dropping to 41.8% if we exclude the issuance of the SAREB (asset management company for assets arising from bank restructuring).

Yields decline further at the short end of the curve…

In this context, short-term treasury yields broke through the lows of last September. By mid-March, three-month, six-month and one-year Letras del Tesoro were trading at 0.02%, 0.06% and 0.07% respectively, after falling between 10 and 27 bp. In the private sector, yields on commercial paper dropped in the quarter by between 15 and 54 bp, with rates at issuance in three-month, six-month and one-year tenors down to March averages of 0.39%, 0.37% and 0.64% respectively (see table 9).

Short-term interest rates[1] TABLE 9

%	Dec 12	Dec 13	Dec 14	Sep 14	Dec 14	Mar 15[2]
Letras del Tesoro						
3 months	1.14	0.54	0.12	0.05	0.12	0.02
6 months	1.68	0.70	0.25	0.10	0.25	0.06
One year	2.23	0.91	0.34	0.17	0.34	0.07
Commercial paper[3]						
3 months	2.83	1.09	0.55	0.83	0.55	0.39
6 months	3.58	1.36	0.91	1.25	0.91	0.37
One year	3.80	1.59	0.91	0.99	0.91	0.64

Source: Thomson Datastream and CNMV.
1 Monthly average of daily data.
2 Data to 13 March.
3 Interest rates on issuance.

… and in longer maturities, with ten-year government yields down to mid-March levels below 1.2%.

Yields on medium and long-term sovereign bonds traced a parallel decline to those of shorter-dated instruments, with falls in the interval of 42 to 51 bp. By mid-March, three, five and ten-year yields were down to historic lows of 0.23%, 0.51% and 1.26% respectively (see table 10). Corporate bond yields also decreased significantly, with longer maturities to the fore, and by mid-March were trading at 0.69%, 1.68% and 1.99% respectively in three, five and ten-year tenors.

Medium and long bond yields[1] TABLE 10

%	Dec 12	Dec 13	Dec 14	Sep 14	Dec 14	Mar 15[2]
Government bonds						
3 years	3.40	2.00	0.65	0.52	0.65	0.23
5 years	4.22	2.68	0.96	0.94	0.96	0.51
10 years	5.35	4.15	1.77	2.23	1.77	1.26
Corporate bonds						
3 years	4.19	2.63	0.84	0.96	0.84	0.69
5 years	4.66	2.84	1.88	1.80	1.88	1.68
10 years	6.79	4.46	2.32	2.77	2.32	1.99

Source: Thomson Datastream, Reuters and CNMV.
1 Monthly average of daily data.
2 Data to 13 March.

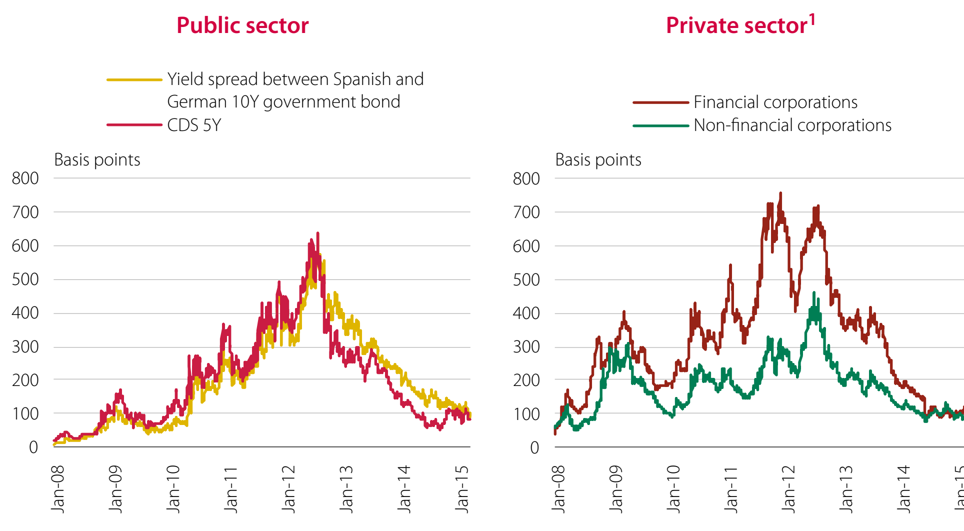
Risk premiums fluctuated at times across sectors of the economy in response to the latest news on Greece, but in most cases ended the quarter below the levels of December 2014 (the exception being financial corporations). In the sovereign sector, the Spanish/German ten-year yield spread, which closed last year at 107 bp, spiked at 135 bp in February before falling back to mid-March levels of 90 bp. The CDS spread of the Spanish sovereign bond traced a similar course, rising from 96 bp at end-2014 to a mid-February peak of 114 then dropping once more to 84 bp (see left-hand panel of figure 17).

With a few fluctuations, sovereign and corporate risk premiums tended to stabilise in 1Q 2015…

Meantime, the main first-quarter developments in corporate bond markets were the stabilising of credit risk premiums among financial corporations in contrast to the narrowing spreads of the non-financial sector. As we can see from the right-hand panel of figure 17, the CDS spreads of Spanish financial corporations averaged 102 bp in mid-March, back practically to the levels of last year's close (101 bp), while the average CDS of non-financial corporations fell from 92 bp in December 2014 to 73 bp in March.

… at close to the levels in place before the European debt crisis (or even lower in some cases).

Risk premiums of Spanish issuers FIGURE 17



Source: Thomson Datastream and CNMV. Data to 13 March.

1 Simple average of the five-year CDS of a sample of Spanish issuers.

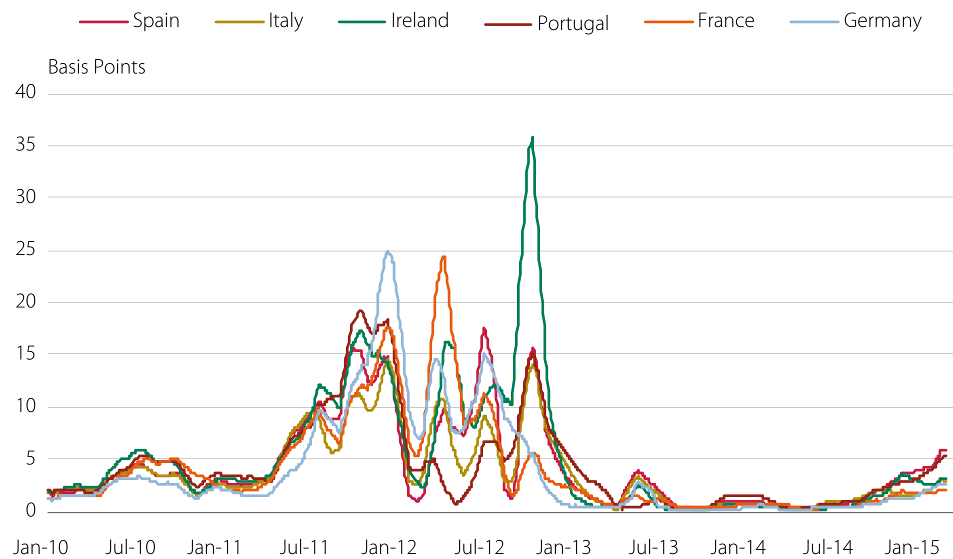
An analysis of sovereign credit risk contagion to ascertain the spillover effect on other euro-area countries of the issues surrounding the Greek economy in recent months –a new government and the uncertain outcome of the talks on its financial assistance program– reveals that levels of contagion have risen by a small margin year to date. However, as figure 18 shows, the impact is residual only compared to the shocks experienced at the heights of the European sovereign debt crisis.

