I Securities markets and their agents: situation and outlook

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1 Executive summary

- Global economic activity deteriorated with some intensity in the second half of 2012. European economies were the worst affected, due to the contractionary impact of fiscal policy in certain countries, on top of weaker foreign trade and the fallout in the real economy from successive waves of debt market turmoil. In this last sphere, policy actions at national and European level and progress in the ongoing restructuring of the region's financial system have ushered in a calmer mood since summer 2012 which continues to this day.[1] The absence of inflationary pressures in major economic areas has kept official interest rates running at historical lows. And the latest forecasts augur world growth of 3.5% in 2013 and 4.1% in 2014, with emerging market economies again to the fore.

- The performance of international financial markets through second-half 2012 and the first months of 2013 reflected the gradual unwinding of tensions from the peak levels of last July. In debt markets, particularly, the trends associated with recent stress episodes reverted with some force, triggering a run-down in the secondary market yields of the government bonds of more fragile economies and a limited increase in those of the most solid sovereign issuers, accompanied in equity markets by a price surge that has lasted almost straight through from the middle months of 2012. Primary debt markets too recouped some of their dynamism, with private corporates leading the way. Another welcome development has been the remission of credit risk contagion between the public sectors of European economies.

- Spanish GDP contracted by an annual 1.9% in the closing quarter of 2012 for a full-year average of -1.4% (-0.9% and -0.6% respectively in the euro area). Inflation spiked in October at 3.5% due to rising energy prices and the hike in VAT but has since eased substantially (2.8% in February), leaving the differential vs. the euro area at just over one point. Employment shrank by 4.4% in the course of 2012, while the jobless rate reached year-end levels of 26% against a backdrop of falling unit labour costs. The general government deficit closed at nearly 7.0% of GDP (9.4% in 2011), excluding aid to the financial sector, which summed a further 3.3%. Leading forecasters say the Spanish economy will remain in recession through 2013 and manage a small advance in 2014.

- The Spanish financial system is in the thick of a restructuring and recapitalisation drive which has been gathering momentum since last June's ap-

1 The closing date for this report is 15 March.

peal to the EU for financial assistance. As part of the process, banks have begun to transfer their problematic assets to the Asset Management Company for Assets Arising from Bank Restructuring (SAREB). Banking business, meantime, will likely stay slow in the near term due to the weakness of domestic activity.

- The aggregate profits of non-financial listed corporations fell by 45% in full-year 2012 to 12.65 billion euros as activity continued to stagnate. Their debt levels, meantime, dropped by 4.1% to 296 billion euros.

- Spanish equity markets entered a bull phase at end-July 2012 that has continued through the first months of 2013, helped by strongly improving market liquidity and diminished volatility. The Ibex 35 was able to follow up its full-year loss of 4.7% with a 5.5% advance in the first quarter of 2013, mirroring the performance of other key European indices. Gains extended to practically all market sectors and indices, though trading stayed thin by historical standards. The late-July flare-up in debt market turmoil prompted the CNMV, along with its Italian counterpart, to impose a new short-selling ban, which in Spain's case was later rolled over to 31 January 2013.

- Domestic fixed-income markets returned to something like normality in the closing months after the trials of mid-year, and have conserved this calmer mood through the first quarter of 2013. The result has been a sizeable reduction in the short and long bond yields of economic agents, and a narrowing of their credit spreads. In particular, the Spanish ten-year bond was yielding 4.9% at mid-March this year, almost three points below the peak levels of late July 2012 (7.6%), while the spread vs. the German *Bund* was down to 344 bp (against its 635 bp high). There was evidence too of a significant decoupling between the price movements of Spanish government bonds and shares. In primary markets, the volume of debt issues filed with the CNMV expanded 23.8% in 2012 as far as 357.8 billion euros, though the rhythm has noticeably slackened in the first months of 2013.

- Assets under management in investment funds declined by 6.3% in 2012 to 124 billion euros on the sustained flow of unit-holder redemptions (portfolio returns were positive in the period). Liquidity conditions continued to improve, delivering a 1.3 point reduction in the ratio of less-liquid assets as far as 4.3% at the 2012 close. Management companies were able to grow their profits 4.1% thanks to cost contention and increased revenues from sources other than UCITS management. The industry has begun this year on a more buoyant note with some drift over from bank deposits, though constraints on households' saving capacity point to tough times still ahead.

- Investment firm business remained depressed as market turmoil cut heavily into trading volumes, their main income source. The result was a net profits slump of 78% to 50.3 million euros, and a sharp deterioration in the earnings figures of loss-making firms, though their numbers did not increase. The number of firms on the register also reduced further in 2012, even though bank sector restructuring has so far exerted only a limited impact in corporate terms. Solvency conditions, meantime, continued in the comfort zone.

- The report includes five exhibits:

  – The first sets out the main characteristics and operational mechanisms of the newly constituted Asset Management Company for Assets Arising from Bank Restructuring (SAREB).

  – The second runs through the key conclusions of the FSB's analysis on five targeted areas of shadow banking activity.

  – The third exhibit summarises recent legislative changes affecting the prospectus and transparency requirements applicable to securities issuers.

  – Exhibit four considers the key elements of ESMA's recently approved guidelines on the remuneration policies of alternative fund managers in the light of the Alternative Investment Fund Managers Directive (AIFMD).

  – Finally, the fifth offers a description of ESMA's 2012 guidelines clarifying certain aspects of MiFID suitability requirements and the steps taken by the CNMV to facilitate company compliance.

2 Macro-financial setting

2.1 International economic and financial developments

The international financial climate has brightened somewhat in these past months…

The international financial climate has improved modestly since the third quarter of 2012, particularly among the economies worst hit by the debt crisis, giving new impetus to equity markets and restoring risk premiums to more manageable levels. Meantime, capital flows to emerging market economies have been gaining momentum. In Europe, the austerity programmes launched by governments, the restructuring of the financial systems most damaged by the crisis, and a series of EU-level decisions to preserve financial stability throughout the zone, have dispelled part of the uncertainty weighing on market agents.

…though activity remains sluggish, especially in Europe.

After surprising on the upside in the third quarter, activity again appeared to soften as the year drew to a close. GDP growth was uneven across the main economic regions. Advance was strongest in the United States and Japan, with rates nearing 2%, and the emerging markets, with a combined rate ahead of 5%. In Europe, something of a gap emerged between the core economies, especially Germany and France, which outperformed in the opening quarters, and the periphery countries, which stayed stuck in recession for almost all of 2012 (see table 1).

Persistently low-key inflation in advanced economies…

Inflation in main advanced economies has held more or less steady[2] after the steep run-down of the first six months, to begin 2013 with rates ranging from 1.6% in the United States to 2.7% in the United Kingdom. The outlier was again Japan, with

2 In the euro area, annual inflation has fallen more sharply from 2.5% in October 2012 to 1.8% in February 2013.

full-year inflation of zero percent. Consumer price stability was favoured by domestic demand weakness in most economies and lessening pressure from commodity prices, especially energy. Core inflation too held to an even course, with only occasional spikes in some economies due to tax measures or hikes in tariff prices.

Gross domestic product (annual % change) TABLE 1

					IMF[1]	
	2009	2010	2011	2012	2013F	2014F
World	-0.7	5.3	3.9	3.2	3.5 (-0.1)	4.1 (-0.1)
United States	-3.0	2.4	1.8	2.2	2.0 (-0.1)	3.0 (0.1)
Euro area	-3.8	2.0	1.6	-0.5	-0.2 (-0.3)	1.0 (-0.1)
Germany	-5.1	4.0	3.1	0.9	0.6 (-0.3)	1.4 (0.1)
France	-3.0	1.6	1.7	0.0	0.3 (-0.1)	0.9 (-0.2)
Italy	-5.5	1.8	0.6	-2.2	-1.0 (-0.3)	0.5 (=)
Spain	-3.7	-0.3	0.4	-1.4	-1.5 (-0.1)	0.8 (-0.2)
United Kingdom	-3.9	1.8	0.9	0.0	1.0 (-0.1)	1.9 (-0.3)
Japan	-5.5	4.7	-0.5	1.9	1.2 (=)	0.7 (-0.4)
Emerging	2.8	7.5	6.3	5.1	5.5 (-0.1)	5.9 (=)

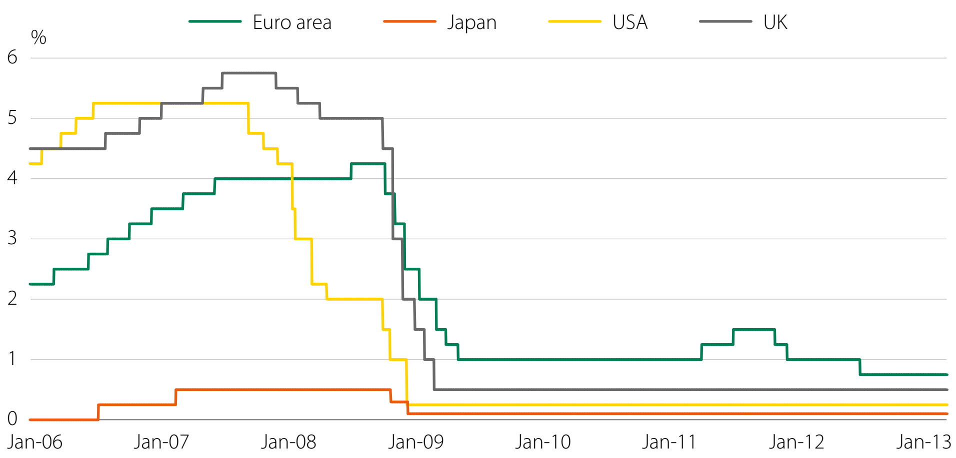
Source: IMF, Thomson Datastream and Eurostat.

1 In brackets, change with respect to the last published forecast. IMF, forecast published January 2013 versus October 2012.

…allows interest rates to be kept at lows.

With inflation expectations anchored at low levels in most major economies, official interest rates were either left untouched versus mid-year 2012 or lowered even further, as in the case of the euro area.[3] Official rates in the United States, euro area, United Kingdom and Japan closed February 2013 at historical lows of 0-0.25%, 0.75%, 0.5% and 0.1%, respectively. As previous years, unconventional measures were the monetary instrument of choice, primarily the purchase of financial assets.

Official interest rates FIGURE 1



Source: Bloomberg. Data to 15 March.

3 The ECB cut official euro-area rates by 25 bp to 0.75% at the start of July 2012.

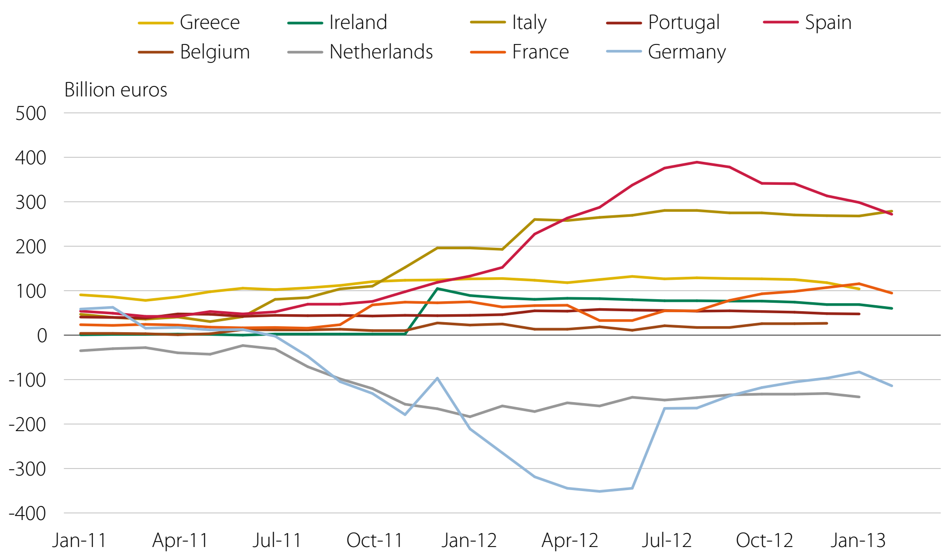
Tensions on international financial markets have lessened considerably since the third quarter of 2012, particularly in Europe. Easier financing conditions have allowed the most elevated sovereign spreads to come down appreciably, boosted prices on equity markets, and helped reopen debt markets for Europe's banks, which were able to scale back their recourse to Eurosystem funding. A number of factors underlie this improvement. Some relate to the ECB's decision to do "whatever is needed" to preserve the single currency, particularly its announcement of a conditional bond-buying program, and declarations by EU leaders on the need to advance towards banking and fiscal union. Equally vital have been the fiscal austerity programmes set in train by many euro-area economies.

Policy actions in Spain and Europe have calmed the mood on financial markets since the third quarter of 2012…

Gross borrowing from the Eurosystem has fallen slightly in recent months on banks' more fluid access to debt markets, though levels remain elevated (above 1.1 trillion euros). As we can see from figure 2, net creditor and debtor positions by country have evolved towards a lesser reliance by Spanish banks and more stable borrowings by their Italian peers. Though entities have repaid almost 236 billion euros of the total borrowed in the ECB's two special long-term refinancing operations (LTROs) of 22 December 2011 and 1 March 2012, the cost of this kind of funding remains very advantageous for those European banks not yet able to tap primary markets in conditions of normality.

…and allowing the region's banks to relay a little less on Eurosystem funding.

(Net) Eurosystem funding FIGURE 2



Source: Bloomberg, Banco de España and Bank of Greece. Data to February for Spain, Italy, France, Germany and Ireland, and to January for remaining countries except Belgium (December). In Greece's case, the data refer to the net liabilities of OMFIs (other monetary financial institutions) with the Bank of Greece, which factor not only Eurosystem borrowings but also the Emergency Liquidity Assistance (ELA) which provisionally replaced Eurosystem funding.

In long-term debt markets, the more settled mood of late 2012 and the first months of 2013 has taken some of the strain off the sovereign bond yields of more vulnerable economies, while prompting a limited increase in safe-haven yields. As figure 3 shows, the main beneficiaries were the Portuguese and Irish bonds, whose yields dropped to mid-March levels of around 6% and less than 4% respectively. Both countries, moreover, have successfully renewed their issuance programmes on pri-

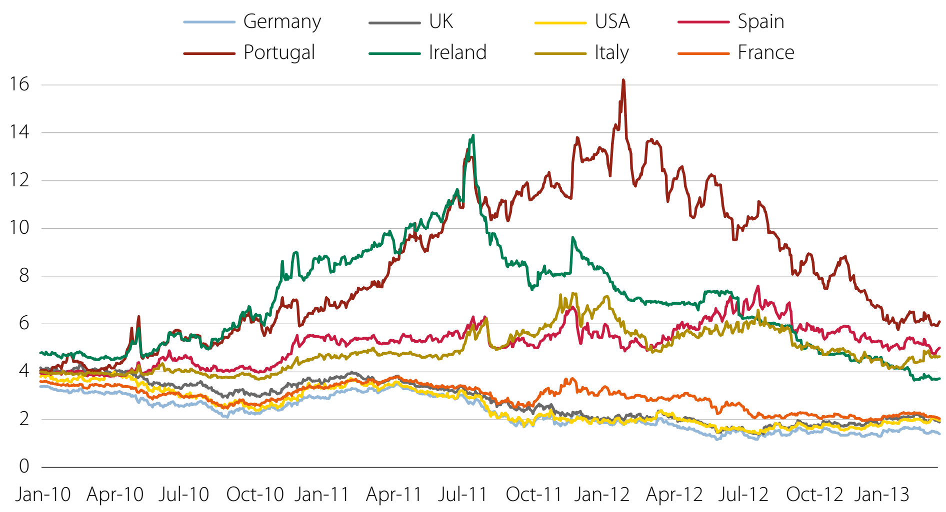
Government bond yields fall in more fragile economies as market tensions abate…

mary markets[4] following receipt of European financial assistance. Meantime, yields on Spanish and Italian bonds, the worst affected by the last bout of market turbulence, receded more than two points from mid-2012 highs as far as 4.9% and 4.6% respectively at the closing date for this report.

…accompanied by limited rises in the yields of safe-haven economies…

Finally, 10-year German, UK and U.S. yields, which had registered record lows of around 1.15%, 1.38% and 1.40% respectively at the height of market tensions, tended to stabilise or move slightly higher in the first weeks of 2013. By mid-March, their yields were oscillating between the 1.5% of the German *Bund* and the 2% of the U.S. benchmark.

Ten-year government bond yields FIGURE 3



Source: Thomson Datastream. Data to 15 March.

…the combined result being a substantial decrease in risk spreads on sovereign debt…

The sovereign risk spreads of a wide set of European economies, as derived from yield spreads and CDS premiums, have receded with force in recent months in line with government bond yields. As we can see from figure 4, the 5-year CDS of Spanish and Italian bonds[5] dropped below 300 bp around mid-March in contrast to the 600 bp peaks of July 2012, while those of sounder European economies crept below 200 bp. In some cases, these CDS spreads marked a return to the levels preceding the first turbulence outbreak of 2010.

…and less contagion of sovereign credit risk.

In this more benign risk climate, contagion indicators point to a dwindling spillover between euro-area public sectors, and between the financial and sovereign sector (see figure 5).

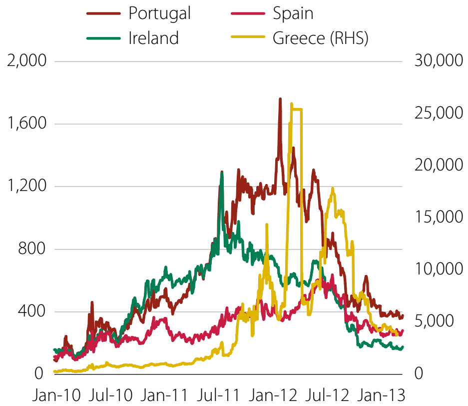
4 Generally, the bonds placed had maturities below five years, except one Irish issue in the ten-year tenor.

5 In Italy, the political vacuum opened up after the general elections of 24 and 25 February and Fitch's announcement on 8 March that it would downgrade the country's debt (from A- to BBB+ with a negative outlook) have partially reversed the downtrend in bond yields and risk spreads. In effect, political uncertainty and a stalled policy of structural reforms have dealt an adverse shock to the recession-mired Italian economy, and are the reasons behind its revise-down, the agency says.

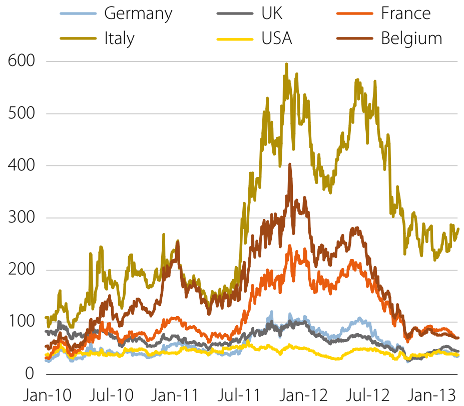
Sovereign credit spreads, 5-year CDS

FIGURE 4

Countries that have sought financial assistance



Other countries

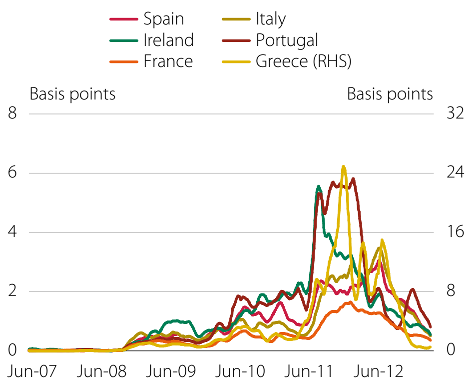


Source: Thomson Datastream. Data to 15 March.

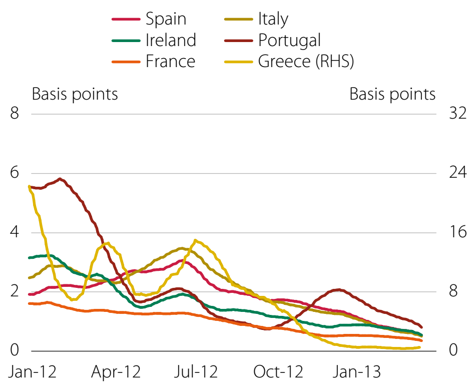
Sovereign credit risk contagion in the euro area[1]

FIGURE 5

Since 2007



Since 2012



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

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

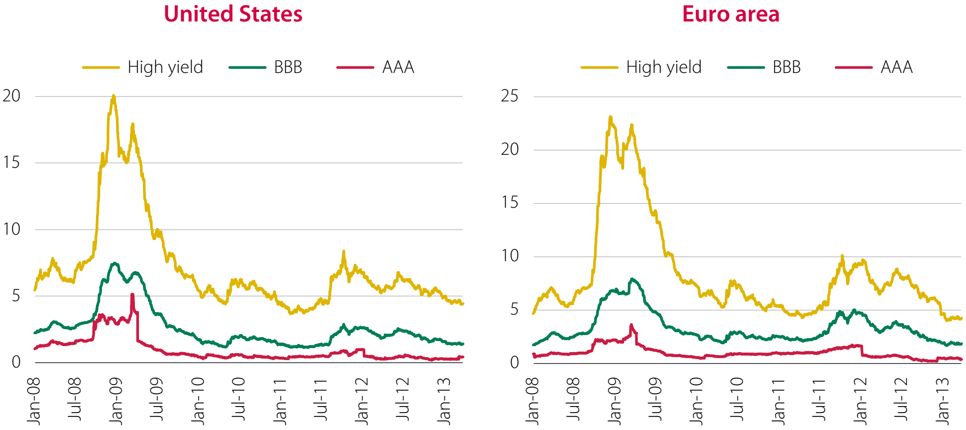
Corporate debt markets boom...

The sovereign debt crisis unfolding in Europe over the last few years has not only fuelled a flight to quality into the bonds of safer economies; it has also piled investors into private corporate debt. As we can see from figure 6, heavy buying of corporate bonds has helped to contain their risk spreads, even through periods of stress, while tempting corporate borrowers back to the markets in both the United States and Europe.

Corporate bond yields

FIGURE 6

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



Source: Thomson Datastream and CNMV.

1 In the euro area, versus the German 10-year benchmark.

…and bank sector issuance picks up slightly. Public debt issuance, meantime, continues in retreat.

Net issuance on international debt markets summed 4.6 trillion dollars in the full-year period, 22.2% less than in 2011. The decline traced to lower net sovereign debt issuance (down 17% to 3.6 trillion dollars), as countries persevered with fiscal tightening, and, in smaller measure, to the stall in financial institution placements in the year's opening months. As figure 7 shows, the net debt financing (less redemptions) of financial institutions in the United States and Europe stayed negative through 2012, albeit with modest improvement in the second half as market tensions eased. By instrument, outright issuance of both investment-grade and high-yield instruments picked up strongly in the year, while asset-backed securities (ABS) gained new steam, especially in the United States. But the main mover on primary markets was the non-financial corporate sector, with a deluge of sales that exceeded one trillion dollars, more than double the total of 2011, and breaking down 37% from U.S. and 32% from European issuers.

The primary debt market trends have been prolonged into 2013.

Data for the opening months of 2013 point to the persistence of these trends, i.e., a decrease in public debt issuance, a tentative return by the banks, and a sales boom in the corporate sector.

Leading stock indices began the year in bullish mood, with gains strongest in the U.S. and Japan,…

After a year that closed with most indices posting gains ahead of 10%, the stock markets of major advanced economies prolonged their bull run into 2013, with U.S. and Japanese indices leading by a comfortable margin (up nearly 10% and over 20% to mid-March respectively). In the United States, support came from the country's more buoyant activity, but also the agreement reached around the "fiscal cliff" and further stimulus from the Federal Reserve.[6] Among the European indices, gains ranged from the 0.7% of Italy's Mib 30 to the 10% of the UK's FTSE 100 (see table 2). The more settled climate of the past few months has certainly boosted shares to some extent, but the weakness of growth, as confirmed by fourth-quarter data, continues to weigh on equity markets worldwide.

6 The most important being the September announcement of its third balance-sheet expansion programme (QE3), the December rollover of the government bond buying programme and, especially, its decision to keep interest rates low while unemployment is above 6.5%.

Net international debt issuance FIGURE 7

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

…at a time of reduced volatility.

Volatility in world equity markets has stayed subdued in recent months, despite creeping higher in Europe from early February on. In all, levels of historical and implied volatility are consistent with those we might expect in the absence of market turbulence.

Performance of main stock indices[1]

TABLE 2

%	2009	2010	2011	2012	1Q12	2Q12	3Q12	4Q12	1Q13 (to 15 March) % prior qt.	% Dec	% y/y[2]
World											
MSCI World	27.0	9.6	-7.6	13.2	10.9	-5.8	6.1	2.1	7.9	7.9	9.4
Euro area											
Euro Stoxx 50	21.1	-5.8	-17.1	13.8	6.9	-8.6	8.4	7.4	3.4	3.4	4.5
Euronext 100	25.5	1.0	-14.2	14.8	8.3	-4.7	5.0	6.0	6.4	6.4	8.8
Dax 30	23.8	16.1	-14.7	29.1	17.8	-7.6	12.5	5.5	5.7	5.7	12.4
Cac 40	22.3	-3.3	-17.0	15.2	8.4	-6.6	4.9	8.5	5.6	5.6	6.9
Mib 30	20.7	-8.7	-24.0	10.2	7.9	-11.3	8.6	6.0	0.7	0.7	-2.8
Ibex 35	29.8	-17.4	-13.1	-4.7	-6.5	-11.3	8.5	6.0	5.5	5.5	1.6
United Kingdom											
FTSE 100	22.1	9.0	-5.6	5.8	3.5	-3.4	3.1	2.7	10.0	10.0	8.8
United States											
Dow Jones	18.8	11.0	5.5	7.3	8.1	-2.5	4.3	-2.5	10.8	10.8	9.7
S&P 500	23.5	12.8	0.0	13.4	12.0	-3.3	5.8	-1.0	9.4	9.4	11.1
Nasdaq-Cpte	43.9	16.9	-1.8	15.9	18.7	-5.1	6.2	-3.1	7.6	7.6	6.3
Japan											
Nikkei 225	19.0	-3.0	-17.3	22.9	19.3	-10.7	-1.5	17.2	20.8	20.8	24.0
Topix	5.6	-1.0	-18.9	18.0	17.3	-9.9	-4.2	16.6	22.3	22.3	21.3

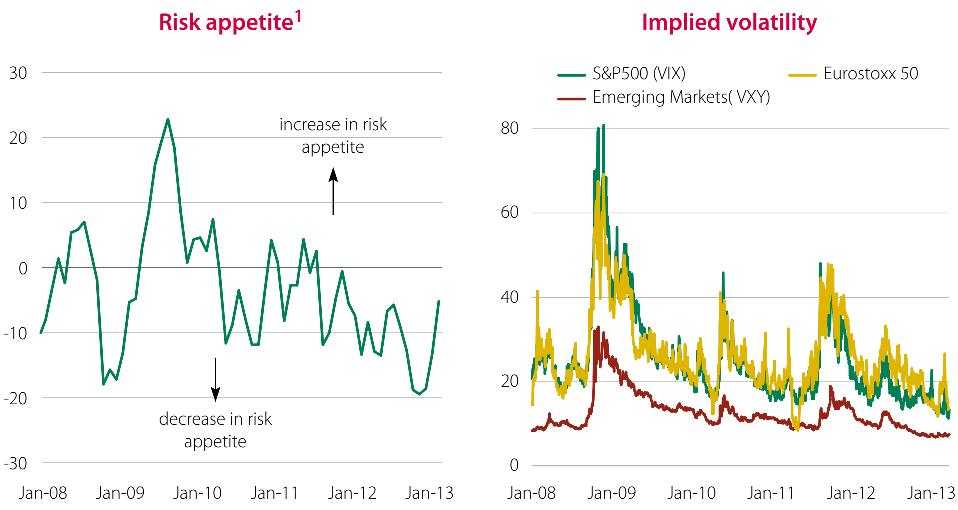
Source: Datastream.

1 In local currency.

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

Financial market indicators

FIGURE 8



Source: Thomson Datastream and CNMV.

1 State Street indicator.

2.2 National economic and financial developments

Spain's GDP contracts 0.8% in the fourth quarter of 2012, for a full-year decline of 1.4%,…

According to the latest Quarterly National Accounts data for the closing quarter of 2012, the national economy slowed by a further 0.5 points quarter on quarter to -0.8%, and by 0.3 points to 1.9% in year-on-year terms. On these results, real GDP contracted 1.4% in 2012, compared to the 0.4% growth of 2011. The activity stall was comparable to elsewhere in the euro area, where growth sank by 0.5 points to -0.6% quarter on quarter and by 0.3 points to -0.9% year on year.

…as more rapidly deteriorating domestic demand…

The steeper fourth-quarter decline in activity reflected the ailing state of domestic demand, which detracted 4.7 points from GDP growth (-4.0 points in the third quarter). The contraction moreover extended to all components. In particular, private consumption declined by 3% in year-on-year terms (-2.1% vs. the prior quarter), due in part to consumers bringing forward purchases ahead of the September hike in VAT. Government consumption, meantime, decelerated by an additional point to -4.1% year on year. Finally, gross fixed capital formation dropped 0.5 points for a year-on-year rate of -10.3%. The equipment component lost a further point to 7.9%, while construction investment, down 12.3%, managed to smooth its decline by one decimal point.

…cancels out the positive input from the net exports side.

Net exports went some way to offsetting the extractive effect of domestic demand, with a positive contribution of 2.8 points (2.4 points in the previous quarter). Improvement here traced to faster falling imports, down from -3.4% to -5.4% year on year, while exports slowed their advance by one point to 3.2%, in response to the growth stall in Spain's main export market, the European Union.

All supply-side sectors, except agriculture, hunting and forestry, lost ground in the closing quarter.

On the supply side, all sectors except agriculture, hunting and forestry, closed the fourth quarter in negative terrain. Industrial production slowed its rate of decline by 0.5 points to -2.9% year on year, but manufacturing industry contracted 0.2 points more than in the preceding quarter, as far as -3.6%. The decline in construction levelled off at -8.5%, improving 0.4 points on the previous quarter, and, finally, services shrank by a further 0.6 points to -1.2%. The largest decreases under this last head corresponded to financial and insurance activities, along with retail, transport, and hotels and catering. Finally, the primary sector, the only one in positive rates, saw growth decelerate 0.5 points to 1.9% in year-on-year terms.

Inflation rates have retreated from October highs thanks to lower energy taxes.

Spanish inflation spiked in October at 3.5%, due to hikes in VAT and tariff prices, and renewed pressures from the energy component, but has since eased back to a February rate of 2.8% (2.7% in January). Core inflation too reached an October peak of 2.5%, then fell to 2.1% in December, before creeping back to 2.3% in February 2013. Spain's inflation differential with the euro area, which was negative over the first half of 2012, closed completely in August and has since widened steadily to 1.1 points.

In the labour market, the year ended with employment down by 4.7% and the unemployment rate at 26%.

The latest figures on employment and joblessness confirm the parlous state of Spain's labour market. Employment, specifically, deteriorated by a further 0.1% as far as -4.7% year on year in the closing quarter (-4.4% in full-year 2012). This is equivalent to the net destruction of 805,000 jobs in one year. The unemployment rate climbed to 26% in the fourth quarter (25% in the third and 22.9% in the year-ago period), while the number of households with all members out of work rose by 258,700 to 1,833,700. Unit labour costs, finally, prolonged their descent (-3.4% in 2012) on higher productivity per worker (up by 3.2%) and a small decline in employee wages (-0.3%).

Spain: main macroeconomic variables (annual % change) TABLE 3

	2009	2010	2011	2012	IMF[1] 2013F	IMF[1] 2014F	EC[2] 2013F	EC[2] 2014F
GDP	**-3.7**	**-0.3**	**0.4**	**-1.4**	**-1.5**	**0.8**	**-1.4**	**0.8**
Private consumption	-3.8	0.7	-0.9	-2.2	-2.4	0.7	-2.7	-0.2
Government consumption	3.8	1.5	-0.5	-3.7	-5.5	-1.4	-5.4	-1.1
Gross fixed capital formation, of which:	-17.9	-6.2	-5.3	-9.1	-5.8	-1.3	-6.6	-1.0
Construction	-16.6	-9.8	-9.0	-11.5	-7.6	-1.2	n.a.	n.a.
Machinery and equipment	-23.6	2.7	2.4	-6.6	-4.2	-1.8	-3.0	0.1
Exports	-9.8	11.2	7.7	3.0	3.9	4.1	4.2	5.7
Imports	-16.8	9.3	-0.8	-5.0	-3.1	1.6	-3.8	2.0
Net exports (growth contribution, p.p.)	2.5	0.3	2.3	2.5	2.1	0.9	2.6	1.3
Employment[3]	**-6.3**	**-2.5**	**-1.7**	**-4.4**	**-2.4**	**1.6**	**-3.1**	**0.0**
Unemployment rate	**18.0**	**20.1**	**21.6**	**25.0**	**27.0**	**26.0**	**26.9**	**26.6**
Consumer price index	**-0.3**	**1.8**	**3.2**	**2.4**	**2.0**	**1.4**	**1.7**	**1.0**
Current account balance (% GDP)	**-4.8**	**-4.5**	**-3.5**	**-0.8**	**0.4**	**1.0**	**1.0**	**2.5**
General government balance (% GDP)[4]	**-11.2**	**-9.7**	**-9.4**	**-10.0**	**-6.4**	**-6.7**	**-6.7**	**-7.2**
Public debt (% GDP)	**53.9**	**61.5**	**69.3**	**83.9**	**93.2**	**98.7**	**95.8**	**101.0**
Net lending (+)/borrowing (-) vs. the rest of the world (% GDP)[5]	**-93.7**	**-88.9**	**-91.8**	**-92.9**	**-92.1**	**-88.8**	**n.a.**	**n.a.**

Source: Banco de España, IMF and National Statistics Office (INE).
1 IMF forecasts of January 2013.
2 European Commission forecasts of February 2013.
3 In full-time equivalent jobs.
4 Figures for 2011 and 2012 include government aid to credit institutions amounting to 0.5% and 3.3% of GDP respectively.
5 The net lending/borrowing position of 2012 corresponds to the IMF forecast of January 2013.
n.a.: not available.