The Greek situation has barely ruffled other European economies, according to sovereign credit risk contagion indicators.

The gross volume of fixed-income issues filed with the CNMV stood at 27.61 billion euros in 1Q 2015 (to 13 March), a long way ahead of the 16.40 billion of the year-ago period. The bulk of this increase traces to the SAREB (asset management company for assets arising from bank restructuring), which resumed issuance on a major scale (10.15 billion euros against the 4.09 billion of 1Q 2014). Stripping out this amount, first-quarter issuance was 41.8% higher at 17.46 billion euros.

Fixed-income issues filed with the CNMV sum a hefty 27.60 billion euros in the opening quarter.

Sovereign credit risk contagion in the euro area: Shocks from Greece[1] FIGURE 18



Source: Thomson Datastream and CNMV. Data to 13 March 2015.

1 For more details on the methodology employed to construct these indicators, see table 1.2 of the CNMV Annual Report for 2010, and the first chapter of the CNMV Quarterly Bulletin corresponding to 1Q 2011.

Although SAREB issues account for most of the increase, sales of other instruments like mortgage covered bonds climb sharply in the period.

The stand-out by instrument is probably the surge in sales of mortgage covered bonds, up from 2.25 billion in 2014 to 4.30 billion in 2015, and non-convertible bonds, up from 5.65 to 13.64 billion (see table 11). Note that the figure for this last segment includes the first internationalisation bond of a Spanish banking major, amounting to 460 million euros. These bonds are backed by export or internationalisation credits, and, like internationalisation covered bonds[13], were devised during the recent economic crisis to help firms operating in foreign markets to get round problems of access to bank finance[14].

Foreign bond sales account for a growing share of total Spanish fixed-income issuance.

Debt issuance abroad advanced strongly in the period, taking a growing share of the overall total. In 2014, foreign sales reached 56.74 billion euros, 30% of the total, compared to 25.6% in 2013 and 20.4% in 2012 (see figure 19). The provisional figure for 1Q 2015 is upwards of six billion euros, with 61% corresponding to commercial paper and the rest to bonds and debentures (see table 11).

13 Internationalisation covered bonds are fixed-income instruments backed by a portfolio of loans and credits granted previously by the issuer and linked to the financing of export or internationalisation credits to companies meeting certain credit standards. Conversely, internationalisation bonds are only backed by loans and credits assigned to the issue by public document.

14 See Royal Decree 579/2014 of 4 July implementing certain aspects of Law 14/2013 of 27 September to support entrepreneurs and their internationalisation with regard to internationalisation bonds and internationalisation covered bonds.

Fixed-income issuance by Spanish issuers

FIGURE 19

Abroad | Government Guaranteed | SAREB | Field with the CNMV[1]

Million euros

500,000
450,000
400,000
350,000
300,000
250,000
200,000
150,000
100,000
50,000
0

2010 2011 2012 2013 2014

Source: CNMV and Banco de España.

1 Issues registered with the CNMV excluding guaranteed and SAREB issues.

Gross fixed-income issues

TABLE 11

Registered[1] with the CNMV	2011	2012	2013	2014	2014 3Q	2014 4Q	2015 1Q[2]
NOMINAL AMOUNT (billion euros)	**287,490**	**357,830**	**138,839**	**130,258**	**19,886**	**62,345**	**27,615**
Mortgage bonds	67,227	102,170	24,800	23,838	3,750	5,638	4,300
Territorial bonds	22,334	8,974	8,115	1,853	135	0	3,500
Non-convertible bonds and debentures	18,692	86,442	32,537	41,155	2,536	28,025	13,637
Convertible/exchangeable bonds and debentures	7,126	3,563	803	750	0	0	0
Asset-backed securities	68,410	23,800	28,593	29,008	7,640	15,663	0
Domestic tranche	63,453	20,627	24,980	26,972	7,550	14,460	0
International tranche	4,957	3,173	3,613	2,036	90	1,203	0
Commercial paper[3]	103,501	132,882	43,991	33,654	5,825	13,019	6,177
Securitised	2,366	1,821	1,410	620	0	0	700
Other commercial paper	101,135	131,061	42,581	33,034	5,825	13,019	5,477
Other fixed-income issues	0	0	0		0	0	0
Preference shares	200	0	0		0	0	0
Memorandum item:							
Subordinated issues	28,549	7,633	4,776	7,999	1,545	4,211	0
Covered issues	10	0	193	196	0	0	0

Abroad by Spanish issuers	2011	2012	2013	2014	2014 3Q	2014 4Q	2015 1Q[4]
NOMINAL AMOUNT (billion euros)	**120,043**	**91,882**	**47,852**	**56,736**	**11,941**	**12,251**	**6,006**
Long-term	51,365	50,312	34,452	35,281	5,918	5,977	2,315
Preference shares	0	0	1,653	5,602	1,500	0	0
Subordinated debt	242	307	750	3,000	1,500	0	0
Bonds and debentures	51,123	50,005	32,049	26,679	2,918	5,977	2,315
Asset-backed securities	0	0	0	0	0	0	0
Short-term	68,677	41,570	13,400	21,455	6,023	6,274	3,691
Commercial paper	68,677	41,570	13,400	21,455	6,023	6,274	3,691
Securitised	322	11,590	0	0	0	0	0

Memorandum item: Gross issuance by subsidiaries of Spanish companies resident in the rest of the world

	2011	2012	2013	2014	2014 3Q	2014 4Q	2015 1Q[4]
NOMINAL AMOUNT (million euros)	**108,538**	**49,392**	**48,271**	**41,682**	**9,196**	**9,412**	**4,912**
Financial corporations	79,342	18,418	8,071	9,990	3,259	1,192	1,015
Non-financial corporations	29,197	30,974	40,200	31,691	5,937	8,220	3,897

Source: CNMV and Banco de España.

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

2 Data to 13 March.

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

4 Data to 31 January.

4 Market agents

4.1 Investment vehicles

Financial UCITS[15]

The fund industry consolidates the recovery begun in 2013, with 27% growth in assets under management to almost 200 billion euros. The increase draws mainly on net new sales in these investment products.

Assets under management in investment funds rose by 26.8% in 2014 to 198.72 billion euros, building on the expansion initiated the previous year (see table 13). This new growth spurt, which brings industry-wide assets close to the levels of mid-2008, had its origin primarily in net subscriptions approaching 36 billion euros (see table 12). The largest inflows corresponded to balanced fixed-income (15.71 billion euros), fixed-income (13.49 billion) and balanced equity (6.57 billion) funds, while net redemptions were highest, by a distance, in guaranteed fixed-income products (10.45 billion euros). The experience was similar the previous year with regard to the large outflows from guaranteed fund categories, but while 2013 subscriptions were mainly into fixed-income funds, the somewhat riskier balanced funds category also did good business in 2014.