The general government deficit closed at 10% of GDP, of which 3.3 points were aid to the financial sector.

According to provisional budgetary execution figures, the general government deficit, excluding aid to the financial sector, closed the year at 70.82 billion euros, 6.7% of GDP, improving on the previous year's 95.27 billion (9% of GDP), likewise discounting the said aid.[7] Breaking down the deficit figure by branch of government, we find the largest overspend in central government accounts (3.8% of GDP against 3% in 2011), followed by the autonomous communities (1.7% of GDP against 5% in 2011), local authorities (0.2% against 0.8% respectively) and Social Security (1% against 0.1%). Aid to financial institutions summed 3.3% of GDP in 2012 (0.5% in 2011), lifting the general government deficit as far as 10% (9.4% in 2011). Finally, general government debt swelled to 84.1% of GDP from 69.3% in 2011.[8]

7 In March, Eurostat, the EU statistics office, located Spain's general government deficit for 2012 at 6.98% of GDP excluding aid to the financial sector.

8 This 14.8 point increase in the 2012 public debt ratio responded mainly to the gap between expenditure and revenues (including interest expenses on public debt and aid to the financial sector), but other factors also intervened. Chief among them: i) the EFSM loan channelled through the FROB to recapitalise Group 1 credit institutions and provide capital to SAREB; ii) the Fund for the Financing of Payments to Suppliers (FFPP in its Spanish initials); iii) Spain's contribution to the European Financial Stability Facility (EFSF); iv) the issues of the Electricity Deficit Amortisation Fund (FADE in its Spanish initials); and, v) the 1.1% contraction in nominal GDP. It bears mention that the creation of the Regional Liquidity Fund (FLA in Spanish) will not add to the public debt, since the funds it raises for central government will be used to finance the redemption of autonomous community outstanding debt and cover their funding needs, thereby consolidating the cross-transfer of funds between central and regional government.

Exhibit 1: "Incorporation of the Asset Management Company for Assets Arising from Bank Restructuring (SAREB)"

SAREB was set up in November 2012 further to the memorandum of understanding on the provision of financial support to the Spanish banking system agreed between the Spanish and European authorities in July 2012.[1] Its corporate purpose is essentially the acquisition, efficient management and orderly disposal of the impaired real estate assets held by credit institutions in receipt of state aid, optimising their value while mitigating, as far as possible, their negative impact on Spanish economic agents.

SAREB has been incorporated as an unlisted public limited company under the supervision of the Banco de España, with a maximum duration of 15 years.[2] As regards financial structure, SAREB will draw its own funds from share capital and subordinated debt, but may also finance its activity through debt issues secured by the Spanish state.[3] This debt will be subscribed for by credit institutions with assets transferred to SAREB and will be eligible as collateral for ECB credit operations. SAREB debt will be tradeable on the AIAF fixed-income market.

The company's board of directors comprises fifteen members (five independent directors, four of them appointed by the FROB, and the remainder nominated by private investors), under a regime similar to that established for credit institution board members by Royal Decree 1245/1995. The same conditions will also apply to general managers and other senior executive officers. Its operations will be subject to the control of a series of committees, including a Monitoring Committee.

Given the difficulties of bringing SAREB's management capabilities up to steam in a relatively short time, the day-to-day management of the transferred assets will initially correspond to the transferring entities, who will nonetheless hold no discretionary powers in their respect. The corresponding services will then be progressively contracted out to providers selected by procurement.

Assets will be divested through bank asset funds (BAFs), which are separate blocks of assets, without legal personality, composed of the assets and liabilities transferred to them by SAREB. These BAFs may be organised into independent compartments and are authorised to issue securities or contract other obligations against the assets held in each. They must also register with the CNMV, and their management and representation must be entrusted exclusively to a securitisation fund manager which meets the requirements contained in Law 9/2012 and its implementing regulations, under the continuing supervision of the CNMV.

SAREB will be governed by the requirements of the Capital Enterprises Law as regards the drawing-up of annual accounts, but may not elect to file abridged financial statements. It will also prepare a business report every six months setting out the essential information related to its activities during this period, the extent to which the targets established in its business plan have been met and explanations for any deviations from those targets. It will send this report to the Banco de España and the SAREB Monitoring Committee, who may call for any supplementary disclosures they deem necessary. SAREB must also make all mandatory information regarding its annual accounts and management report publicly available.

The assets to be transferred to SAREB consist of foreclosed real estate assets with a net book value, after valuation adjustment, exceeding one hundred thousand euros, loans to property developers whose net book value exceeds two hundred and fifty thousand euros, and instruments representing the share capital of real estate sector companies which confer joint control or a significant influence. The FROB is also empowered to order the transfer of consumer or SME loans, home purchase mortgages and any assets whose degree of impairment could jeopardise the transferror's viability, following a report from the Banco de España. In this first phase, the value of the total assets transferred to SAREB cannot exceed 90 billion euros, though the door is left open to raise this limit subject to a favourable report from the FROB.

The Banco de España determines the transfer value of the assets acquired by the SAREB on the basis of their estimated economic value minus certain discounts.[4] These additional adjustments means the transfer prices set for SAREB acquisitions do not automatically stand as a valuation benchmark for the real estate assets of non-segregating financial institutions. The average transfer price estimated by Banco de España represents a discount of around 63% over the book value of the assets (79.5% for land, 63.2% for ongoing uncompleted developments and 54.2% for completed homes). In the case of funding to developers, the average discount will be a lower 45.6%, including adjustments of 32.4% for completed projects and 53.6% for loans granted to finance urban land.

On a conservative estimate, the SAREB is expected to obtain a return on equity (ROE) over its lifetime of an annual 14%. It has so far acquired assets from Group 1 banks with a gross book value of 71 billion euros, comprising 54 billion in developer loans and 17 billion in foreclosed properties.[5] In exchange, the transferring entities have received SAREB issued debt for the sum of 37 billion euros. The difference between this last amount, reflecting the cash value or transfer price of the assets taken on, and their gross carrying value produced a hole of 34 billion euros, which was filled through a 37 billion euro injection of public funds (via the FROB) borrowed from the European Financial Stability Mechanism (EFSM). Removing these problematic assets from bank balance sheets, including "doubtful" property developer loans, took a sizeable chunk from the December balance of bank non-performing loans (down 24 billion to 167 billion euros), lowering the NPL ratio by one full point to 10.4%.

1 SAREB was incorporated under Law 9/2012 of 14 November, on the restructuring and resolution of financial institutions and its implementing regulation, Royal Decree 1559/2012 of 15 November on the legal regime applying to asset management companies.

2 The state's participation (through the FROB) in SAREB's capital may at no point exceed 50%. The company, accordingly, is not consolidated in general government accounts, but appears in the category of non-monetary financial institution under "Other financial intermediaries" beside the likes of securitisation funds and broker-dealer firms.

3 To prepare it for receiving the impaired assets of Group 1 (nationalised banks) and Group 2 (banks with capital shortfalls unable to meet them without recourse to state aid), SAREB was set up with own funds of 4.80 billion euros, comprising 25% share capital (1.20 billion euros, 55% from private investors and

the rest from the FROB) and subordinated debt (3.60 billion in mandatorily convertible bonds, 54% placed with private investors and the rest acquired by the FROB). Own funds raised amount to 9.4% of the cash value of assets under management (51 billion euros).

4 Estimates of economic value start from the baseline scenario of the stress tests conducted by consultancy firm Oliver Wyman, completed in September 2012, which used a valuation horizon of two years. Discounts applied allow for the longer duration of the SAREB business plan (15 years), the market volatility of the transferred assets, the associated operating and interest expenses, discounts on block portfolio disposals, execution costs, the cost of recovering delinquent loans and general expenses.

5 The gross book value of the assets transferred to the SAREB by Group 2 entities stood at 20 billion euros in February 2013, compared to a transfer value of 14 billion euros. Their acquisition was financed through the issue of SAREB senior debt.

Spanish financial institutions in the thick of a restructuring process,…

The Spanish financial sector again had to fight on two fronts: the business weakness brought about by the stall in domestic activity and the broader process of sector recapitalisation and restructuring, which moved up a gear in June 2012 with the request for financial assistance from the EU. By year end, the financial institutions with the severest capital shortfalls, according to the stress tests run in summer 2012, had transferred impaired assets to the Asset Management Company for Assets Arising from Bank Restructuring (SAREB) for the amount of 51 billion euros (see exhibit 1). Of the capital shortfalls identified, summing 56 billion euros in the worst-case scenario, 39 billion correspond to state aid via the FROB's purchase of shares and subordinated debt.[9]

…characterised by hefty impairment losses on financial and non-financial assets…

Sector restructuring weighed on banks' income statements through 2012, as they provisioned heavily against impairment losses (on financial and, to a lesser extent, non-financial assets). The result was a sector-wide loss of almost 85 billion at the pre-tax profit line, despite minor improvement in gross operating income, up from 57 billion in 2011 to 59 billion at the 2012 close, and a two billion reduction in operating expenses to 27 billion euros. It seems likely, however, that sector income statements will now recover some of their lost form, with the system recapitalised and problematic assets taken off the balance sheets of ailing banks.

…and a sharp decline in lending to business and households.

Lending to non-financial private sectors tailed off increasingly through the second half of 2012 and first months of 2013,[10] with the January rate down to -5.3% year on year (-2.2% in January 2012). The finance reaching non-financial corporations shrank by 6.3%, while loans to households dropped by a lower 3.7%. In straight number terms, this equates to a 150 billion decrease in loans outstanding over full-year 2012. As regards the euro area, the latest data point to some contraction in consumer credit to business and households, albeit less so than in Spain, and some timid expansion in home purchase loans. Spanish non-financial corporations were again able to counter the dearth of bank finance by tapping capital markets, with a preference for fixed-income instruments. The result was year-on-year growth in outstanding debt securities of 13.5% to January 2013 (contrasting with an 8.5% decrease in bank credit).

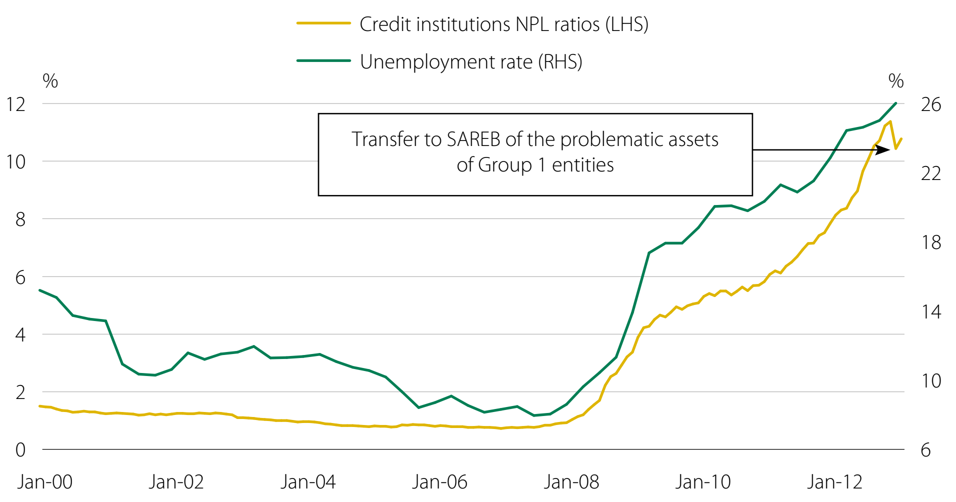
9 Remaining measures to make up the full amount of the shortfall, primarily those concerning the management of hybrid and subordinated debt instruments and private capital rising efforts, are set out in the IMF report Spain: *Financial Sector Reform – Second Progress Report*, of March 2013.

10 The figures referred to include loans transferred to the SAREB. This company's absorption of a large volume of private-sector loans make it a key actor in any analysis of the financing of the Spanish economy.

Financial sector NPL ratios fall 1% in December to 10.4% as problematic assets start being hived off to SAREB.

Credit institution NPL ratios rose 0.4 points in January to 10.8%. This followed a December dip on the first round of asset transfers to SAREB (see figure 9), with the ratio retreating one full point from its November peak of 11.4% (the highest level of the available historical series). Delinquent loans were again strongly linked to real estate and construction, with year-end ratios of 29.6% and 24.5% respectively, after a 1-2 point fall in the closing quarter reflecting their high profile in the SAREB transfer. Meantime, the NPL ratio of remaining productive activities rose 1.2 points in the same period to 8.7%. Non-performance in the household sector advanced to 4.9% in December 2012 (4.4% in September), with unsecured loans as the main locus (6.8% in September rising to 8.1% in December) ahead of mortgage loans (up by 0.3 points in the fourth quarter to 4.3%).

Credit institution NPL ratios and the unemployment rate[1] FIGURE 9



Source: Banco de España and INE. NPL ratios to January 2013, unemployment rate to December 2012.

1 % of the active population.

Debt issuance by Spanish financial institutions[1] FIGURE 10

Source: Dealogic.

1 Senior bonds and mortgage covered bonds. Floating-rate issues. The size of the bubble is proportional to the size of the issue.

Credit institution financing conditions were adversely impacted by financial market tensions over the first half of 2012. Banks, however, were able to cover their needs in reasonable comfort by taking up government guarantees for sector debt financing and stepping up their recourse to Eurosystem funding. Also, international debt markets have tentatively reopened for the entities in best repair, allowing in a significantly higher number and volume of unsecured issues at longer maturities and a lower cost.

Deposit-taking entities remain heavily dependent on Eurosystem funding, despite easier financing conditions.

The aggregate profits of non-financial listed companies dropped 45.4% in 2012 as far as 12.65 billion euros (see table 4), on the sluggish state of domestic activity. Much of this decline was down to retail and service companies, whose aggregate profits crashed by 51% to 4.63 billion euros, and the deepening losses of construction and real estate firms, which summed over 5.10 billion in the full-year period. The best performers in relative terms were energy companies, whose profits slipped by a bare 3%, while the aggregate profits of the industry sector dropped from 2.77 billion euros in 2011 to 2.47 billion in 2012.

The aggregate profits of non-financial listed corporations shrink by 45% in 2012…

Earnings by sector:[1] non-financial listed companies TABLE 4

	EBITDA[2]		EBIT[3]		Net profit	
Million euros	**2H11**	**2H12**	**2H11**	**2H12**	**2H11**	**2H12**
Energy	26,643	27,949	17,144	17,588	10,741	10,421
Industry	6,716	7,237	4,455	4,845	2,767	2,467
Retail and services	29,557	28,924	15,500	14,176	9,453	4,632
Construction and real estate	5,095	5,079	2,207	1,579	-166	-5,108
Adjustments	231	63	354	197	353	234
AGGREGATE TOTAL	**68,242**	**69,252**	**39,660**	**38,385**	**23,148**	**12,646**

Source: CNMV.

1 Year to date.

2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

The aggregate debt levels of non-financial listed companies decreased by 4.1% to 296.30 billion euros, of which 60% was lodged with construction and real estate operators and a further 37% with energy sector firms (see table 5). Aggregate leverage, meantime, edged down in the year from 1.44 to 1.40, with the reduction extending to all sectors except construction and real estate. Companies' debt coverage ratio, measuring the years needed to repay existing debt assuming constant EBITDA, held more or less flat at 4.3, while their interest cover (EBIT/interest expenses) worsened slightly between 2011 and 2012. The latter indicator deteriorated in all the sectors followed with the exception of industry, although ratios were at their lowest in construction and real estate.

…while their debt levels fall by 4.1% to 296 billion euros.

Gross debt by sector: listed companies

TABLE 5

Million euros		2008	2009	2010	2011	2012
Energy	Debt	82,608	100,572	98,283	95,853	91,233
	Debt/ Equity	0.89	1.08	0.95	0.92	0.85
	Debt/ EBITDA[1]	2.82	3.46	2.81	3.27	3.26
	EBIT[2]/ Interest expenses	3.67	3.38	4.15	3.30	3.14
Industry	Debt	15,645	15,953	14,948	17,586	16,836
	Debt/ Equity	0.69	0.69	0.58	0.63	0.62
	Debt/ EBITDA	2.71	3.05	2.11	2.54	2.33
	EBIT/ Interest expenses	3.41	3.15	5.00	3.90	3.98
Construction and real estate	Debt	119,788	104,762	99,917	83,716	76,213
	Debt/ Equity	3.77	4.08	3.42	2.98	3.50
	Debt/ EBITDA	31.87	22.48	11.18	15.00	15.01
	EBIT/ Interest expenses	0.01	0.31	0.98	0.52	0.33
Retail and services	Debt	112,322	108,579	115,413	113,142	113,466
	Debt/ Equity	2.14	1.78	1.60	2.01	1.99
	Debt/ EBITDA	3.58	3.70	3.38	3.78	3.92
	EBIT/ Interest expenses	2.86	3.28	3.94	2.45	2.06
Adjustments[3]	Debt	-20,802	-1,908	-1,792	-1,404	-1,378
AGGREGATE TOTAL	**Debt**	**309,561**	**327,958**	**326,769**	**308,893**	**296,320**
	Debt/ Equity	1.63	1.63	1.43	1.44	1.40
	Debt/ EBITDA	4.63	4.82	3.84	4.29	4.28
	EBIT/ Interest expenses	2.01	2.42	3.12	2.30	2.09

Source: CNMV.

1 Earnings before interest, taxes, depreciation and amortisation.

2 Earnings before interest and taxes.

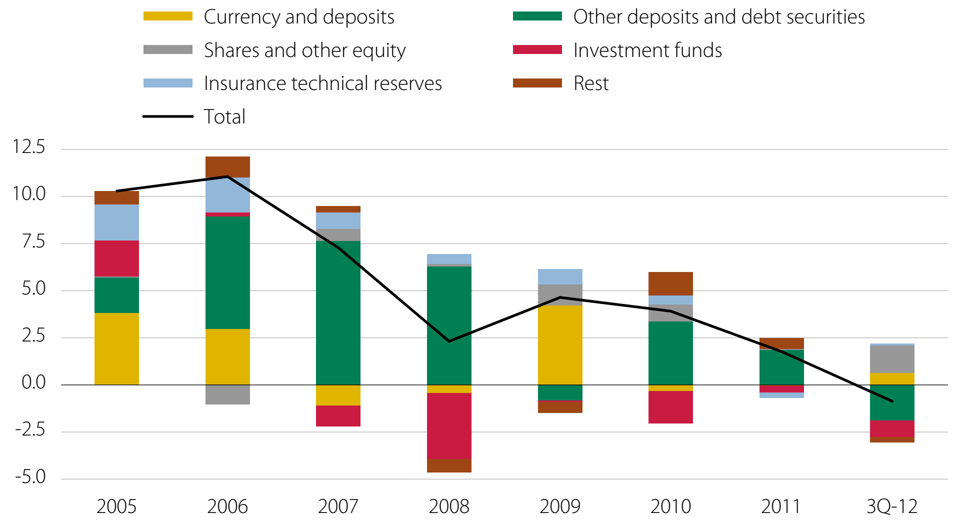
3 In drawing up this table, we eliminated the debt of issuers consolidating accounts with some other Spanish listed group. The figures in the adjustments row correspond to eliminations from subsidiary companies with their parent in another sector.

Households stabilise their debt but go on losing financial wealth. Last year's large outflows from deposits, debt instruments and investment funds have begun to level off.

Indicators for the third quarter of 2012 locate the indebtedness and financial burden of households at just over 120% and 15% respectively of disposable income. These essentially flat ratios are because household borrowings and income have fallen by a similar margin. Households' net financial wealth, meantime, continued in decline due to depreciating real estate. As regards investment decisions, the salient development has been the gathering tide of financial divestments, as far as 0.9% of GDP in the third-quarter period,[11] with the biggest disposals corresponding to time deposits, fixed-income instruments and investment funds. This trend, which marked a break with the investing customs of Spanish households (see figure below), has seemingly remitted in the closing months of 2012, to judge by the recovery in bank deposits.

11 Cumulative four-quarter data.

Households: financial asset acquisitions (% GDP) FIGURE 11



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

2.3 Outlook

In its latest forecasts, published in January, the IMF augurs global growth of 3.5% this year and 4.1% in 2014, back to more or less the rate of 2011. The advanced economies, it projects, will expand 1.4% this year, on a par with 2012, and 2.2% in 2014, while the emerging economies will manage a 5.5% advance in 2013 followed by 6% in 2014, just short of the 6.3% attained in 2011.

The IMF is forecasting world growth of 3.5% in 2013 and 4.1% in 2014…

The main risks for these projections remain tilted to the downside, despite the more robust state of international financial markets. In Europe, it would be premature to say that the sovereign debt crisis has been laid to rest, making it all the more necessary to complete the restructuring of the region's financial system and move ahead with integration projects like the banking and fiscal union. Fiscal consolidation is still a major near- and mid-term challenge that affects not only Europe but other advanced economies like Japan and the United States. The risks facing the emerging economies are of a different nature, though here too the task in hand for most countries is to adopt economic policies that rebalance growth and make them more resilient to possible domestic imbalances and global demand shocks.

…amid fears of renewed sovereign debt market tensions and with leading economies striving to fight back to fiscal health.

The IMF's July projections for the Spanish economy point to a slowdown in domestic activity extending to 1.5% in 2013, and a return to positive growth in 2014 of 0.8%. These estimates mark a minor revise-down over its previous forecasts of October 2012. Despite improved conditions on domestic financial markets in these past few months, the macro scenario remains hedged by uncertainty, given the state of the Spanish labour market and the need to let adjustment processes run their course (real estate sector, financial sector, deleveraging, etc.). In general, however, the reform and restructuring of the domestic banking system, and the government's deployment of less contractionary measures, without losing sight of fiscal targets, could alleviate the downside risks.

Activity in Spain will likely stay subdued in the coming quarters amid intense fiscal adjustment and bank sector restructuring.

Exhibit 2: "The shadow banking system: latest FSB recommendations"

Shadow banking has been defined as financial intermediation involving entities and activities outside the regular banking system. Such intermediation can be good for the economy in providing agents with a wider choice of investment and financing vehicles. But experience from the recent crisis has demonstrated the capacity of some non-bank entities and transactions to operate on a large scale in ways that create bank-like risks to financial stability. The increase in system risk associated with shadow banking lies not only in its direct but also indirect activity, through its web of connections with the banking sector. Yet shadow banking has never been the prime focus of prudential regulation, so has stayed unconstrained by the controls and conditions operating on entities and transactions in the regular banking sphere.

Further to the requests made by the G-20 at its summits in Seoul (2010) and Cannes (2011), the Financial Stability Board is working with other international bodies to draft a set of recommendations for the regulation and oversight of this activity in order to avoid and/or minimise latent risks. In the process, the FSB has pinpointed five areas where it believes policies are needed to mitigate the potential systemic risks associated with shadow banking:

i. To mitigate the spill-over effect between the regular banking system and the shadow banking system.

ii. To reduce the susceptibility of money market funds (MMFs) to "runs", i.e., a spate of investor withdrawals.

iii. To assess and mitigate systemic risks posed by entities other than money market funds working within the shadow banking system.

iv. To assess and align the incentives associated with securitisation.

v. To dampen risks and pro-cyclical incentives associated with secured financing contracts such as repos and securities lending.

Diverse institutions have analysed these five target areas and come up with their reports. On 18 November 2012, the FSB published two consultative documents[1] with a series of recommendations on regulating the entities that make up the shadow banking system (point iii) and repos and securities lending (point v). IOSCO, meantime, brought out recommendations last October and November relating to money market funds (point ii) and securitisation[2] (point IV) respectively, while the Basel Committee for Banking Supervision (BCBS) is working on its own recommendations addressing point i, which are due to be published this mid-year.

In its securitisation report, IOSCO issues a series of recommendations, drawn from its consultation with industry organizations, aimed at aligning incentives between stakeholders, building confidence in this kind of market and removing, where possible, impediments to cross-border activity. To this end, it proposes risk retention by the originator, already obligatory in some jurisdictions, as a central tenet of industry operation, and recommends enlarging and improving disclosure through, for instance, the conduct of regular stress tests on underlying assets, and a move towards the standardisation of securitisation products, along the lines initiated by the industry itself.

IOSCO has also published recommendations to improve the working of money market funds, in the light, particularly, of the massive outflows these funds have suffered in recent years. The first point it makes is that MMFs should be explicitly defined within the collective investment scheme universe, and in the corresponding regulations. The competent authorities are also urged to ensure that MMFs value their assets according to current market prices (rather than amortised cost) and maintain a minimum amount of liquid assets, with which they can face redemptions and thereby prevent fire sales.

In its section on the entities other than MMFs engaged in shadow banking, the FSB proposes classifying them by reference to five predefined economic functions (rather than their legal forms or names), so the competent authorities can set and enforce rules according to whether they belong to one or other group. All policies applied should, if necessary, be reformulated to provide international consistency in assessing their risks.

The FSB has also examined the risks posed by the securities lending and repo markets, and has drafted recommendations in their regard. In essence, these propose enhanced transparency, with reporting requirements binding on all agents; regulatory changes in respect of haircuts on transactions, which should be based on long-run risk, and the possibility of introducing floors on haircuts where there is material procyclicality risk; and structural market changes, including increased use of central counterparties and the reform of the bankruptcy law treatment of these transactions, in view of its difficult enforcement.

According to the timeline envisaged by the FSB, a full report containing final recommendations on the five target areas should be ready by September of this year.

1 *A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* (http://www.financialstabilityboard.org/publications/r_121118a.pdf) and *Policy Recommendations to Address Shadow Banking Risks in Securities Lending and Repos* (http://www.financialstabilityboard.org/publications/r_121118b.pdf).
2 *Policy Recommendations for Money Market Funds* (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD392.pdf) and *Global Developments in Securitisation Regulation* (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD394.pdf).

3 Spanish markets

3.1 Equity markets

Share prices rally as of end-July 2012 in a climate of improved liquidity and lesser volatility, but trading volumes remain thin.

Domestic equity markets have enjoyed a bull run since the end of July 2012 and the ECB's announcement of new measures to preserve the financial stability of the euro area, which cushioned them in part from the potentially adverse impact of the reform and restructuring of the Spanish financial system. Prices, moreover, have continued rising through the first quarter of 2013, though more haltingly at times of political uncertainty, especially in Italy. The year also started off with a robust improvement in market liquidity conditions and reduced levels of volatility, albeit with the persistence of the thin trading volumes that have dominated since the start of the crisis. The easing of financial market tensions also permitted the removal, on 1 February, of the short-selling ban in force since 23 July 2012.[12]

Rises have persisted through the first quarter of 2013 in most domestic stock indices …

The Ibex 35 advanced 5.5% in the first quarter of this year on the heels of the vigorous rally of August-December. These second-half gains, however, failed to offset the price slide of the opening months, leaving the index 4.7% in negative territory over full-year 2012 (see table 6). After ending last year with opposing fortunes, small and medium cap indices moved higher in the opening months, with the small cap index in the lead (gains of 11.9% and 5.7% in 2013 to date against -24.4% and 13.8 respectively in full-year 2012). Finally, the indices tracking the Latin American companies traded on domestic platforms performed unevenly in the first quarter, with the 2% fall in the FTSE Latibex All-Share contrasting with the 4.6% rise of the FTSE Latibex Top (-10.7% and -2.6% respectively in 2012).

…and sectors.

The first-quarter advance was headed by consumer services (17.5% after a 12.7% gain in 2012), followed by technology and telecommunications (11.5% after -18.3% in 2012), oil and energy (6.7% after -16%), basic materials, industry and construction and financial and real estate services (3.6% in both cases after -8% and -4.7% in 2012). Consumer goods was the only sector to lose ground in the opening quarter, slipping back 0.2% after the strong surge of 2012 (55.6%). Closer analysis shows that the sub-sectors performing most strongly in the first months of 2013 were transport and distribution (within consumer services), insurance (financial and real estate services), pharmaceutical products and biotechnology (consumer goods), telecommunications and others (technology and telecommunications) and oil (oil and energy), with gains ranging from 11% to 41%. Other sub-sectors too held in positive terrain, the exceptions being food and drink and clothing and footwear (consumer goods), real estate and others (financial and real estate services) and minerals, metals and metal processing (basic materials, industry and construction) albeit with falls in no case exceeding 5%.

The P/E of the Ibex 35 increases more slowly in the first months of 2013.

The price-earnings ratio[13] (P/E) of the Ibex 35 lost some of its momentum after advancing steadily through the second half of 2012, supported by the price rally of the third quarter and, in lesser measure, the fall in expected earnings. The more modest increase of the opening months was repeated on other advanced economy indices, conserving the Spanish index the midway slot in the international P/E ranking which it has occupied since the third quarter of 2012. By March, specifically, the Ibex 35 multiple was at 12.1 times, compared to the 11.7 of last year's close and the 9.2 of year-end 2011.

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12 For more information, see www.cnmv.es

13 On one-year forward earnings.

Performance of Spanish stock market indices and sector TABLE 6

%							1Q 13 (to 15 March)		
Index	**2009**	**2010**	**2011**	**2012**	**3Q 12[1]**	**4Q 12[1]**	**% prior qt.**	**% Dec**	**% y/y**
Ibex 35	29.8	-17.4	-13.1	-4.7	8.5	6.0	5.5	5.5	2.3
Madrid	27.2	-19.2	-14.6	-3.8	8.2	6.1	5.7	5.7	2.7
Ibex Medium Cap	13.8	-5.6	-20.7	13.8	4.0	12.6	5.7	5.7	10.1
Ibex Small Cap	17.6	-18.3	-25.1	-24.4	11.0	-6.0	11.9	11.9	-10.7
FTSE Latibex All-Share	97.2	9.0	-23.3	-10.7	2.6	-6.7	-2.0	-2.0	-21.1
FTSE Latibex Top	79.3	9.7	-17.1	-2.6	-1.2	-2.9	4.6	4.6	-11.6
Sector[2]									
Financial and real estate services	**47.3**	**-31.7**	**-18.9**	**-4.7**	**11.5**	**5.4**	**3.6**	**3.6**	**-2.1**
Banks	50.0	-33.1	-20.3	-4.8	11.2	5.0	3.3	3.3	-2.5
Insurance	18.9	-26.4	12.5	-2.0	27.8	8.5	17.9	17.9	10.3
Real estate and others	-31.8	-53.3	-47.5	-14.4	36.5	31.7	-3.0	-3.0	0.3
Oil and energy	**-2.7**	**-8.6**	**-2.7**	**-16.0**	**5.8**	**10.6**	**6.7**	**6.7**	**-0.3**
Oil	12.4	10.2	14.9	-35.4	19.4	1.6	11.9	11.9	-10.5
Electricity and gas	-8.4	-14.2	-10.8	-5.4	0.1	15.2	4.5	4.5	4.0
Basic materials, industry and construction	**22.5**	**-15.2**	**-14.3**	**-8.0**	**4.6**	**8.8**	**3.6**	**3.6**	**-2.9**
Construction	17.7	-14.9	-6.9	-9.3	4.0	14.6	3.0	3.0	-1.6
Manufacture and assembly of capital goods	9.9	-29.2	-12.2	-8.8	4.7	6.7	2.1	2.1	-0.4
Minerals, metals and metal processing	36.4	-9.1	-33.7	-8.7	-0.6	3.2	-2.7	-2.7	-18.8
Engineering and others	92.7	-0.1	-29.0	3.8	14.5	-4.8	5.2	5.2	2.1
Technology and telecommunications	**22.8**	**-12.8**	**-20.9**	**-18.3**	**1.1**	**-0.3**	**11.5**	**11.5**	**-5.7**
Telecommunications and others	23.3	-12.8	-20.8	-23.0	0.1	-1.5	12.4	12.4	-9.1
Electronics and software	3.0	-12.0	-21.3	39.4	7.7	7.9	6.0	6.0	29.6
Consumer goods	**26.3**	**17.0**	**5.7**	**55.6**	**16.5**	**9.1**	**-0.2**	**-0.2**	**40.3**
Textiles, clothing and footwear	38.3	28.6	12.7	66.2	18.5	9.1	-3.0	-3.0	45.4
Food and drink	7.0	25.3	-6.3	25.0	7.0	12.2	-4.1	-4.1	12.6
Pharmaceutical products and biotechnology	14.5	-22.2	-7.3	68.3	23.1	4.4	14.8	14.8	60.6
Consumer services	**32.3**	**-0.1**	**-24.2**	**12.7**	**2.4**	**13.0**	**17.5**	**17.5**	**19.0**
Motorways and car parks	36.2	-10.1	-3.7	5.7	7.6	8.5	8.0	8.0	8.8
Transport and distribution	3.8	55.3	-34.9	29.7	-4.9	20.2	40.2	40.2	49.8

Source: BME and Thomson Datastream.

1 Change vs. previous quarter.

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

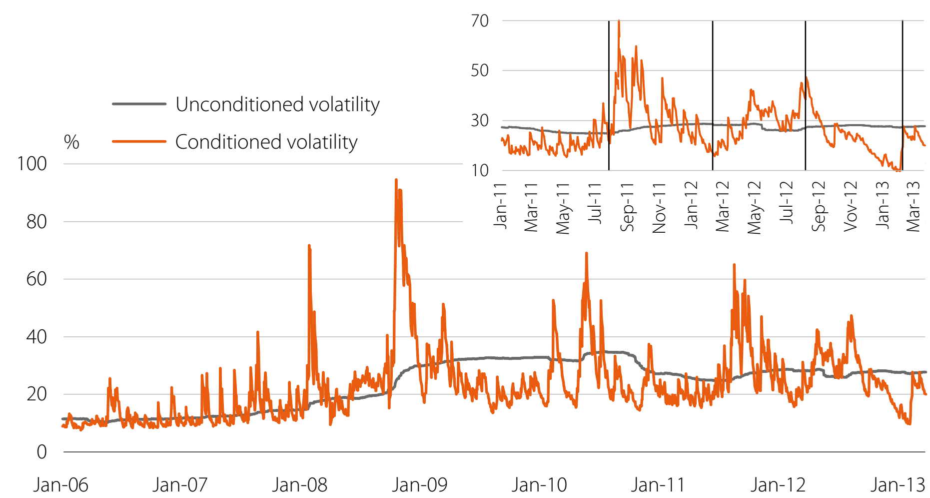
The earnings yield gap stabilises after a third-quarter fall.