Net investment fund subscriptions TABLE 12

				2014			
Billion euros	2012	2013	2014	1Q	2Q	3Q	4Q
Total investment funds inversión	**-12,737.7**	**24,133.0**	**35,972.7**	**10,069.9**	**10,766.0**	**8,828.3**	**6,308.5**
Fixed income[1]	-5,843.6	13,783.1	13,492.7	3,633.3	2,957.0	3,678.6	3,223.8
Balanced fixed income[2]	-775.2	2,059.3	15,712.0	2,323.5	4,901.7	4,103.7	4,383.1
Balanced equity[3]	-383.1	1,881.9	6,567.7	1,208.8	1,439.1	2,349.7	1,570.1
Euro equity[4]	-163.7	1,730.3	2,184.9	955.0	782.9	460.6	-13.6
International equity[5]	-420.6	900.2	531.8	422.8	376.5	-145.6	-121.9
Guaranteed fixed-income guaranteed	-853.0	-4,469.2	-10,453.6	-3,763.4	-2,662.7	-1,707.5	-2,320.0
Guaranteed equity[6]	-3,523.5	-2,070.2	-909.5	-23.7	-43.4	-566.0	-276.4
Global funds	-7.5	847.4	2,182.3	413.7	534.5	576.6	657.5
Passively managed[7]	572.1	9,538.2	4,970.9	4,357.3	2,084.9	-343.8	-1,127.5
Absolute return[7]	-1,339.4	-67.8	1,693.9	542.7	395.6	422.2	333.4

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 balanced fixed income.

3 Includes: Euro and international balanced equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed and partial protection equity funds.

7 New categories as of 2Q 09. Absolute return funds were previously classed as global funds.

15 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

Number	2012	2013	2014	2014 1Q	2014 2Q	2014 3Q	2014 4Q
Total investment funds inversión	**2,185**	**2,045**	**1,951**	**2,037**	**2,023**	**1,959**	**1,951**
Fixed income[1]	454	384	359	374	375	367	359
Balanced fixed income[2]	125	122	123	119	119	117	123
Balanced equity[3]	117	128	131	127	126	125	131
Euro equity[4]	127	108	103	103	104	103	103
International equity[5]	211	193	191	190	190	186	191
Guaranteed fixed-income	398	374	280	355	336	303	280
Guaranteed equity[6]	361	308	273	307	297	275	273
Global funds	192	162	162	160	163	165	162
Passively managed[7]	85	169	227	205	217	222	227
Absolute return[7]	115	97	102	97	96	96	102
Assets (million euros)							
Total investment funds	**124,040.4**	**156,680.1**	**198,718.8**	**169,513.6**	**182,735.8**	**192,199.6**	**198,718.8**
Fixed income[1]	40,664.6	55,058.9	70,330.9	59,381.8	62,740.7	66,841.2	70,330.9
Balanced fixed income[2]	5,500.9	8,138.0	24,314.3	10,600.2	15,666.0	19,917.0	24,314.3
Balanced equity[3]	3,179.9	6,312.4	13,570.4	7,648.6	9,242.9	11,668.9	13,570.4
Euro equity[4]	5,270.2	8,632.8	8,401.5	7,753.1	8,601.7	8,693.6	8,401.5
International equity[5]	6,615.0	8,849.0	12,266.4	11,693.7	12,426.8	12,151.9	12,266.4
Guaranteed fixed-income	36,445.0	31,481.2	20,417.0	27,529.5	24,920.1	23,122.1	20,417.0
Guaranteed equity[6]	14,413.2	12,503.8	12,196.4	12,810.3	12,940.7	12,497.2	12,196.4
Global funds	4,358.6	4,528.1	6,886.3	5,007.9	5,650.3	6,255.6	6,886.3
Passively managed[7]	2,991.2	16,515.9	23,837.5	21,847.0	24,898.6	24,971.5	23,837.5
Absolute return[7]	4,601.9	4,659.9	6,498.1	5,241.5	5,648.0	6,080.4	6,498.1
Unit-holders							
Total investment funds	**4,410,771**	**5,050,719**	**6,409,806**	**5,410,205**	**5,814,175**	**6,134,711**	**6,409,806**
Fixed income[1]	1,261,634	1,508,009	1,941,567	1,612,002	1,712,748	1,818,308	1,941,567
Balanced fixed income[2]	188,574	240,676	603,099	314,879	425,424	506,220	603,099
Balanced equity[3]	138,096	182,223	377,265	211,810	252,255	313,796	377,265
Euro equity[4]	220,450	293,193	381,822	323,474	347,335	384,252	381,822
International equity[5]	398,664	457,606	705,055	531,270	601,531	651,495	705,055
Guaranteed fixed-income	1,075,852	1,002,458	669,448	871,622	796,983	744,545	669,448
Guaranteed equity[6]	727,880	608,051	557,030	613,296	602,530	577,616	557,030
Global funds	101,321	128,741	223,670	146,223	168,796	195,290	223,670
Passively managed[7]	125,003	441,705	686,526	575,262	673,166	692,827	686,526
Absolute return[7]	173,297	188,057	264,324	210,367	233,407	250,362	264,324
Return[8] (%)							
Total investment funds	**5.50**	**6.50**	**3.67**	**1.71**	**1.41**	**0.43**	**0.08**
Fixed income[1]	3.54	2.28	2.41	0.89	0.67	0.55	0.28
Balanced fixed income[2]	4.95	4.16	3.67	1.57	1.34	0.71	0.01
Balanced equity[3]	7.83	10.85	4.70	1.69	1.89	0.77	0.28
Euro equity[4]	12.31	28.06	2.09	5.01	3.04	-2.35	-3.38
International equity[5]	13.05	20.30	6.61	2.22	2.92	-0.91	2.27
Guaranteed fixed-income	4.85	4.96	2.54	1.56	0.71	0.39	-0.14
Guaranteed equity[6]	5.07	6.15	2.64	1.26	1.59	0.38	-0.60
Global funds	7.44	8.71	4.63	1.65	1.69	0.68	0.54
Passively managed[7]	7.10	8.88	7.74	3.45	2.64	1.49	-0.02
Absolute return[7]	3.84	2.46	1.98	0.82	0.75	0.18	0.22

* 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 balanced fixed income.

3 Includes: Euro and international balanced equity.

4 Includes: Euro equity

5 Includes: International equity.

6 Includes: Guaranteed equity and partial protection equity funds.

7 New categories as of 2Q09. All absolute return funds were previously classed as global funds.

8 Annual return for 2012, 2013 and 2014. Quarterly data comprise non-annualised quarterly returns.

Portfolio returns also input positively (3.7%). Despite sector expansion, the number of funds declined further in 2014…

Investment fund portfolio returns held in positive territory over full-year 2014 (3.7%), albeit with some underperformance vs. the two previous years and some falling-off between the first and the second half. The highest earning categories were passively managed funds, with 7.7%, and international equity, with 6.6%. Note that the portfolio returns of international and euro equity funds sank to 6.6% and 2.1% respectively from over 20% in 2013 on the more hesitant tone of equity markets, especially from mid-year onwards. Despite the industry expansion of the last two years, fund management companies kept up their rationalisation drive, with further cuts in fund numbers albeit on a rather more reduced scale. By end-December, a total of 1,951 schemes were on the register, 94 fewer than in 2013. The decline was steepest (94) in the guaranteed fixed-income category, followed by guaranteed equity (36). Passively managed funds repeated the success of the previous year with a 58 jump in numbers to 227 at the 2014 close.

… contrasting with an increase of over 1.3 million unit-holders to 6.4 million at the 2014 close.

The more buoyant mood abroad was reflected in unit-holder numbers, which swelled by some 1.3 million in the year to more than 6.4 million. Most of this new custom found its way into fixed-income and balanced fixed-income funds (an additional 434,000 and 362,000 unit-holder respectively). Only guaranteed funds lost out in the period, closing with 384,000 fewer investors.