The earnings yield gap, which reflects the return premium required to be invested in equity versus long-term government bonds, has held more or less flat since the last quarter of 2012, after narrowing sharply in the third quarter on an escalating P/E ratio and the steeply falling yields of the long-term Spanish bond. The result was a mid-March gap of 3.4, ahead of the 3.3 of the 2012 close but well below the 5.2 of June that year, and not far off its historical average since 1999 (3.2).

Market volatility retreats from the highs of mid-2012…

Ibex 35 volatility was choppier in the first months of 2013 after last year's descent from the highs of late July (when it was testing 50%), but remained low by historical standards at just over 20%.

Historical volatility of the Ibex 35 FIGURE 12

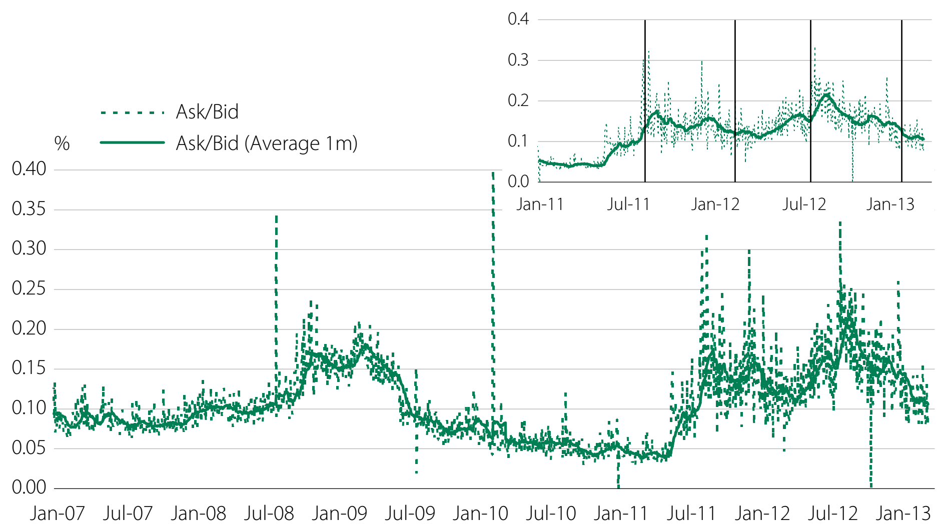


Source: Thomson Datastream and CNMV. Data to 15 March. The vertical lines in the enlarged figure refer respectively to the introduction and lifting of the previous short-selling ban on 11 August 2011 and 16 February 2012 respectively, and the new ban starting on 23 July 2012 and ending on 1 February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

…and liquidity conditions pick up strongly.

The liquidity conditions of the Ibex 35 (measured through the bid/ask spread) resumed the improvement path of last September-October, after the interruption of the closing months (see figure 13). The year's more settled mood was reflected in a March spread of 0.11%, in line with the average recorded since the series was begun in 2003, and comfortably below both the 0.15% of end-2012 and the 0.21% of August that year.

Ibex 35 liquidity. Bid-ask spread FIGURE 13

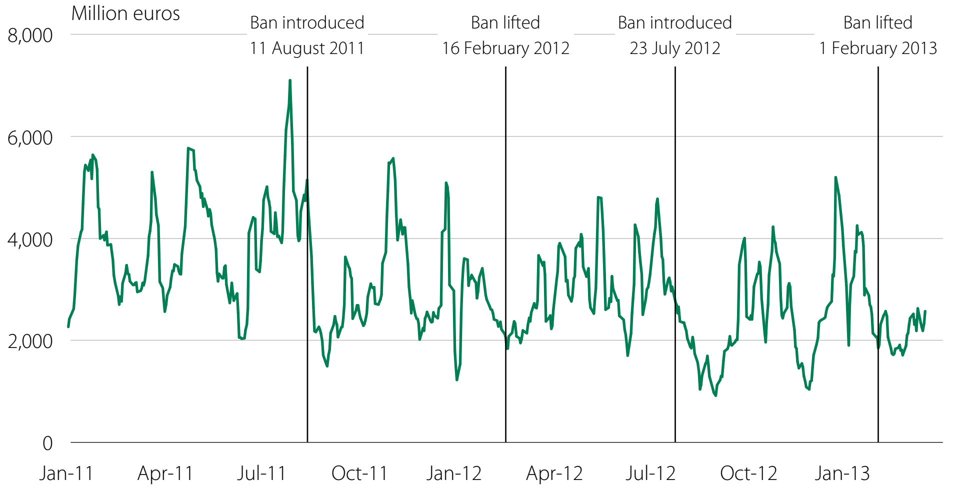


Source: Thomson Datastream and CNMV. Data to 15 March. The vertical lines in the enlarged figure refer respectively to the introduction and lifting of the previous short-selling ban on 11 August 2011 and 16 February 2012 respectively, and the new ban starting on 23 July 2012 and ending on 1 February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

The Spanish stock market registered a trading volume of 138.67 billion euros in the first three months of 2013 (to 15 March), 4.3% less than in the same period last year (see table 7). Average daily volume, at 2.62 billion, was higher than last year's second-half average (2.26 billion) but lower than in the first six months (2.96 billion). As we can see from figure 14, market trading volumes shrank for a period of around twenty trading days following the entry of the short-selling ban, and rebounded in the seven sessions after it was lifted.[14] Overall, however, trading volumes on Spanish stock markets reached their lowest point since the onset of the crisis.[15]

Trading on Spanish stock markets remains thin by historical standards.

Daily trading on the Spanish stock market[1] FIGURE 14



Source: CNMV. Data to 15 March 2013.

1 Moving average of five trading days.

Equity issuance on domestic markets surged by 57% to 4.99 billion euros compared to the first three months of 2012 (see table 8). Note, however, that the capital raised this year to date is inflated by the FROB's recapitalisation and subsequent sale of a credit institution, while last year's first-quarter figure included the merger by takeover of one entity by another (36% of the total), a capital increase by a medium-sized bank (28%) and a subscription offer of shares addressing the holders of certain preference shares and subordinated debt instruments issued by another medium-sized bank (27%).

Equity issuance expanded strongly in the first quarter of 2013 on transactions derived from the bank sector restructuring process.

14 For a fuller analysis of how the short-selling restrictions deployed since 2011 have affected euro-area stock markets, see the article by Carlos Aparicio Roqueiro "Empirical study on the bans on short selling in Europe in 2011 and 2012", in this Bulletin.

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

Turnover on the Spanish stock market

TABLE 7

Million euros

	2009	2010	2011	2012	3Q 12	4Q 12	1Q 13[1]
All exchanges	**886,135**	**1,037,284**	**925,667**	**667,443**	**153,483**	**138,303**	**138,674**
Electronic market	880,544	1,032,447	920,879	663,076	152,438	137,463	137,516
Open outcry	73	165	48	40	8	8	5
of which SICAVs[2]	20	8	6	0	0	0	0
MAB[3]	5,080	4,148	4,380	4,025	947	755	1,070
Second Market	3	3	2	0	0	0	0
Latibex	435	521	358	302	90	77	84
Pro memoria: non-resident trading (% all exchanges)							
	64.5	75.3	81.3	n.a.	n.a.	n.a.	n.a.

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

1 Cumulative data from 1 January to 15 March.

2 Open-end investment companies.

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

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

Capital increases and public offerings[1]

TABLE 8

	2009	2010	2011	2012	3Q 12	4Q 12	1Q 13[2]
CASH AMOUNTS[3] (million euros)	**11,391**	**16,017**	**17,146**	**21,142**	**5,695**	**6,962**	**4,988**
Capital increases	11,389	15,407	17,019	19,911	5,291	6,186	4,988
Of which, through POS	17	959	6,239	2,457	75	0	0
National tranche	15	62	5,827	2,457	75	0	0
International tranche	2	897	412	0	0	0	0
Public offering of shares	2	610	127	1,231	405	776	0
National tranche	2	79	125	1,231	405	776	0
International tranche	0	530	2	0	0	0	0
NUMBER OF FILINGS[4]	**53**	**69**	**92**	**105**	**27**	**30**	**26**
Capital increases	53	67	91	103	26	29	26
Of which, through POS	2	12	8	7	1	0	0
Of which, bonus issues	11	15	22	22	10	4	9
Public offering of shares	1	3	2	3	1	1	0

Source: CNMV.

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

2 Data to 15 March.

3 Excluding amounts recorded in respect of cancelled transactions.

4 Including all transactions registered, whether or not they eventually went ahead.

Exhibit 3: "Amended legislation on prospectuses and transparency requirements for the issuers of securities"

Royal Decree 1698/2012 of 31 December amending the legislation on prospectuses and transparency requirements in relation to the issuance of securities rounds off the transposition of Directive 2010/73/EU, till now only partly written into Spanish law. As the legislator affirms in the preamble to this latest text, its purpose is to reduce the administrative burden involved in publishing an issue prospectus, while modernising and improving part of the applicable rules.

Main novelties are as follows:

– Revision of some of the thresholds determining when an offer is a public offer, with the result that a prospectus is no longer mandatory in the following cases:

  a) When the denomination per unit of the securities or minimum amount per investor is at least 100,000 euros (previously 50,000 euros).

  b) When the number of persons to whom the offer is addressed is no more than 150 (previously 100 persons).

  c) When the offer's total consideration is no more than five million euros (previously 2,500,000 euros) calculated over a twelve-month period.

– The resale of securities carried out through financial intermediaries will be exempt from the obligation to publish an additional prospectus, provided that a valid prospectus is already available to the public and the issuer or party responsible has consented in writing to its use.

– A prospectus will be valid from the date it is filed with the CNMV rather than the date it is published. Also, an electronic version must be made available on the issuer's website.

– The concept of key information is given legal definition as the essential information, appropriately structured, that must be provided to investors so they understand the nature and risks of the issuer, the guarantor and the securities that are being offered or admitted to trading on a regulated market. Also, the definition of qualified investor is recast to align it with the definition of professional investor as per the Markets in Financial Instruments Directive (MiFID).

– A series of provisions affect the summary of the prospectus. First, this document is given a specific, harmonised format, and brought within the key information requirement set out above. Second, a summary can be dispensed with in the admission to trading of non-equity securities whose denomination per unit is higher than 100,000 euros. Finally, whoever applies for the securities to be admitted to trading on Spanish secondary markets must translate the summary into Spanish when the full prospectus is not in that language.

– Two new conditions refer to the final terms issued under a base prospectus. On the one hand, issuers must communicate the final terms of passported propectuses to the competent authority of the host Member State. On the other, issuers of commercial paper with a maximum maturity of 12 months will not have to present final terms for each offering or admission to listing.

The reform of EU legislation on the prospectus for public offerings of securities and their admission to trading was also advanced by Commission Delegated Regulation 486/2012 of 30 March 2012 amending the Prospectus Regulation and in force since 1 July 2012. Among its innovations, we can single out the introduction of a proportionate disclosure schedule for certain operations, and a template for the "form of final terms".

3.2 Fixed-income markets

Domestic debt market tensions abate in the closing months,…

The tensions rending domestic financial markets over the middle months of 2012 have abated since the third quarter on the ECB's announcement of a new secondary market bond-buying programme,[16] the headway made in recapitalising and restructuring Spain's financial system, and the upkeep of the country's fiscal consolidation drive. This calmer mood has permitted: (i) a run-down in yields of public and private debt securities, (ii) declining risk premiums in both sectors of the economy, (iii) an upswing in government bond turnover in secondary markets, and (iv) a sizeable increase in government debt holdings in non-resident hands. Another result has been the visible uncoupling between price movements in public sector financial instruments and those issued by the banks.

…permitting a run-down in public and private debt yields in both short…

Against this backdrop, short-term Treasury bill rates closed the year at 1.1%, 1.7% and 2.2% in three, six and twelve-months tenors respectively, then went on falling as far as March averages of 0.3%, 0.9% and 1.4% (see table 9). In contrast to the second half of 2012, when 12-month rates fell at a significantly greater speed, this first-quarter decline was more evenly paced across different maturities, in the range of 76 bp to 88 bp. Commercial paper yields, after holding relatively steady through the closing months of 2012, headed abruptly lower in 2013, with falls of between 138 bp in the three-month maturity and 190 bp at twelve months.

…and long maturities…

Long government bond yields have come down substantially after peaking last July above 7% at the height of market turbulence. As we can see from table 10, three, five and ten-year yields recorded March averages of 2.8%, 3.6% and 4.9% respectively, substantially below the equivalent levels at the 2010, 2011 and 2012 close. Long-term corporate bond yields traced a similar course as far as 3.2%, 4.1% and 6.8% respectively in March 2013, a good 270 bp away from their mid-2012 highs.

16 This programme, involving what are known as outright monetary transactions (OMTs), focuses on the shorter part of the yield curve, particularly maturities of between one and three years, and is predicated on an application from the government to the appropriate European financial assistance mechanism (see http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html).

Short-term interest rates[1]

TABLE 9

%	Dec 10	Dec 11	Dec 12	Sep 12	Dec 12	Mar 13[3]
Letras del Tesoro						
3 month	1.60	2.20	1.14	0.93	1.14	0.33
6 month	2.71	3.47	1.68	1.74	1.68	0.92
12 month	3.09	3.27	2.23	2.52	2.23	1.35
Commercial paper[2]						
3 month	1.37	2.74	2.83	2.85	2.83	1.45
6 month	2.52	3.52	3.58	3.56	3.58	1.75
12 month	3.04	3.77	3.80	3.69	3.80	1.90

Source: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Interest rates at issue.

3 Data to 15 March.

Medium and long corporate bond yields[1]

TABLE 10

%	Dec 10	Dec 11	Dec 12	Sep 12	Dec 12	Mar 13[2]
Government bonds						
3 year	3.87	4.01	3.40	3.88	3.40	2.78
5 year	4.65	4.65	4.22	4.84	4.22	3.60
10 year	5.38	5.50	5.33	5.92	5.33	4.90
Corporate bonds						
3 year	4.31	5.63	3.76	5.32	3.76	3.19
5 year	5.44	6.35	4.71	6.47	4.71	4.07
10 year	6.42	9.24	7.70	9.13	7.70	6.79

Source: Thomson Datastream, Reuters and CNMV.

1 Monthly average of daily data.

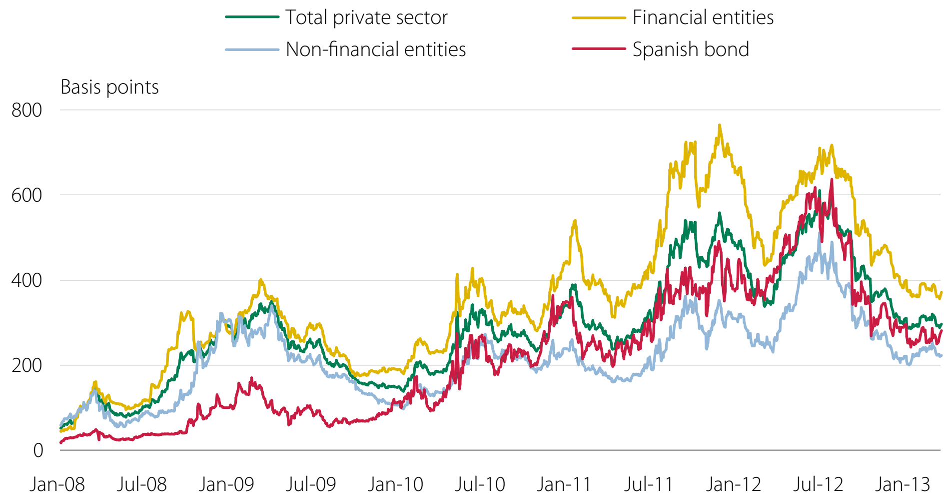
2 Data to 15 March.

…and taking much of the heat off sovereign risk premiums in a context of less contagion.

On this performance, Spain's sovereign risk premium, as derived from 5-year CDS, pulled steadily back from its end-July peak of 640 bp to a year-end level of 300 bp and onto 270 bp in mid-March (see figure 15). Meantime, the ten-year Spanish/German spread narrowed from close to 635 bp in late July to 396 bp at end-December 2012 and 344 bp in mid-March 2013. This lesser perception of sovereign risk extended across Europe, accompanied by a notable downturn in indicators of credit risk contagion from more vulnerable to more solid economies (see figure 5).

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

FIGURE 15



Source: Thomson Datastream and CNMV.

1 Simple average. Data to 15 March.

There is evidence too of some uncoupling between the price movements of Spanish government bonds and shares.

Private sector risk spreads tended to mirror the progress of their sovereign equivalents in 2012 and the first months of 2013, with a sharp ascent to the month of July giving way to a sustained easing movement. As figure 15 shows, the average CDS spreads of corporate issuers, which in normal market circumstances exceed those of public debt, held at comparable levels over the period of greatest tension due to the contemporaneous spike in bank sector risk premiums. Specifically, the CDS spreads of Spanish private-sector issuers retreated from end-July highs of over 600 bp to 300 bp in mid-March 2013. Between these same dates, the average CDS spreads of Spanish banks dropped from over 700 bp to approaching 370 bp, while those of financial corporations fell from around 500 bp to just over 220 bp. This decline in the credit spreads of the various sectors of the Spanish economy was accompanied from August onwards by a loosening correlation between the price movements of Spanish government bonds and shares (see figure 16).