Preliminary data for January 2015 point to continuing expansion

Preliminary data for the opening month of 2015 suggest that industry expansion retains momentum, with assets under management up by 2.8% to 204.4 billion euros and the unit-holder total up by 160,000 to 6.57 million. Fund numbers, meantime, appear to have stabilised.

Less-liquid instruments amount to just 1% of industry assets at end-2014.

The liquidity conditions of fund fixed-income portfolios continued to improve. The volume of less-liquid assets fell by almost 1.20 billion (-35%) to 2.16 billion euros (see table 14) at the 2014 close, with most of the headway made in the first six months. On this showing, the ratio of less-liquid to total industry assets dropped by one percentage point from 2.1% to 1.1%, the salient development being the declining weight (from 15.3% to 5.6%) of less-liquid instruments issued by financial corporations, from AAA down the ratings scale.

Estimated liquidity of investment fund assets TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Tipo de activo	**Jun 14**	**Sep 14**	**Dec 14**	**Jun 14**	**Sep 14**	**Dec 14**
Financial fixed income rated AAA/AA	202	112	29	18%	10%	3%
Financial fixed income rated below AAA/AA	1,214	1,469	1,177	6%	7%	6%
Non-financial fixed income	280	320	328	6%	6%	5%
Securitisations	554	555	623	21%	21%	19%
AAA-rated securitisations	40	41	97	100%	100%	100%
Other securitisations	514	514	526	20%	18%	18%
Total	**2,249**	**2,457**	**2,157**	**8%**	**8%**	**7%**
% of investment fund assets	**1.2**	**1.3**	**1.1**			

Source: CNMV.

Real estate schemes

The ongoing adjustment in Spanish construction and real estate continued to bear down on the real estate investment sector. Worst off were real estate investment funds, with two deregistrations ensuing from the May spin-off of two funds and the transfer of part of their assets to financial investment funds. Earlier still, in February, another fund agreed its spin-off and transfer to a financial investment fund, concluding in its deregistration in January this year[16]. The result of these operations was a drastic reduction in real estate fund assets, down by 88.6% in 2014 to 420 million euros, while unit-holder numbers closed at a bare 4,000 after falling 30.1%. Fund portfolio returns were negative to the tune of 5.9%, although the scale of losses was less than in previous years. Also, the second-half performance (-2.1%) offered some improvement on the first (-3.9%) as real estate prices tended to level off.

Real estate schemes continued to suffer the effects of the prolonged downturn in real estate and construction. A series of closures in the year prompted a 88.6% slump in real estate fund assets.

Real estate investment companies also suffered setbacks across all main variables. Seven remained in operation at the 2014 close, three fewer than in 2013 following one new entry and four deregistrations. Asset shrinkage was mild in the circumstances, contained at 5.5% to 806.5 million euros, while shareholder numbers fell 17.4% to 845 at the December close.

Real estate company numbers and assets likewise decline, but by a significantly smaller margin.

Hedge funds

The Spanish hedge fund industry grew its assets by an overall 24.1% to 1.72 billion euros between January and November 2014, while schemes in operation numbered 55 at the annual close compared to 51 in 2013.

The hedge fund industry enjoys a period of expansion…

For pure hedge funds, 2014 marked the consolidation of the growth trend of recent years. A 31.8% advance in assets under management to 1.37 billion euros at the end of November drew equally on portfolio returns and net investor subscriptions (see table 15). Portfolio returns in this sub-sector averaged 5.1% over January-November despite running negative in the closing stretch (-1.1% from July to November). Net sales, meantime, came to 278.4 billion euros in the first eleven months.

… with pure hedge funds out in front, on asset growth of 31.8%…

For funds of hedge funds, a small advance in assets marked a tentative break with the downtrend of recent years. Despite four fund closures in the year, the sub-sector managed to boost its assets to 356 million euros in November 2014, a 1.5% improvement on fourth-quarter 2013. Unit-holder numbers dropped by 9.2% to a November total of 2,743, while portfolio returns reached a creditable 7.2%.

… and funds of hedge funds still behind, though with signs of a breakout from the recent-year downtrend.

16 Although the fund did not deregister until January 2015, it stopped filing financial statements with the CNMV in December 2013, so is not computed in the figures for the 2014 close.

Main hedge fund and fund of hedge fund variables

TABLE 15

	2012	2013	2014	2014			
				1Q	2Q	3Q	4Q[1]
FUNDS OF HEDGE FUNDS							
Number	24	22	18	21	20	20	18
Unit-holders	3,338	3,022	2,743	2,994	2,972	2,737	2,743
Assets (million euros)	540	350.3	355.7	352.1	354	367.5	355.7
Return (%)	0.88	4.39	7.21	0.66	1.42	4.42	0.57
HEDGE FUNDS							
Number	36	29	37	28	30	33	37
Unit-holders	2,427	2,415	2,605	2,513	2,631	2,627	2,605
Assets (million euros)	918.6	1,036.7	1,366	1,172.4	1,261.5	1,353	1,366
Return (%)	7.17	16.48	5.06	4.21	1.97	-1.0	-0.15

Source: CNMV.

1 Data to November 2014, except number of schemes, to December of the same year.

Foreign UCITS marketed in Spain

Foreign UCITS make further headway, with assets under management up by 44% to almost 79 billion euros…

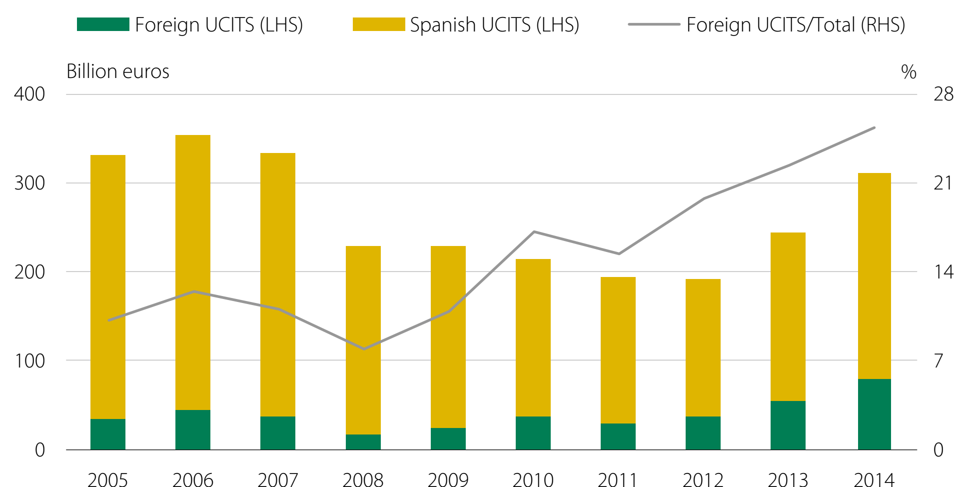
This segment prolonged the strong run initiated in mid-2012, which lifted assets under management by 163% between 2011 and 2014. This last year, specifically, saw investment surge by 44.2% to just short of 79 billion euros. As we can see from figure 20, foreign UCITS now account for 25.3% of assets under management in Spain, after working up steadily from the 8% share of 2008, at the start of the crisis.

… and both companies and funds advancing across all main variables.

Both funds and companies participated in the expansion. Companies, which dominate the segment, grew their assets 46.6% to 67.74 billion euros, while funds secured a 31% advance to 11.17 billion. Investor numbers rose by 23.4% to 1,317,674, while the number of schemes jumped from 780 to 805.