Primary market activity also moved up a gear in the latter half of 2012,…

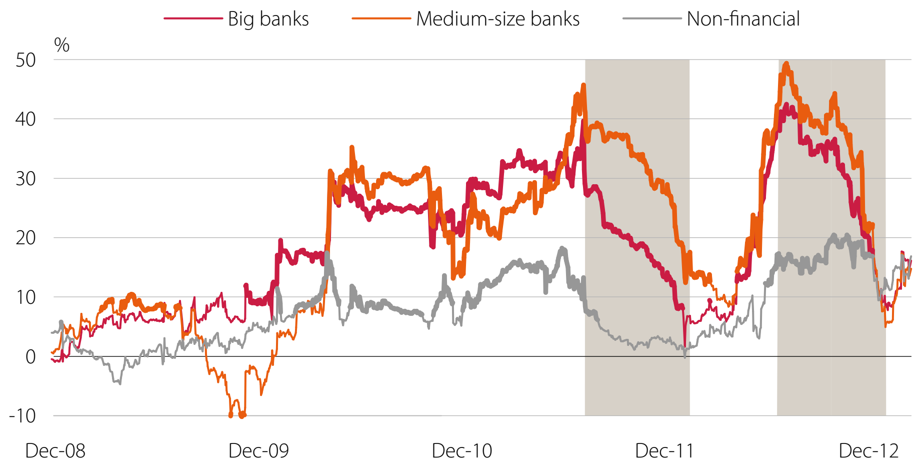
Spain's financial corporations, banks especially, have taken advantage of the second-half decline and subsequent stabilisation in market tensions to resume issuance of marketable debt securities and simultaneously scale down their net Eurosystem borrowings. The gross volume of fixed-income issues registered with the CNMV in 2012 came to 357.83 billion euros, 23.8% more than in 2011. This advance, which brought issuance close to 2009 levels, was driven by increased placements of government-backed non-convertible bonds, mortgage covered bonds and commercial paper, offsetting the decline in issuance of asset-backed securities.

…but has tapered off in the opening months of 2013, on more modest sales of commercial paper and mortgage covered bonds.

This year, however, the issuance spurt has been running out of steam, with gross sales in the first three months down 60% versus the year-ago period to 40.58 billion euros. Leading the year-on-year decline were commercial paper and mortgage covered bonds, down by 78% and 60% respectively to 9.03 and 8.19 billion euros (22% and 20% of the year-to-date total). The other big drop was in convertible bonds, down by 62% to 425 million euros, though their weight in the total is relatively small.

Correlation between returns on national government bonds and shares[1,2,3]

FIGURE 16



Source: Thomson Datastream and CNMV.

1 Ordinary least square (OLS) estimates are run on each portfolio, in rolling six-month windows, where the left side of the equation is the return (log) of the share portfolio and the right side the return (log) of the Eurostoxx 300 and that of a portfolio long in national government bonds and short in German bonds (Iboxx indices). The coefficient corresponding to the government bond portfolio is multiplied by the standard deviation of the return on this portfolio during the estimation period, and divided by the standard deviation in the same period of the return on the corresponding portfolio of shares.
2 The shaded area represents the period when the short-selling ban was in force in Spain.
3 The line of each correlation indicator alternates between thick and fine. A thick line means we cannot rule out that the regression coefficient for the variable representing the inverted spread was significantly different from zero to 10% over the period in question.

Non-convertible bond sales are also down to a lesser extent, the majority carrying a state guarantee.

Sales of non-convertible bonds fell by a lower 42%, in year-on-year terms, to 15.56 billion euros, equivalent to 38% of the total amount (29% in the first quarter of 2012 and 24% in the full-year period). Almost all non-convertible issues in last year's closing quarter and the first quarter of 2013 comprised government-backed securities issued by "bad bank" SAREB against the receipt of assets from Group 1 and Group 2 entities. Government-backed bonds were also prominent in the issuance mix of 1Q 2012, except then their use was primarily as collateral in bank sector funding operations with the ECB.

Securitisation markets remain notably lethargic.

Asset-backed securities, meantime, raised 7.38 billion euros (18% of total issuance, against 7% in 2012). This was 20% less than one year ago, reflecting the still depressed state of securitisation markets. No issues were reported of either preference shares (repeating the zero issuance of 1Q 2011) or territorial covered bonds (2.50 billion in 1Q 2011).

Foreign debt financing decreases in the year, with short-term instruments leading the decline.

Foreign debt financing by domestic institutions dropped to just over 92 billion euros, 23.2% less than in 2011 (see table 11). This decline was entirely due to lower sales of short-term paper, whilst long-term issues remained notably dynamic (54.7% of total 2012 issuance against 42.8% one year before).

Gross fixed-income issues

TABLE 11

filed[1] with the CNMV	2009	2010	2011	2012	2012 3Q	2012 4Q	2013 1Q[2]
NUMBER OF ISSUES	**512**	**349**	**353**	**334**	**48**	**69**	**53**
Mortgage bonds	75	88	115	94	27	18	14
Territorial bonds	1	9	42	18	2	0	0
Non-convertible bonds and debentures	244	154	87	134	13	23	24
Convertible/exchangeable bonds and debentures	6	3	9	7	0	2	3
Asset-backed securities	76	36	45	35	1	17	10
Commercial paper facilities	73	59	53	46	5	9	2
Securitised	2	2	2	1	0	1	0
Other commercial paper	71	57	51	45	5	8	2
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	37	0	2	0	0	0	0
NOMINAL AMOUNT (million euros)	**387,476**	**226,449**	**288,992**	**357,830**	**60,680**	**84,904**	**40,585**
Mortgage bonds	35,574	34,378	67,227	102,170	29,800	13,020	8,195
Territorial bonds	500	5,900	22,334	8,974	1,674	0	0
Non-convertible bonds and debentures	62,249	24,356	20,192	86,442	91	39,815	15,562
Convertible/exchangeable bonds and debentures	3,200	968	7,126	3,563	0	843	425
Asset-backed securities	81,651	63,261	68,413	23,800	1,884	11,185	7,377
Domestic tranche	77,289	62,743	63,456	20,627	1,884	9,398	6,854
International tranche	4,362	518	4,957	3,173	0	1,788	523
Commercial paper[3]	191,342	97,586	103,501	132,882	27,230	20,041	9,026
Securitised	4,758	5,057	2,366	1,821	275	300	180
Other commercial paper	186,583	92,529	101,135	131,061	26,955	19,741	8,846
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	12,960	0	200	0	0	0	0
Pro memoria:							
Subordinated issues	20,989	9,154	29,199	7,633	581	2,492	1,422
Covered issues	4,794	299	10	0	0	0	0

abroad by Spanish issuers	2009	2010	2011	2012	2012 3Q	2012 4Q	2013 1Q[4]
NOMINAL AMOUNT (million euros)	**149,686**	**127,731**	**120,043**	**92,083**	**17,330**	**20,100**	**8,800**
Long-term	47,230	51,107	51,365	50,353	10,783	13,164	7,909
Preference shares	3,765	0	0	0	0	0	0
Subordinated debt	2,061	0	242	307	0	0	0
Bonds and debentures	41,404	50,807	51,123	50,046	10,783	13,164	7,909
Asset-backed securities	0	300	0	0	0	0	0
Short-term	102,456	76,624	68,677	41,730	6,547	6,936	891
Commercial paper	102,456	76,624	68,677	41,730	6,547	6,936	891
Securitised	108	248	322	11,590	2,756	1,695	-

Source: CNMV and Banco de España.

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

2 Data to 15 March.

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

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

4 Market agents

4.1 Investment vehicles

Financial UCITS[17]

Investment fund assets shrink by 6.3% to 124 billion euros as the redemption drain continues.

Assets under management in mutual funds dropped 6.3% in 2012 to just over 124 billion euros, their lowest level since the second half of the 1990s. This annual outflow, exceeding 8.30 billion euros, had its origin exclusively in unit-holder redemptions (11.50 billion in the year), while portfolio returns were a positive 5.5% (see table 13). Over 80% of the shrinkage, moreover, took place in the second quarter, as mounting financial market tensions provoked a flight of savings from the industry while eroding the value of portfolio investments. By category, the decline was steepest among fixed-income funds (6.28 billion euros), guaranteed equity funds (3.60 billion) and, in smaller measure, absolute return funds (1.39 billion). The only categories recording net inflows on any scale, and fitfully at that, were guaranteed fixed-income and passively managed funds.

Net investment fund subscriptions TABLE 12

				2012			
Million euros	2010	2011	2012	1Q	2Q	3Q	4Q
Total investment funds	**-25,580.9**	**-10,839.0**	**-11,495.4**	**-1,652.3**	**-3,095.8**	**-3,176.6**	**-3,570.7**
Fixed income[1]	-27,150.0	-10,427.7	-5,662.5	-726.9	-1,781.3	-1,880.9	-1,273.4
Balanced fixed income[2]	-1,416.9	-1,925.7	-651.6	-237.9	-123.6	-173.6	-116.5
Balanced equity[3]	-90.1	-320.5	-281.6	-134.0	-26.0	-68.3	-53.3
Euro equity [4]	-696.9	152.0	-109.7	-151.5	67.8	-2.1	-23.9
International equity[5]	1,151.9	-817.6	-370.2	-14.0	-113.8	-55.9	-186.5
Guaranteed fixed-income guaranteed	4,716.0	7,228.3	-334.5	584.1	-2.6	58.5	-974.5
Guaranteed equity[6]	-2,500.1	-3,061.6	-3,353.1	-731.6	-700.6	-805.1	-1,115.8
Global funds	323.7	945.3	-7.8	157.9	-72.1	-101.1	7.5
Passively managed[7]	-790.3	-274.5	572.1	29.3	114.6	67.8	360.4
Absolute return[7]	871.8	-2,337.0	-1,296.5	-427.7	-458.2	-215.9	-194.7

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.

Further decline too in the number of funds registered …

Fund numbers continued to dwindle throughout 2012, which closed with 2,185 schemes in operation compared to 2,310 at end-2011. The reduction was greatest in those categories suffering the highest outflows, namely fixed income (54) and guaranteed equity (59), while growth was confined, by the same token, to guaranteed fixed income and passively managed funds.

17 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	2010	2011	2012	2012 1Q	2012 2Q	2012 3Q	2012 4Q
Total investment funds	**2,408**	**2,310**	**2,185**	**2,300**	**2,255**	**2,197**	**2,185**
Fixed income[1]	537	508	454	491	479	459	454
Balanced fixed income[2]	160	140	125	140	132	128	125
Balanced equity[3]	138	128	117	130	122	119	117
Euro equity[4]	172	148	127	143	135	129	127
International equity[5]	232	220	211	222	220	214	211
Guaranteed fixed-income	276	351	398	375	385	393	398
Guaranteed equity[6]	499	420	361	404	384	369	361
Global funds	192	203	192	200	198	194	192
Passively managed[7]	61	59	85	64	75	75	85
Absolute return[7]	141	133	115	131	125	117	115
Assets (million euros)							
Total investment funds	**143,918.2**	**132,368.6**	**124,039.9**	**131,994.5**	**125,120.7**	**125,108.2**	**124,039.9**
Fixed income[1]	56,614.6	46,945.5	40,664.6	45,101.8	42,837.8	41,512.2	40,664.6
Balanced fixed income[2]	7,319.0	5,253.6	5,500.9	5,686.9	5,430.9	5,512.9	5,500.9
Balanced equity[3]	3,470.5	2,906.1	3,179.9	3,234.2	3,040.3	3,116.2	3,179.9
Euro equity[4]	5,356.8	4,829.2	5,270.2	4,815.6	4,516.5	4,891.7	5,270.2
International equity[5]	8,037.3	6,281.2	6,615.0	6,813.2	6,373.7	6,663.2	6,615.0
Guaranteed fixed-income	26,180.2	35,058.0	36,445.0	36,677.0	35,421.7	36,489.9	36,445.0
Guaranteed equity[6]	22,046.5	18,014.5	14,412.7	17,408.5	15,943.0	15,383.0	14,412.7
Global funds	4,440.3	5,104.7	4,358.6	4,545.5	4,272.1	4,288.4	4,358.6
Passively managed[7]	2,104.8	1,986.2	2,991.2	2,053.9	2,190.9	2,456.2	2,991.2
Absolute return[7]	8,348.1	5,989.7	4,601.9	5,657.8	5,093.9	4,794.4	4,601.9
Unit-holders							
Total investment funds	**5,160,889**	**4,835,193**	**4,410,741**	**4,759,243**	**4,634,772**	**4,531,940**	**4,410,741**
Fixed income[1]	1,622,664	1,384,946	1,261,634	1,362,443	1,326,504	1,297,686	1,261,634
Balanced fixed income[2]	270,341	206,938	188,574	204,653	195,137	193,992	188,574
Balanced equity[3]	171,336	145,150	138,096	145,472	141,784	140,387	138,096
Euro equity[4]	266,395	237,815	220,433	224,886	225,774	220,342	220,433
International equity[5]	501,138	448,539	398,664	442,753	432,816	417,276	398,664
Guaranteed fixed-income	790,081	1,042,658	1,075,852	1,071,544	1,070,002	1,082,897	1,075,852
Guaranteed equity[6]	1,065,426	912,298	727,867	874,249	832,332	783,203	727,867
Global funds	105,720	127,336	101,321	113,396	105,966	105,824	101,321
Passively managed[7]	90,343	100,416	125,003	101,901	108,166	110,678	125,003
Absolute return[7]	277,445	229,097	173,297	217,946	196,291	179,655	173,297
Return[8] (%)							
Total investment funds	**0.35**	**-0.08**	**5.50**	**2.41**	**-1.75**	**2.72**	**2.08**
Fixed income[1]	0.11	1.56	3.54	1.51	-0.47	1.35	1.12
Balanced fixed income[2]	-0.54	-1.34	4.95	2.3	-1.55	2.41	1.75
Balanced equity[3]	-0.98	-5.64	7.83	3.25	-2.9	4.12	3.3
Euro equity[4]	-2.94	-11.71	12.31	3.34	-6.34	8.16	7.28
International equity[5]	14.22	-10.83	13.05	8.91	-3.63	5.27	2.32
Guaranteed fixed-income	-0.67	3.28	4.85	2.48	-2.32	2.42	2.27
Guaranteed equity[6]	-1.79	0.14	5.07	1.63	-2.43	3.89	1.99
Global funds	3.22	-4.64	7.44	3.56	-1.23	2.95	2.03
Passively managed[7]	-2.36	-7.33	7.1	1.97	-4.31	5.50	4.04
Absolute return[7]	1.53	-1.87	3.84	1.68	-1.04	1.81	1.36

Source: CNMV.

* Data for funds 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 2009 , 2010 and 2011. Quarterly data comprise non-annualised quarterly returns.

Unit-holder numbers closed the year at 4,410,000, 424,000 fewer than at end-2011. The decline was relatively steady throughout the year and hit mainly at guaranteed equity (184,000) and fixed-income funds (123,000).

… and unit-holder numbers,…

Preliminary data for January 2013 indicate a certain reversal of all these trends. According to the figures, investment funds assets would have increased 2% in the space of the month to 126.5 billion euros, on portfolio gains (1.1%) and net fund subscriptions (exceeding one billion euros). The recent cap imposed on bank deposit interests has presumably redirected funds into the industry's most deposit-like category, essentially fixed-income schemes (guaranteed or otherwise), though subscription volumes were also up in passively managed funds.

…though both trends have partially corrected in the early months of 2013.

The liquidity conditions of fund fixed-income portfolios continued to improve from mid-year on in absolute and relative terms. As we can see from table 14, the amount of less-liquid assets fell by over one billion euros between June and December, from 6.45 to 5.39 billion (-16.4%). On this showing, the ratio of less-liquid assets dropped from 5.2% of total fund assets in June 2012 to 4.3% at the annual close. As regards the composition of these less-liquid holdings, we can point to the growing share of financial institution debt instruments rated below AA (up from 69% to 76%) and a parallel decline in the weight of asset-backed securities (from 21% to 14%).

The liquidity conditions of private fixed-income portfolios continue to improve.

Estimated liquidity of investment fund assets TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	**Jun 12**	**Sep 12**	**Dec 12**	**Jun 12**	**Sep 12**	**Dec 12**
Financial fixed income rated AAA/AA	466	425	348	24	27	23
Financial fixed income rated below AAA/AA	4, 443	4, 514	4, 120	19	20	19
Non-financial fixed income	165	132	148	6	4	5
Securitisations	1, 374	966	774	50	41	42
AAA-rated securitisations	65	53	44	95	96	97
Other securitisations	1, 309	912	730	49	40	40
Total	**6, 448**	**6, 037**	**5, 390**	**21**	**20**	**20**
% of investment fund assets	**5.2**	**4.8**	**4.3**			

Source: CNMV.

Real estate schemes

The downturn in Spanish construction and real estate continued to make life hard for this category of funds, whose returns deteriorated further in 2012. By the end of the year, a total of six funds remained in operation, the same number as at end-2011, though only five were truly operative, with a sixth being wound up as we write. The number of real estate investment companies, meantime, was unchanged at eight.

The real estate and construction crunch continue to complicate life for real estate investment schemes in 2012.