Assets of foreign UCITS marketed in Spain

FIGURE 20



Source: CNMV.

The collective investment industry is currently riding high on a reduced rate scenario that has set investors casting round for more profitable investment alternatives than low-earning bank deposits. Europe's monetary policy stance suggests interest rates will remain at lows for some time to come, so this factor should continue to favour the industry from a demand standpoint. From a supply side perspective, investment fund management and distribution remains highly profitable for Spanish banks, who will likely be keen therefore to continue their involvement in the sale of these investment products[17]. As to the mid-tem business the industry can capture, this will depend on the strength of private sector savings, eroded during the crisis years by stagnant disposable income. But in the short term, at least, economic and employment recovery are factors playing in its favour.

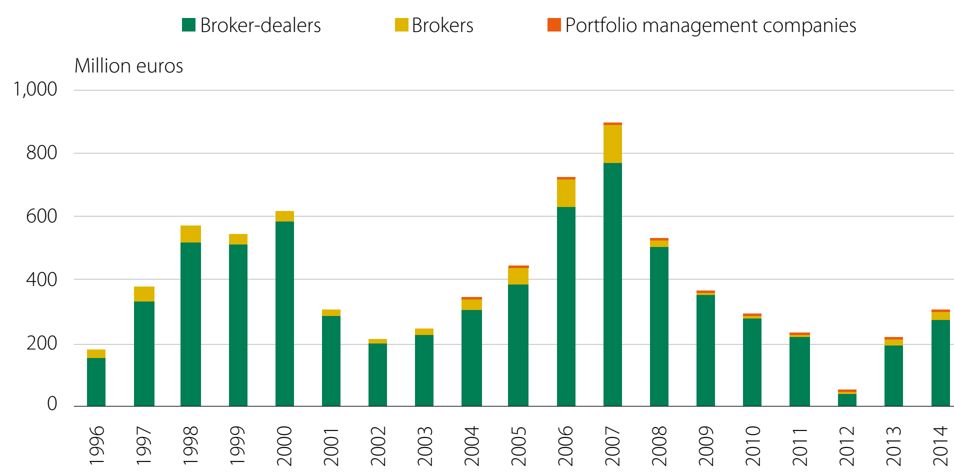
Reduced interest rates and improvement in private-sector income give solid grounds for optimism about the future of the fund industry.

4.2 Investment firms

The more supportive tone of financial markets boosted investment firm earnings over 2014. The sector as a whole posted profits before taxes of 306 million euros, 41% more than in 2013 (see figure 21). Moreover, all groups of intermediaries –broker-dealers, brokers and portfolio management companies– shared in the advance. At the annual close, 83[18] firms were listed on the CNMV registers, four fewer than in 2013. Of this total, six were passported to operate in other EU countries via a branch and 41 under the free provision of services (one more than at end-2013).

Investment firms registered with the CNMV secure a strong advance in earnings thanks to the year's more buoyant markets.

Investment firm pre-tax profits[1] FIGURE 21



Source: CNMV.

1 Except investment advisory firms.

Broker-dealers obtained combined pre-tax profits of 275.6 million euros, 42% more than in 2013 and representing 90% of sector-wide earnings (see table 16). Driving the advance was higher fee income, improvement at other gross income lines and a

Broker-dealer profits rise 42% on higher fee income and operating cost savings.

17 See Ramiro Losada's article "The market power of mutual fund managers in the Spanish retail market" in the CNMV's Quarterly Bulletin for the fourth quarter of 2014.

18 Excluding investment advisory firms, which are dealt with separately in a later section in view of their different characteristics.

reduction in operating expenses. Fee income, specifically, rose by 11.9% to 633.3 million euros. The biggest-earning items under this heading were placement and underwriting fees, at over 21.4 million euros, and UCITS marketing fees, which came in at just under 63 million. Fees on securities administration and custody and portfolio management topped 21 million in both cases. Note that order processing and execution, firms' largest source of fee income, brought in 1.5% less despite increased volumes of intermediated trading due to lower average brokerage fees.

Aggregate income statement (Dec 14)

TABLE 16

	Broker-dealers			Brokers			Portfolio managers		
Thousand euros	**Dec 13**	**Dec 14**	**% var.**	**Dec 13**	**Dec 14**	**% var.**	**Dec 13**	**Dec 14**	**% var.**
1. Net interest income	67,333	74,177	10.2	1,799	1,119	-37.8	667	574	-13.9
2. Net fee income	387,216	445,317	15.0	110,422	120,634	9.2	9,362	11,104	18.6
2.1. Fee income	565,787	633,263	11.9	130,738	147,137	12.5	18,603	15,411	-17.2
2.1.1. Order processing and execution	347,522	342,462	-1.5	40,196	41,745	3.9	–	–	–
2.1.2. Placement and underwriting	4,824	21,414	343.9	4,715	8,129	72.4	–	–	–
2.1.3. Securities administration and custody	17,987	22,347	24.2	505	567	12.3	–	–	–
2.1.4. Portfolio management	15,581	21,046	35.1	16,267	15,062	-7.4	17,028	13,572	-20.3
2.1.5. Investment advising	10,500	10,638	1.3	5,707	7,260	27.2	1,575	849	-46.1
2.1.6. Search and placement	8,659	4,367	-49.6	55	0	-100.0	–	–	–
2.1.7. Margin trading	22	0	-100.0	11	0	-100.0	–	–	–
2.1.8. UCITS marketing	51,766	62,948	21.6	35,823	46,565	30.0	0	0	–
2.1.9. Others	108,926	148,041	35.9	27,459	27,809	1.3	0	990	–
2.2. Fee expense	178,571	187,946	5.3	20,316	26,503	30.5	9,241	4,307	-53.4
3. Results of financial investments	256,110	222,077	-13.3	5	775	15,400	9	-6	–
4. Net exchange differences	-149,033	-110,808	–	-237	498	–	-24	132	–
5. Other operating income and expense	10,566	14,383	36.1	-1,396	604	–	-8	-369	-4,512.5
GROSS INCOME	**572,192**	**645,146**	**12.7**	**110,593**	**123,626**	**11.8**	**10,006**	**11,435**	**14.3**
6. Operating expenses	384,638	372,003	-3.3	89,726	96,616	7.7	6,388	5,530	-13.4
7. Depreciation and other charges	-609	6,197	–	2,420	2,630	8.7	64	45	-29.7
8. Impairment losses	3,123	1,437	-54.0	25	13	-48.0	0	0	–
NET OPERATING INCOME	**185,040**	**265,509**	**43.5**	**18,422**	**24,366**	**32.3**	**3,554**	**5,860**	**64.9**
9. Other profit and loss	9,529	10,120	6.2	854	466	-45.4	9	0	-100.0
PROFITS BEFORE TAXES	**194,569**	**275,629**	**41.7**	**19,276**	**24,832**	**28.8**	**3,563**	**5,860**	**64.5**
10. Corporate income tax	53,764	83,162	54.7	4,955	4,910	-0.9	1,091	1,725	58.1
PROFITS FROM ONGOING ACTIVITIES	**140,805**	**192,467**	**36.7**	**14,321**	**19,922**	**39.1**	**2,472**	**4,135**	**67.3**
11. Profits from discontinued activities	0	0	–	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**140,805**	**192,467**	**36.7**	**14,321**	**19,922**	**39.1**	**2,472**	**4,135**	**67.3**

Source: CNMV.

Gross income growth and lower expenses boost net operating income by 43.5% to 265 million.

The aggregate gross income of the broker-dealer segment rose by 12.7% in the year to 645 million euros. Besides fee income, the improvement drew on higher net interest income and lower exchange losses. Conversely, gains on financial investments reduced by 13.3% to 222 million euros. Gross income growth combined with a 3.3% decrease in operating expenses to deliver a 43.5% increase in net operating income, which closed the year at 265.6 million euros.

For brokers too, the more supportive environment impacted positively on 2014 income statements, whose highlight was a 28.8% jump in pre-tax profits to 24.8 million euros. The advance was led by fee income, up by 12.5% to 147.1 million euros (see table 16). The largest increases under this head corresponded to UCITS marketing, placement and underwriting and investment advisory fees, which brought in 10.7, 3.4 and 1.6 million more respectively, although the biggest-earning fee items in absolute terms were UCITS marketing (32% of the total) and order processing and execution (28% of the total). Gross income, finally, climbed by 11.8% to 123.6 million euros, while operating expenses, at 96.6 million, were 7.7% higher than in 2013.

Brokers earn almost 29% more in 2014 as fee income picks up strongly, with UCITS marketing, and placement and underwriting services leading the advance.

Portfolio management companies secured full-year profits of 5.86 million, 64.5% more than in 2013 (see table 16). In contrast to other financial intermediaries, the improvement was sourced from a sizeable reduction in fees paid (down 53.4%) along with operating cost savings of 13.4%. Fee income, however, contracted across all main lines, by 20.3% in portfolio management and 46.1% in investment advisory services. Since assets under management in this sub-sector expanded in 2014, income slippage is presumably down to reductions in the fees applied.

Portfolio manager profits also rise but the growth source is lower fees paid.

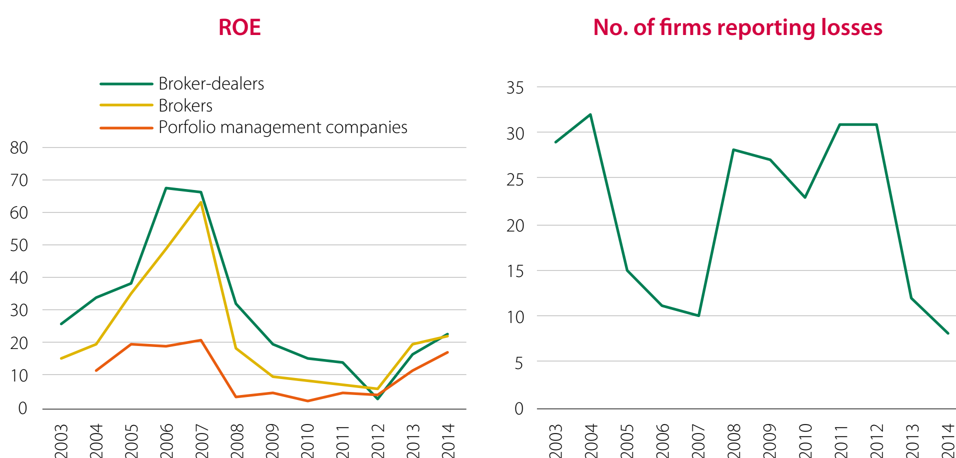
Firms' strong earnings performance ensured that sector return on equity (ROE) held to the improvement path initiated in 2013 (see left-hand panel of figure 22). The broker-dealers segment managed the largest advance, from 16.4% in 2013 to 23% at the 2014 close, while brokers' ROE rose from 19.3% to 22.2%. The ratio of portfolio management companies, finally, increased by 5.5 points to 17%.

Greater earnings strength translates as a significant advance in investment firm ROE…

The number of firms reporting losses was reduced compared to recent years, with only eight in this position at end-2014, compared to twelve in 2013 and 31 in 2012 (see right-hand panel of figure 22). For the second year running, no portfolio management companies posted losses, while the number of loss-making broker-dealers and brokers was down by two in both cases to three and five respectively. The result was further progress in reducing sector-wide losses, which closed the year at 6.7 million euros (8.1 million in 2013).

… and a decrease in the number of loss-making firms and the scale of their losses.

Pre-tax ROE of investment firms and loss-making entities FIGURE 22



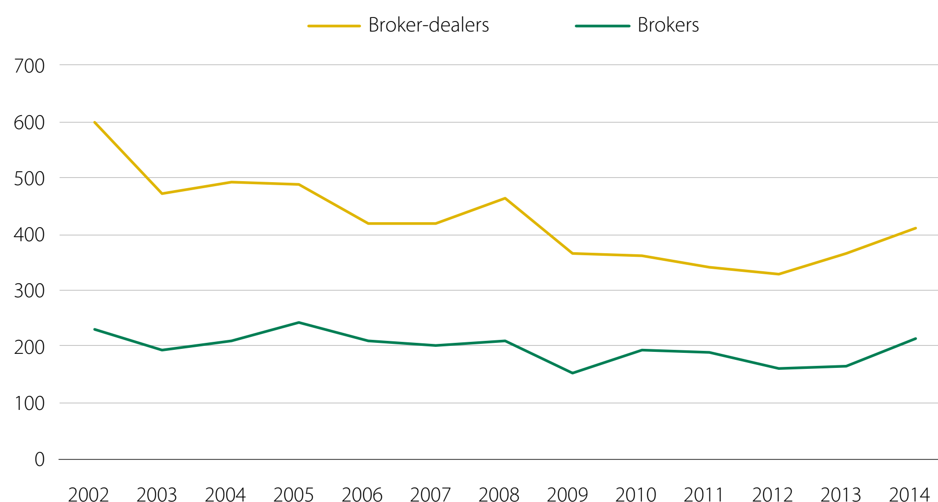
Source: CNMV.

Investment firm solvency holds up well in a year that brought several regulatory novelties in this area.

Investment firms kept up sound solvency ratios over 2014. These standards were affected in the year by a series of regulatory changes, starting with the entry to force of Regulation (EU) 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, which changes the method for calculating investment firm capital requirements. There were changes too in firms' solvency reporting obligations pursuant to CNMV Circular 2/2014 of 23 June on the exercise of various regulatory options regarding the solvency of investment firms and their consolidable groups, which exempts some firms from the requirement to report on their compliance with solvency standards. According to this new regulatory framework, the 2014 ratios of Spanish investment firms[19], defined as the surplus of eligible to required capital, stood at 4.1 for broker-dealers and 2.1 for brokers (see figure 23).

Investment firm capital adequacy FIGURE 23

(Surplus of eligible capital to the minimum requirement, %)



Source: CNMV.

IAF business expands further in 2014, with assets under advice up by 21.3% to 21.4 billion euros.

Investment advisory firms (IAFs) continued doing lively business. Assets under advice climbed by 21.3% to 21.4 billion euros[20] and fee income by 43.6% to 47.8 million (see table 17), with the advance taking in all customer segments. Specifically the advised assets of retail and professional clients rose by 14.6% and 22.3% respectively versus full-year 2013, and those of eligible counterparties[21] (the "others" item) by 24.8%. Retail clients continued to account for the majority of industry contracts (93%, the same proportion as in 2013). Finally, the number of IAFs rose by 17 to 143 at the 2014 close, eleven of them passported to provide investment advice in other EU countries under the free provision of services.

19 The information stated refers to 95% of the broker-dealers and 93% of the brokers required to report solvency ratios as at December 2014.