On the fund side, main variables performed on a par with the previous years, though with declines smoothing slightly (except in returns). Hence fund assets decreased by 6.5% to 4.20 billion euros, while unit-holder numbers closed 4,517

Real estate funds lost 6.5% of their assets while returns sank to -6.0%.

lower at 25,218. Aggregate fund returns were negative in every quarter, summing a full-year loss of 5.96% (see table 15). Note also that a majority of these schemes' assets are in the hands of investors belonging to the management company's financial group.

Main real estate scheme variables

TABLE 15

	2009	2010	2011	2012	2012 1Q	2012 2Q	2012 3Q	2012 4Q
FUNDS								
Number[1]	8	7	6	6	6	6	6	6
Unit-holders	83,583	75,280	29,735	25,218	29,754	27,716	27,587	25,218
Assets (million euros)	6,465	6,116	4,495	4,202	4,447	4,386	4,314	4,202
Return (%)	-8.31	-4.74	-3.23	-5.96	-0.86	-1.23	-1.83	-2.17
COMPANIES								
Number	8	8	8	8	8	8	8	8
Shareholders	928	943	943	937	939	939	935	937
Assets (million euros)	309	322	313	284.1	310.8	305.1	294.7	284.1

Source: CNMV.

1 Funds filing financial statements.

Assets under management in real estate investment companies down 9.2%.

Finally, assets under management in real estate investment companies dropped by 9.2% in 2012 to 284 million euros, while their shareholder numbers slipped from 943 to 937.

Hedge funds

Another divergent performance from the hedge fund industry …

The hedge fund landscape was again defined by the slump in fund of hedge fund business, profoundly affected by the crisis, and a pure hedge fund segment in steady expansion by the measure of both assets and investor numbers. In both types of scheme, a significant number of funds are in the process of liquidation.

…with fund of fund assets down 4.7% to 546 million euros,…

As we can see from table 16, funds of hedge funds lost 4.7% of their assets between December 2011 and November 2012, as far as 546 million euros, while unit-holder numbers reduced by 420 to 3,385. Redemptions outstripped subscriptions in every quarter of the year (except the last, for which no data were available at the closing date for this report).

…compared to a 15% advance in pure hedge fund assets to 838 million euros.

Conversely, pure hedge funds increased their assets by 15.1% between December 2011 and November 2012, to over 838 million euros, and enlarged their unit-holder roll from 2,047 to 2,304. Asset growth drew on year-long fund subscriptions but also owed a lot to portfolio gains, except for a brief dip in the second quarter of 2012 with market tensions at their height.

Main hedge fund and fund of hedge fund variables

TABLE 16

	2009	2010	2011	2012			
				1Q	2Q	3Q	4Q[2]
FUNDS OF HEDGE FUNDS							
Number[1]	38	28	27	27	28	26	24
Unit-holders	5,321	4,404	3,805	3,592	3,607	3,513	3,385
Assets (million euros)	810.2	694.9	573.0	568.0	561.4	561.3	545.8
Return (%)	7.85	3.15	-1.70	1.15	-2.21	1.36	
HEDGE FUNDS							
Number[1]	29	33	36	36	36	36	36
Unit-holders	1,917	1,852	2,047	2,077	2,169	2,305	2,304
Assets (million euros)	652.0	646.2	728.1	775.3	774.5	828.7	838.1
Return (%)	14.94	5.37	-2.60	3.66	-2.42	2.72	1.29

Source: CNMV.

1 Funds filing financial statements.

2 Data to November 2012.

Exhibit 4: "ESMA guidelines on remuneration policies under the Alternative Investment Fund Managers Directive (AIFMD)"

Directive 2011/61/EU of 8 June 2011 on alternative investment fund managers (AIFMD) calls on the European Securities and Markets Authority (ESMA) to develop guidelines on sound remuneration policies in accordance with the Directive's Annex II. The AIFMD requires the managers of the funds within its scope (non-UCITS schemes such as hedge funds, venture capital funds, and real estate funds in Spain) to implement sound, prudent remuneration policies and structures in order to strengthen investor protection and prevent conflicts of interest which could lead to excessive risk taking. It was to comply with this assignment that ESMA approved the corresponding guidelines on 29 January 2013, to apply as of 22 July 2013.

The main issues these guidelines address are: 1) which remuneration items are covered, 2) the identified staff subject to their contents, 3) the application of proportionality, 4) corporate governance in remuneration matters, 5) standards for aligning interest and risk and 6) transparency. Each of these points is dealt with briefly in the paragraphs that follow.

For the purpose of the guidelines, remuneration consists of all forms of compensation paid by the manager, any amount paid by the fund itself, including carried interest, and any transfer of units or shares in respect of professional services rendered. Remuneration can comprise both a fixed and a variable component (depending on performance or other contractual criteria) and may include monetary payments or benefits (such as cash, shares, options or pension contributions) or non-monetary benefits (discounts, car allowance, mobile phone, etc.).

The staff within the scope of the guidelines (identified staff) are all those whose professional activities have a material impact on the risk profile of the manager or the funds it manages, along with the staff of any entity to whom the manager has delegated risk management or investment management functions. The manager is obliged to identify all such groups of staff.

The diverse risk profiles and characteristics of managers, as regards their own size and that of the funds they manage, their internal organisation and the nature, scope and complexity of their activities, justifies a proportional approach to compliance with these guidelines, allowing certain requirements to be adapted to each manager's particular circumstances (setup of a remuneration committee, variable remuneration in instruments, establishment of a deferral period for payment in kind, among others).

The guidelines approach the governance of remuneration by reference primarily to the supervisory function and the remuneration committee. Proportionality operates in both cases, to the extent that having a remuneration committee may be optional for certain AIFMs. The supervisory function is responsible for evaluating and reviewing the manager's procedures on a regular basis. It is accordingly in charge of approving and maintaining the remuneration policy of the AIFM and overseeing its implementation, and should also approve any subsequent material exemptions or changes and carefully consider and monitor their effects. The remuneration committee, where one exists, should be made up of non-executive members of the supervisory function, the majority of whom qualify as independent. Among its main responsibilities is to support and advise the supervisory function in designing remuneration policies and to ensure that such policies are in line with the objectives and interests of the AIFM, the AIFs it manages and the investors of such AIFs.

The guidelines include a series of measures to promote the better alignment of interests and risk. These are of binding application to the remuneration packages of identified staff, though managers are urged to consider their AIFM-wide application. Their first requirement is that managers should implement a fully flexible policy of variable remuneration, which should be exclusively associated to the achievement of objectives by identified staff. Fixed remuneration, by the same token, should be sufficiently high to remunerate the professional services rendered, in line with level of education, degree of seniority, level of expertise required, etc.

Variable remuneration is the key element in any remuneration system that seeks an optimal alignment of interests and risk. For ESMA, a fully flexible policy means that this remuneration component should be performance-based and risk-adjusted, such that incentives to take risks are constrained by incentives to manage risk in an effective manner. To this end, the guidelines specify three phases or subprocesses for the calculation and implementation of variable remuneration.

The first phase (performance and risk measurement process) concerns the accrual period during which the right to receive variable remuneration is earned, and the measurement of the risk-adjusted performance that serves as its calculation base (although it also contemplates adjusting performance measures for risk at a later stage). Performance assessment can make use of both quantitative and qualitative criteria, including judgmental measures, as long as they are properly documented. Regarding the length of the accrual period, the text specifies a minimum of one year, while pointing out that multiyear periods allow for greater certainty, given the longer time horizon of most managed funds.

The second phase, the award process, and the third, the pay-out process, refer respectively to the process of determining individual awards, and the form and timing of variable payment. In the second phase, the manager must translate its risk-adjusted performance assessment into a variable remuneration component for each staff member. The main difficulty here is in determining how individuals have contributed to carry risk, given that some risks may materialise in future, and adjusting accordingly. In the pay-out phase, managers have the opportunity to adjust variable payments through contractual arrangement known as clawbacks, when the staff member agrees to return ownership, or maluses, when payment is reduced or cancelled on evidence of malconduct, such that remuneration reflects actual risk outcomes and the real achievement of objectives. To facilitate such ex-post adjustments in variable remuneration, 40% to 60% of payment should be deferred for a period of between three and five years. Likewise, for the purpose of better aligning the interests of managers and clients, the guidelines state that at least 50% of variable remuneration, including both the upfront and deferred part, should be paid in financial instruments issued by or bearing a close link to managed vehicles (for instance, shares or share-related instruments), specifying a retention period during which they cannot be sold.

Finally, a set of guidelines deal with managers' obligations regarding the internal and external disclosure of remuneration information, primarily information of a qualitative nature. Disclosure reports should be published annually at least and set out the decision-making process used to determine remuneration payments, how pay and performance are linked, a description of the main performance metrics used, and how they take into account current and future risks, in a way that is clear and easily understandable to the reader.

Foreign UCITS marketed in Spain

Investment in foreign UCITS climbs 26.8% to almost 38 billion euros.

Investment in foreign UCITS expanded by 26.8% after the contraction of the previous year, to close at 38 billion euros. This level of investment, surpassing the figure for 2010, owed to the higher volumes captured by investment companies, while funds reported some erosion across all key variables. The number of investors and schemes also rose in the year by 7.2% to 816,417 and by 2% to 754.

Outlook

The redemption flood of recent years, which has left industry assets at an all-time low,...

The collective investment industry has suffered more than most from the consequences of the crisis, with unit-holder redemptions escalating to all-time highs. These persistent outflows, aggravated at times of stress by a slump in investor confidence, are also the result of fierce competition from low-risk investment products marketed by the banks, primarily deposits and, more recently, commercial paper, whose attractive conditions marked an attempt by deposit-taking entities to draw in customer funds at a time of scarce liquidity.

…may be stemmed in the coming months, as competition from other investment products slackens off.

In the short term, we can see both good and bad portents for the investment fund industry. On the one hand, the ongoing recapitalisation and restructuring of the Spanish banking system will facilitate banks' access to alternative funding sources (the markets, for instance), and this, along with the recently imposed interest rate caps on bank deposits, could boost investment fund inflows over coming months. On the other, the savings constraints faced by households coping with lower disposable income could limit the industry upside. Also, a new wave of sector reorganisation could be just around the corner, given the numerous schemes operating in losses and the prospect of further management company mergers or acquisitions as bank restructuring continues its course.

4.2 Investment firms

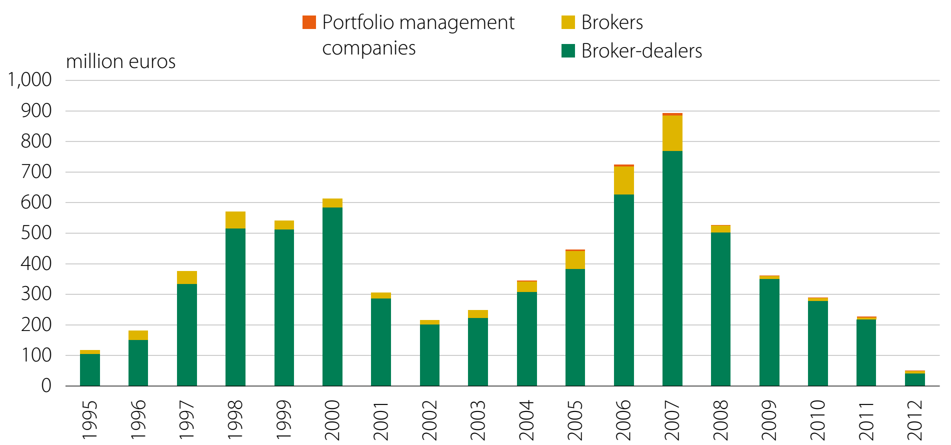
Investment firm business suffers a historical setback in 2012.

For the fifth year running, investment firms had to struggle with the fallout from domestic market turmoil, which has driven down revenues across all main business lines. In this complex landscape, the number of loss-making firms was unchanged with respect to 2011, but the volume of their losses was substantially higher. Sector capital adequacy remained in the safety zone, albeit with some narrowing of margins.

Broker-dealer pre-tax profits fall 81% on a slump in income from financial investments and investment service fees …

The aggregate pre-tax profits of broker-dealers plunged by 81% in 2012 to 42 million euros, with the fall tracing mainly to financial investments and investment service fee income (see table 17). Closer examination of this last item shows that income on order processing and execution decreased by 34% to 348 million euros, in line with the trading contraction on domestic financial markets. Other captions suffering a reverse were investment advisory services (down by 91% to 5.1 million) and UCITS marketing (down 24% to 45 million euros). The 71% advance under the "others" caption to 149 million euros and lower exchange rate losses failed to offset the decline under remaining income heads, driving gross income down to 448 million, 32% less than in 2011.

Investment firm pre-tax profits[1,2] FIGURE 17



Source: CNMV.

1 Except IAFs.

2 2012 earnings on an annual basis.

Aggregate income statement (2012)

TABLE 17

Thousand euros	Broker-dealers Dec 11	Dec 12	% var.	Brokers Dec 11	Dec 12	% var.	Portfolio managers Dec 11	Dec 12	% var.
1. Net interest income	91,542	56,185	-38.6	2,481	1,910	-23.0	682	732	7.3
2. Net fee income	490,517	410,729	-16.3	97,886	93,235	-4.8	7,988	7,879	-1.4
2.1. Fee income	776,641	588,890	-24.2	112,351	108,187	-3.7	18,477	17,887	-3.2
2.1.1. Order processing and execution	529,711	348,273	-34.3	36,354	38,111	4.8	–	–	–
2.1.2. Issue placement and underwriting	7,446	6,869	-7.8	2,870	3,128	9.0	–	–	–
2.1.3. Securities custody and administration	21,060	19,775	-6.1	441	588	33.3	–	–	–
2.1.4. Portfolio management	16,186	14,882	-8.1	12,352	14,454	17.0	16,582	16,307	-1.7
2.1.5. Investment advising	55,025	5,138	-90.7	5,349	3,092	-42.2	1,894	1,579	-16.6
2.1.6. Search and placement	485	50	-89.7	61	88	44.3	–	–	–
2.1.7. Margin trading	8	8	0.0	42	30	-28.6	–	–	–
2.1.8. UCITS marketing	59,588	45,050	-24.4	21,381	25,949	21.4	0	0	–
2.1.9. Others	87,133	148,846	70.8	33,500	22,745	-32.1	0	0	–
2.2. Fee expense	286,124	178,160	-37.7	14,465	14,952	3.4	10,489	10,008	-4.6
3. Result of financial investments	271,956	9,403	-96.5	622	1,254	101.6	186	4	-97.9
4. Net exchange income	-198,307	-37,362	81.2	78	-106	–	29	-30	–
5. Other operating income and expense	3,952	8,841	123.7	-1,617	-1,356	16.1	-40	29	–
GROSS INCOME	**659,659**	**447,796**	**-32.1**	**99,450**	**94,938**	**-4.5**	**8,845**	**8,615**	**-2.6**
6. Operating expenses	426,672	375,782	-11.9	89,736	87,624	-2.4	7,210	7,122	-1.2
7. Depreciation and other charges	21,532	23,556	9.4	1,944	2,781	43.1	109	87	-20.2
8. Impairment losses	4,076	12,904	216.6	12	-12	–	0	0	–
NET OPERATING INCOME	**207,379**	**35,555**	**-82.9**	**7,758**	**4,545**	**-41.4**	**1,526**	**1,406**	**-7.9**
9. Other profit and loss	9,861	6,450	-34.6	412	2,371	475.5	0	5	–
PROFITS BEFORE TAXES	**217,240**	**42,005**	**-80.7**	**8,170**	**6,916**	**-15.4**	**1,526**	**1,411**	**-7.5**
10. Corporate income tax	68,687	53,786	-21.7	2,681	3,383	26.2	484	458	-5.4
PROFITS FROM ONGOING ACTIVITIES	**148,553**	**-11,782**	**–**	**5,489**	**3,533**	**-35.6**	**1,042**	**952**	**-8.6**
11. Profits from discontinued activities	0	0	–	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**148,553**	**-11,782**	**–**	**5,489**	**3,533**	**-35.6**	**1,042**	**952**	**-8.6**

Source: CNMV.

…despite positive progress in operating cost contention.

Although broker-dealers managed a 12% reduction in operating expenses, their elevated levels (376 million euros), combined with deepening impairment losses, made further inroads into net operating income, which closed 83% down on year-ago levels at 35.5 million euros. It bears mention, however, that the sub-sector's aggregate profit figure was significantly distorted by the performance of one sector operator, without whom the overall decline in profits lessens to 18%.

Broker profits fall by 15% in 2012, in spite of rising revenues in traditional business lines,…

Brokers, meantime, recorded pre-tax profits of 6.9 million euros, 15.4% less than in 2011 (8.2 million). Net fee income, which contributes over 98% of their total gross income, dropped by 4.8% in 2012 to 93.2 million euros. The story, however, varied significantly from one line to the next, with higher inflows from order processing and execution fees (up 4.8% to 38 million euros), UCITS marketing (up 21.4% to 26 million euros) and portfolio management (up 17% to 14.4 million euros), countered by a sizeable decline in fees from other services (down by 32.1% to 22.7 million euros). The result was a 4.5% fall in gross income to 94.9 million euros. Here too, companies made some headway in operating cost contention (down 2.4% to 87.6 million), but not enough to annul their dampening effect below the gross income line.