20 This figure does not include four IAFs (three in the process of deregistration or liquidation) for which no data were available at the closing date for this report, and corresponds accordingly to 97% of firms.

21 Eligible counterparty is a client category defined under the MiFID as requiring a lower degree of protection. It typically includes banks, other financial institutions and national governments.

The prospects for the investment firm industry are looking far more solid thanks to the gathering strength of main business lines, primarily financial market intermediation, UCITS marketing and financial advisory services. However, as we have warned in previous reports, the sector's growth outlook is increasingly conditioned by competitive pressure from national and foreign banks. In 2014, to look no further, credit institutions took in 80% of investment service fees[22], and maintained their dominant grip on business lines like UCITS marketing, securities administration and custody and issue underwriting. Investment firms, meantime, remain more competitive in securities transactions (as witness the recent cuts in brokerage fees), where they took in 53% of the associated revenues in 2014.

More dynamic markets augur a better run for investment firms despite competition from the banks.

Main investment advisory firm variables

TABLE 17

Thousand euros	2012	2013	2014	2013 2H	2014 1H	2014 2H[1]	% var. in year
NUMBER OF FIRMS	**101**	**126**	**143**	**126**	**134**	**143**	**13.5**
ASSETS UNDER ADVICE[2]	**14,776,498**	**17,630,081**	**21,391,417**	**17,630,081**	**14,456,415**	**21,391,510**	**21.3**
Retail customers	3,267,079	4,991,653	5,719,199	4,991,653	5,488,399	5,719,292	14.6
Professional customers	3,594,287	3,947,782	4,828,459	3,947,782	4,465,564	4,828,459	22.3
Others	7,915,132	8,690,646	10,843,759	8,690,646	4,502,452	10,843,759	24.8
NUMBER OF CONTRACTS	**3,484**	**4,002**	**4,629**	**4,002**	**4,344**	**4,639**	**15.9**
Retail customers	3,285	3,738	4,313	3,738	4,044	4,323	15.7
Professional customers	175	235	276	235	264	276	17.4
Others	24	29	40	29	36	40	37.9
FEE INCOME[2]	**26,177**	**33,273**	**47,746**	**33,273**	**21,513**	**47,767**	**43.6**
Fees received	**26,065**	**33,066**	**47,167**	**33,066**	**21,071**	**47,188**	**42.7**
From customers	20,977	26,530	37,930	26,530	17,322	37,943	43.0
From other entities	5,088	6,537	9,236	6,537	3,749	9,245	41.4
Other income	112	206	579	206	442	579	181.1
EQUITY	**13,402**	**21,498**	**26,529**	**21,498**	**22,915**	**26,538**	**23.4**
Share capital	4,365	5,156	5,579	5,156	5,230	5,576	8.1
Reserves and retained earnings	4,798	9,453	8,993	9,453	9,899	8,993	-4.9
Profit/loss for the year[3]	4,239	6,890	11,956	6,890	7,787	11,969	73.7

1 Provisional data (except number of entities) based on data from 97% of IAFs registered with the CNMV.

2 Period-end data at market value.

3 Cumulative data for the period.

22 From January to September.

CNMV consultation on a system for financial instrument classification and identification of especially complex products EXHIBIT 3

The financial instruments offered to retail clients have grown considerably more sophisticated in the prevailing climate of reduced interest rates. And Spain has recently witnessed cases of misselling that have brought to light customers' poor understanding of the nature and risks of certain products, and revealed a need to strengthen disclosure requirements when they are being marketed to this kind of investor.

In September 2014, following the recommendations of the Subcommittee on Transparency in Information on Credit Institution Financial and Mortgage Products formed under the Congress of Deputies Economics Committee, the CNMV launched a public consultation on an initiative whose contents are summarised below:

i) Establishment of a simple, intuitive system so retail clients understand the risk and complexity of the financial products they may wish to invest in. The proposal is to use a synthetic indicator with a five-level risk scale in which each level is associated with a colour, to be accompanied by warnings about the product in question's complexity and liquidity. The methodology would be straightforward, based on checklist points like the existence of a commitment to return capital on maturity, remaining term to maturity, and the issuer's credit rating. This indicator would be included in the pre-sale material banks deliver to clients, together with more detailed information on the characteristics and inherent risks of financial instruments. The idea, it should be stressed, is not to supplant entities' internal systems of suitability and appropriateness testing, which pursue different objectives.

ii) The proposed classification system would be applied to all financial instruments covered by the Securities Market Law, except the units and shares of collective investment schemes, which already have a key information document in standard use.

iii) Certain financial instruments whose complexity advises against their use by non-professional investors would carry a warning saying they are not suitable for retail investors, which clients must state in writing that they have read and understood. Instruments subject to this requirement would be: convertible bonds qualifying as additional tier 1 regulatory capital; structured financial products not guaranteeing the return of at least 90% of the original investment and which involve complex structures potentially masking their real degree of risk; and OTC derivatives held for purposes other than hedging.

Another concern about the growing sophistication of the products available to retail investors is the difficulty of estimating their fair value at the point of sale and during their subsequent life. Prior to last September's consultation, the CNMV had canvassed sector opinion on what it saw as two issues of particular relevance. On the one hand, whether the seller should have to provide its fair value estimate of the financial instrument, especially when the costs to the investor are insufficiently transparent (the case, for instance, with contingent convert-

ible notes, structured products or OTC derivatives). By the same token, when there is a significant difference between the cash amount of the planned transaction and the instrument's fair value estimate, whether the seller, as the CNMV advocates, should issue an explicit warning to this effect. On the other hand, in the case of complex instruments like structured products or OTC derivatives where the non-professional investor may have difficulty calculating possible future returns, consideration should go to providing clients beforehand with quantified information showing different return estimates for different scenarios, with probabilities assigned to each.

After taking in and analysing the responses of investment service providers, their associations and consumer organisations, the CNMV prepared a draft circular which it sent out for public consultation in January 2015.

4.3 UCITS management companies

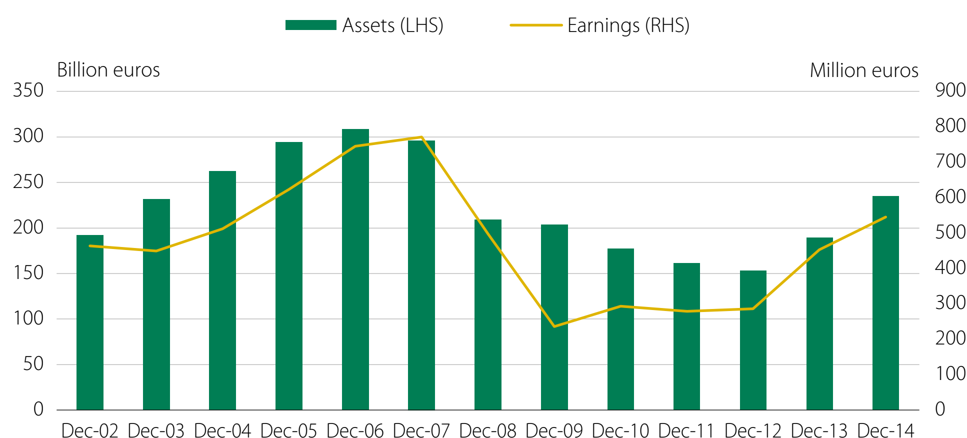
UCITS managers take in 20% more in pre-tax profits and grow assets under management by 24%.