…while portfolio managers see their profits slide by 7.5%.

Finally, the aggregate pre-tax profits of portfolio management companies fell by 7.5% in the full-year period to 1.4 million euros. Aggregate gross income slipped by 2.6% to 8.6 million euros, due mainly to the decrease in net fee income (-1.4% to 17.9 million euros), its largest component. Operating expenses, meantime, were 1.2% lower at 7.1 million euros.

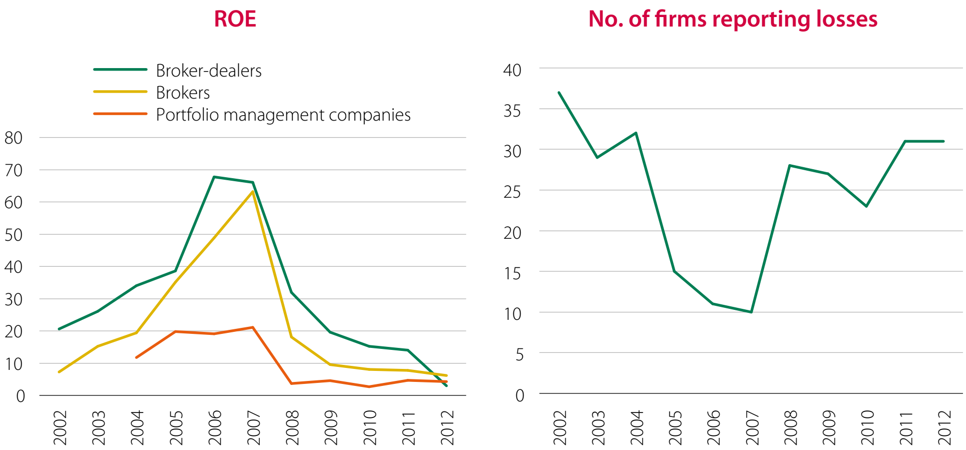
Sector ROE sinks from 15% to 11.6% on the first-half earnings stall.

Sector-wide return on equity (ROE) sank from 11.8% in 2011 to 3% in 2012, in line with the year-long slide in investment firm earnings. By sub-sector, the ROE of broker-dealers took the biggest punishment, with a fall of over eleven points to 3%. Other intermediaries got off more lightly, with declines of over one point, to 6.2%, in the case of brokers, and less than 0.5 points, to 4.2%, in that of portfolio management companies (see figure 18, left-hand panel).

The number of loss-making firms is unchanged, but the size of their losses is six times greater.

Against this sector-wide backdrop of income and earnings decline, 31 firms reported pre-tax losses, the same number as in 2011, although the scale of these losses was considerably greater. Also the numbers are deceptive in that eight firms that ceased trading in the year. Of the total of loss-making firms in operation at the 2012 close, 14 were broker-dealers (13 in 2011), 15 were brokers (17 in 2011) and two were portfolio management companies (one in 2011). Their combined attributable losses in the period stood at 154.5 million euros, almost six times more than the 27 million of the previous year, and triple the sector's aggregate pre-tax profits for 2012.

Pre-tax ROE of investment firms and loss-making entities FIGURE 18



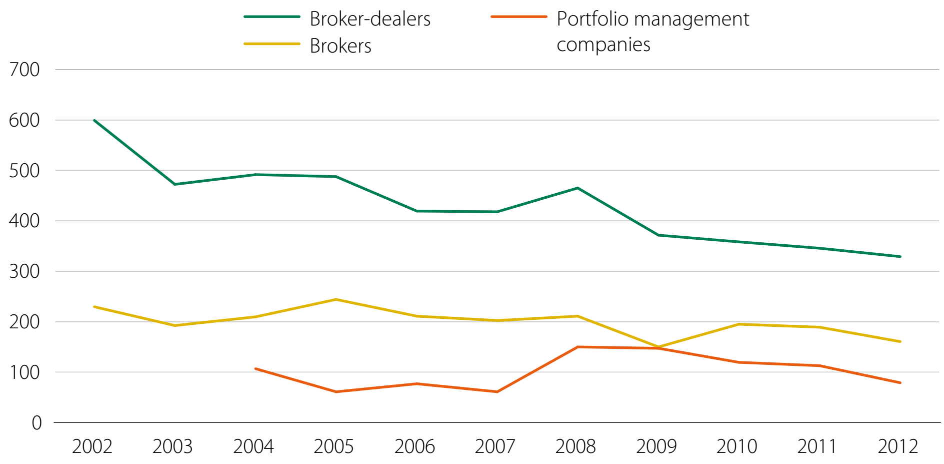
Source: CNMV.

Sector capital ratios remain comfortably clear of minimum requirements.

Investment firms remained comfortably compliant with capital standards, though it bears mention that their surpluses have narrowed by 30% since the advent of new, stricter capital standards in June 2009. The aggregate capital adequacy ratios of the investment firm sector contracted slightly to end-2012, as far as 3.3 times the minimum requirement in the case of broker-dealers (3.5 in 2011), 1.6 times for the broker group (1.9 in 2011) and 0.8 times for portfolio managers (1.1 in 2011).

Investment firm capital adequacy FIGURE 19

(surplus of qualifying equity to the minimum requirement, %)



Source: CNMV.

IAF expansion threatens to run out of steam.

The onward march of investment advisory firms (IAFs) showed signs of faltering in 2012. The number of these firms, which began operating in Spain in 2009 with the transposition of the MiFID, rose from 82 in 2011 to 101 in 2012, but this time business volumes failed to accompany in either assets under advice (down by 8.3% to 14.70 billion euros) or financial advisory contracts outstanding (down 5.7% to 3,468). The bulk of assets under advice (78% of the total) again corresponded to the professional clients segment, with the remaining 22% drawn from retail clients. Sector fee income fell by 18.4% to 25.3 million euros, while aggregate profits, at 3.6 million, were 52.5% less than in 2011 (see table 18).

The heavy losses of the investment services sector suggest a degree of reorganisation may be in the wings.

The outlook for investment firms is far from clear, in view of the grave erosion of traditional revenue streams like order processing and securities placements, and the deterioration suffered by the collective investment industry. One exception in this scenario is companies' growing income from corporate intelligence services, once marginal to their main business. To date, bank sector restructuring has had little impact on sector organisation, accounting for just two of last year's eight closures, with one more likely in 2013. However, the growing scale of some firms' losses could prompt additional moves to reorganise the sector via mergers and/or closures.

Main investment advisory firm variables

TABLE 18

Thousand euros	2010	2011	2012	2012 1H	2012 2H	% semi-annual change	% annual change
NO. OF FIRMS	**52**	**82**	**101**	**97**	**101**	**4.1**	**23.2**
ASSETS UNDER ADVICE[1]	**15,802,743**	**16,033,109**	**14,708,739**	**14,663,856**	**14,708,739**	**0.3**	**-8.3**
Retail customers	1,715,084	2,181,943	3,201,927	2,415,002	3,201,927	32.6	46.8
Professional customers	13,995,206	13,831,973	11,452,681	12,205,216	11,452,681	-6.2	-17.2
Others	92,453	19,193	54,132	43,638	54,132	24.1	182.0
NO. OF CONTRACTS	**2,431**	**3,677**	**3,468**	**3,279**	**3,468**	**5.8**	**-5.7**
Retail customers	2,345	3,542	3,265	3,099	3,265	5.4	-7.8
Professional customers	79	126	185	164	185	12.8	46.8
Others	7	9	18	16	18	12.5	100.0
FEE INCOME[2]	**20,745**	**31,052**	**25,347**	**13,940**	**25,347**	**81.8**	**-18.4**
Fees received	20,629	30,844	25,171	13,855	25,171	81.7	-18.4
From customers	17,132	26,037	20,525	11,668	20,525	75.9	-21.2
From other entities	3,497	4,807	4,646	2,186	4,646	112.5	-3.4
Other income	116	209	175	85	175	105.9	-16.3
EQUITY	**10,057**	**12,320**	**15,123**	**13,098**	**15,123**	**15.5**	**22.8**
Share capital	3,014	3,895	4,448	4,328	4,448	2.8	14.2
Reserves and retained earnings	242	950	7,125	5,904	7,125	20.7	650.0
Profit/loss for the year[2]	6,801	7,474	3,550	2,866	3,550	23.9	-52.5

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

Exhibit 5: "CNMV's adoption of the ESMA guidelines on suitability"

On 25 June 2012, ESMA published a set of guidelines whose aim was to clarify certain aspects of the MiFID suitability requirements in order to ensure their common, uniform and consistent application.[1]

National authorities must expressly notify ESMA of the adoption of these guidelines, which the CNMV has duly done while issuing a communication on the subject.

The guidelines came into force on 21 December, 2012 and, as such, have been incorporated into the Commission's supervisory practices. It bears mention, however, that the CNMV was already applying many of their key tenets (see communication of 19 October) and had published a guide on the subject in 2010.[2]

Set out below are the main points covered by the guidelines:

1. Who:

These guidelines apply to investment firms, including credit institutions that provide investment services, UCITS management companies, and competent authorities.

2. What:

Suitability requirements apply in relation to the provision of investment advice and portfolio management services, as stipulated in article 19.4 of the MiFID and articles 35 and 37 of its Implementing Directive 2006/73/EC. Although they mainly address situations where services are provided to retail clients, they should also be considered as applicable, where relevant, to the services rendered to professional clients

3. Steps to be taken by service providers:

– Improve the information given to clients about suitability testing. Investment firms should inform clients of the reasons for assessing suitability, thereby encouraging them to provide full and accurate responses. At no stage should investment firms or UCITS managers create any ambiguity or confusion about their own responsibilities in the process.

– Establish and implement policies and procedures that enable them to understand the essential facts about their clients and the characteristics of the financial investments available to them. Among the essential facts to be garnered are the client's age, marital status, family situation, employment situation and need for liquidity.

– Ensure that staff involved in material aspects of the suitability process have an adequate level of knowledge and expertise, and, to this end, provide point-of-sale staff with the appropriate training.

– Determine which information is necessary and relevant in relation to a client's knowledge and experience, financial situation and investment objectives by reference to the complexity of the products and services at stake. This proportionality test is of capital importance in two situations: (i) illiquid financial instruments, when the information gathered must include the length of time for which the client is prepared to hold the investment, as specified by the client and checked exhaustively by the provider, and (ii) the difference between investment advice and portfolio management services – what matters in the first case is that the client is able to understand the risks and nature of each financial instrument that the firm plans to recommend, and, in the second, that the client understands the overall risk of his or her portfolio.

– Take steps to ensure that the information collected is consistent and not overly reliant on clients' self-assessment.

– Keep information fully updated when a service is being provided on an ongoing basis.

– Establish criteria to determine who should be subject to the suitability assessment when the client is a legal person or a group of two or more natural persons, or where one or more natural persons are represented by another. Make a record of any agreement concluded to this effect.

– Ensure the suitability of the investment, such that assessments consistently take into account (i) all relevant information about the client (including their current portfolio of investments); (ii) the match between this information and the recommendations made, with particular regard to risk diversification, costs, time horizon and conflicts of interest; and (iii) whether the client has an adequate understanding of the relationship between risk and return.

– Maintain adequate records regarding the suitability assessment, including any investment advice provided and all investments (or divestments) made, in such a way as to enable the detection of failures.

1 *Guidelines on certain aspects of the MiFID suitability requirements*. Available at http://www.esma.europa.eu/system/files/2012-387.pdf

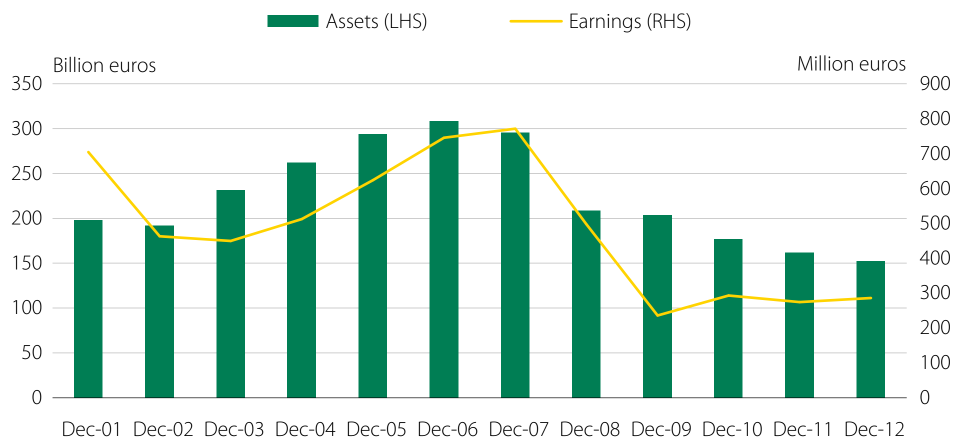
2 *Guía de actuación para el análisis de la conveniencia y la idoneidad*. Available at http://www.cnmv.es/portal/verDoc.axd?t={56cad31c-e05c-4edd-9d07-a4f84e3cd116}

4.3 UCITS management companies

Despite a 5.5% drop in assets to 152.6 billion euros,…

Assets under management in UCITS management companies fell by 5.5% in 2012 to 152.60 billion euros. Though 94% of the difference corresponded to securities investment funds, real estate funds and investment companies also suffered to some extent. The sector's asset volumes have been declining since the crisis broke, though the rate did slow a little in 2012 (see figure 20).

UCITS management companies: assets under management and pre-tax profits FIGURE 20



Source: CNMV.

…UCITS managers are able to grow their profits 4.1%.

Management companies were able, nonetheless, to grow their pre-tax profits by 4.1% in 2012 as far as 286 million euros, with a sharp decrease in fees paid (96% in respect of fund marketing) and higher inflows from portfolio management offsetting a 4.3% fall in fund management fees to 1.42 billion euros (see table 19). Average UCITS management fees inched up from 0.90% to 0.93%, reflecting a shift in the fund mix towards riskier categories that tend to carry higher fees. Sector-wide return on equity (ROE) climbed from 20.7% in 2011 to 23.1%, while the number of loss-making entities dropped back from 32 to 28, generating combined red numbers of 10.2 million euros (11.3 million in 2011).

Management companies' ongoing effort to rationalise their fund offering by means of multiple product mergers was accompanied once more by some timid advances in sector reorganisation, with one new entrant versus ten retirals thinning their ranks to 105 at the 2012 close. Of the ten closures, seven were an offshoot of the broader restructuring of Spanish banks.

Fund mergers are accompanied by some weeding-out of management companies.

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

Million euros

	Assets under management	UCITS management fee income	Average UCITS management fee (%)	Fee ratio (%)[1]
2003	231,458	2,304	1.00	73.8
2004	262,132	2,670	1.02	73.6
2005	293,973	2,976	1.01	72.2
2006	308,476	3,281	1.06	71.5
2007	295,922	3,194	1.08	70.5
2008	209,014	2,302	1.10	70.8
2009	203,730	1,702	0.84	68.6
2010	177,055	1,622	0.91	68.1
2011	161,481	1,479	0.90	66.6
2012	152,644	1,416	0.93	64.6

Source: CNMV.

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

4.4 Other intermediaries: venture capital

The number of venture capital entities (VCEs) increased slightly over full-year 2012, from 336 to 340 (see table 20). Of this total, 139 were venture capital companies (VCCs), 119 venture capital funds (VCFs) and 82 VCE management companies. Twenty-two entities joined the register during the year (ten VCCs, eight VCFs and four VCE managers) compared to 18 retirals, the majority of them (14) VCCs. Points to note were that most new entrants (83%) continued to sign up for the simplified regime, and that the public sector has downsized its industry presence to just two VCCs.

The number of venture capital entities rises slightly in 2012

According to preliminary data furnished by industry association Asociación Española de Entidades de Capital Riesgo (ASCRI), venture capital investment in Spain receded 22.5% in 2012 as far as 2.52 billion euros. As much as 94% of the total, significantly, corresponded to transactions of less than five million euros. This evidences the scale of the investment effort being made in Spanish SMEs, with early-stage companies, in particular, featuring in 38% of the year's transactions. Leveraged buyouts, meantime, accounted for 54% of total investment but only 1.7% of

According to ASCRI, sector investment receded 22.5% in 2012…

transaction numbers. International funds were again prominent, as the source of 60% of annual investment. The sectors attracting most investment were "other services" (26%), products and services (14.5%), medicine and health (13.6%) and communications (10.8%), while IT ventures headed the transaction list (32%). Finally, the venture capital sector raised 2.17 billion euros for its investments, 9% less than in 2011. Of this total, 70% corresponded to international funds investing in Spain.

Movements in the VCE register in 2012 TABLE 20

	Situation at 31/12/2011	Entries	Retirals	Situation at 31/12/2012
Entities	336	22	18	340
Venture capital funds	114	8	3	119
Venture capital companies	143	10	14	139
Venture capital management companies	79	4	1	82

Source: CNMV.

…in what remains a challenging business landscape.

The short-term outlook for the venture capital sector remains hazy for a number of reasons. Foremost among them, the deterioration of domestic activity and the difficulty of obtaining bank finance, which appears likely to last until the end of the financial sector restructuring process. In this uncertain climate, the identification of growth opportunities will be paramount in future.