UCITS management companies had another good year, with reduced interest rates continuing to favour mutual fund investment to the detriment of other instruments like bank time deposits. The result was a 23.8% jump in assets under management to 234.6 billion euros, and pre-tax profits 20.4% higher at 545 million euros (see figure 24) –the best figures since the start of the crisis albeit without recouping past heights. The sector again stood out for its high concentration, with the three largest companies commanding a combined market share of 36% of assets under management.

Management fees rise by 25.7% to over two billion euros, while the average charge remains unchanged at 0.85% of assets.

Management fees, the sectors biggest-earning item, brought in two billion euros, 25.7% more than in 2013. The average management fee, at 0.85% of assets, held at the levels of the previous year (0.84%). The marketing fees paid to other entities used up 61.8% of management fee income, on a par with 2013 but improving slightly on pre-crisis levels closer to 70%. The number of loss-making companies rose from eleven to fourteen at the 2014 close, with combined losses summing 2.89 million euros.

UCITS management companies: Assets under management and pre-tax profits FIGURE 24



Source: CNMV.

Sector reorganisation has apparently reached an end.

A total of 96 UCITS management companies figured in the CNMV registers at end-2014, the same number as in 2013 following two new entries and two deregistrations. This points to a renewed stability after a wave of transactions prompted by the bank sector restructuring of recent years.

UCITS management companies: Assets under management, management fees and fee ratio TABLE 18

Billion euros

	Assets under management	UCITS management fee income[1]	Average UCITS management fee (%)	Fee ratio (%)[1]
2007	295,922	3,194	1.08	70.50
2008	208,861	2,302	1.10	70.80
2009	203,730	1,717	0.84	68.08
2010	177,055	1,639	0.93	67.24
2011	161,481	1,503	0.93	65.60
2012	152,959	1,416	0.93	64.62
2013	189,433	1,594	0.84	61.94
2014	234,588	2,004	0.85	61.80

Source: CNMV.

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

4.4 Other intermediaries: Venture capital

New fund entries lift the number of venture capital entities from 334 to 344.

The number of venture capital entities (VCEs) moved up from 334 to 344 in the course of 2014. The increase owed exclusively to venture capital funds (VCFs), whose numbers rose from 126 to 145, while the numbers of venture capital companies (VCCs) and VCE management companies dropped from 130 to 125 and 78 to 74 respectively (see table 19).

Movements in the VCE register in 2014 TABLE 19

	Situation at 31/12/2013	Entries	Retirals	Situation at 31/12/2014
Entities	**334**	**30**	**20**	**344**
Venture capital funds	126	21	2	145
Venture capital companies	130	6	11	125
Venture capital management companies	78	3	7	74

Source: CNMV.

According to ASCRI, 2014 was a boom year for the venture capital industry on both the investment and fundraising side…

Preliminary data for 2014 furnished by industry association Asociación Española de Entidades de Capital Riesgo (ASCRI) confirm the strength of the recovery initiated in second-half 2013. Investments in the year came to 3.02 billion, 28% more than in 2013, with international funds contributing 78% in a total of 55 transactions. Other developments were the increase in large transactions (of over 100 million euros)

from five in 2013 to nine in 2014 and an 88.5% surge in new funds raised to 4.29 billion euros. This last advance had its origin in higher inflows from international funds and allocations under the Fond-ICO Global tender.

… and with divestments at an all-time high.

Expansion capital transactions tended to predominate (63.5% of the total), with a combined investment of around one billion euros, though early stage transactions also featured large. The most popular receiving sectors were consumer products (24%), hospitality and leisure (15%), communications (9%) and industrial products and services (9%). The big news however was the turnaround in divestments, which rose to a record-breaking 4.67 billion euros. This scale of increase reflects the more supportive market conditions prevailing after a number of years when investors were dissuaded from selling by falling valuations or the clean-up and improvement measures promoted by the industry in investee concerns.

A more supportive macroeconomic setting should boost industry prospects going forward.

The outlook for the venture capital sector remains solidly promising. With recovery gaining traction, everything suggests that fundraising will continue at a healthy pace supported by the return of international funds and Fond-ICO activity. Investment too is expected to accelerate across all target segments in both volume and transaction terms. Finally, the entry to force in November last of Law 22/2014 regulating venture capital and other entities provides a new framework for the sector, with new actors like the SME venture capital entity, intended to channel non-bank finance to companies at the early development stage (see exhibit 4).

New venture capital law and amendment of collective investment scheme legislation

EXHIBIT 4

Law 22/2014 regulating venture capital entities, other closed-ended collective investment schemes[1] and their management companies (hereafter VCL) came into force on 14 November last year. Its passage derogates Venture Capital Law 25/2005 and amends certain aspects of Law 35/2003 on collective investment schemes (hereafter, CISL). The VCL transposes Directive 2011/61/EU on alternative investment fund managers (AIFMD) with regard to closed-ended investment vehicles, while the CISL implements its provisions on open-ended schemes.

The goal of the AIFMD is to provide a regulatory and supervisory framework for alternative investment fund managers of significant size, i.e., those managing portfolios of AIFs whose assets under management exceed 500 million euros, in the case of unleveraged, closed-ended vehicles, or 100 million for all the rest. The conditions it imposes on these large management companies are fairly stringent as regards own fund requirements, asset valuation, delegation of tasks, and risk and liquidity management. Among its novelties, limits are placed on remuneration policies, in order to discourage risk-taking inconsistent with the risk profiles of the AIFs managed, and detailed liability provisions established for depositaries in the event of the loss of instruments in their care. It is also stipulated that one depositary should be appointed for each fund managed. Pursuant to the completion of the single market, the Directive offers to extend these managers a European passport to market their funds to professional investors, along the same lines as the UCITS passport which covers retail funds.

The VCL adopts this same definition in specifying two types of management companies, above and below the AIFMD thresholds. Those above must meet the requirements listed in the preceding paragraph, though all managers are subject to CNMV authorisation and the same own funds regime. The new law accordingly brings the management of closed-ended alternative investment funds within the scope of CNMV authorisation and supervision, in place of the voluntary regime for venture capital entities (VCEs) previously envisaged. Importantly, it also enlarges the range of sector vehicles (previously confined to VCEs), establishing what are known as closed-ended collective investment entities. This new category comprises any closed-ended vehicle, not having a commercial or industrial purpose, that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy.

Besides the changes imposed by the AIFMD, the venture capital law establishes a new type of VCE, the SME venture capital entity, with the goal of channelling non-bank finance to businesses in early stages of development. It also opens the door to VCE marketing to retail investors, provided they invest a minimum of 100,000 euros and declare in writing that they are aware of the risks entailed.

Amendments to the CISL, meantime, are primarily to adapt its articles to the AIFMD. It should be said that the changes will weigh lightly, since existing regulations imposed similar requirements on the managers of open-ended collective investment schemes, regardless of their size. AIFMD-motivated changes are joined by others aimed at implementing provisions of the UCITS V Directive[2], which lays down remuneration policies and a depositary framework along similar lines to the AIFMD.

Note, in closing, that the transposition of UCITS V and the AIFMD will not be complete until the relevant provisions are written into collective investment scheme regulations.

1 Article 2 of the law defines closed-ended collective investment schemes as those whose divestment policy meets the following conditions: 1) the divestment will take place simultaneously with respect to all investors; and (ii) each investor will be remunerated on an individualised basis, in accordance with their rights under the regulations and by-laws applicable to each class of shares or units.

2 Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014, amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.