I Securities markets and their agents: situation and outlook

Contents

1	Executive summary	13
2	Macrofinancial setting	15
2.1	International economic and financial developments	15
2.2	National economic and financial developments	22
2.3	Outlook	33
3	Spanish markets	34
3.1	Equity markets	34
3.2	Fixed-income markets	41
4	Market agents	49
4.1	Investment vehicles	49
4.2	Investment firms	58
4.3	UCITS management companies	62
4.4	Other intermediaries: venture capital	63

List of exhibits

Exhibit 1:	Implementation in Spain of the IOSCO principles on securities regulation: IMF recommendations ensuing from the 2012 FSAP report	23
Exhibit 2:	Key contents of Royal Decree-Law 24/2012 of 31 August on restructuring and resolution of credit institutions	27
Exhibit 3:	Proposed regulation of a new investor information document for packaged retail investment products	31
Exhibit 4:	Reform of legislation on the prospectus to be published when securities are offered to the public or admitted to trading	39
Exhibit 5:	The impact of sovereign debt downgrades: the 'cascade' effect	44
Exhibit 6:	Key modifications to the Regulation on UCITS	51
Exhibit 7:	Proposal for the amendment of UCITS Directive 2009/65/EC	54

1 Executive summary

- The international macroeconomic and financial environment remained generally unsettled during the first-half period in response to Europe's drawn-out sovereign debt crisis and the emergence of slowdown signs in some key emerging economies. The IMF's latest forecasts augur world output growth of 3.5% in 2012 and 3.9% in 2013, with the emerging market economies once more to the fore. Among the advanced economies, activity went on expanding at higher rates in the United States, Japan and Germany, while some major European economies had to battle with recession. The main downside risks for projections are doubts about the measures to be taken by certain European governments and institutions in order to lay to rest the sovereign debt crisis, and fears that the deceleration of emerging nations may be sharper than expected.

- Against this backdrop, the performance of international financial markets was mainly dictated by the fluctuating macroeconomic prospects of different world regions, though the sovereign debt crisis was also a constant presence in Italy and Spain. In equity markets, U.S. and indices and a good number in Europe have posted sizeable gains this year to date,[1] despite the price dip of the second quarter, in a context of more muted volatility. In debt markets, tensions reached a height towards end-July, when the spreads of various European sovereign borrowers widened to annual highs. Since early September, however, news of the detailed arrangements for the ECB's conditional sovereign bond buying programme has helped to calm the market mood. One result is that private-sector debt issuance has picked up from last year's levels, especially among non-financial corporations.

- Spanish GDP contracted by an annual 1.3% in the year's second quarter (-0.5% in the euro area), due to domestic demand weakness. Rising energy prices and the VAT hike triggered an inflation upswing in August and September, while the labour market continued to deteriorate as far as a June unemployment rate bordering on 25% of the active population. According to budgetary execution figures, the central government deficit in national accounts terms was 4.8% in the first eight months of 2012, while that of the autonomous communities (regions) closed the first-half period at 0.8%. The general government target for the full-year period has been set at 6.3% of GDP. The Spanish economy, say leading forecasters, will remain in recession until 2013 at least.

- Spanish credit institutions continue to undergo an intense restructuring process, with the prospect that financial assistance from the European Union (up

1 Data to 14 September.

to one hundred billion euros) and the Government's latest legislative measures will provide a firm platform for recovery.

- The aggregate profits of non-financial listed companies dropped by 40% in the first six months to 8.35 billion euros, in line with the faltering progress of domestic economic activity. The sector's financial leverage ratio ticked up in the period from 1.4 to 1.5.

- Spanish equity markets reflected both the weakness of the domestic economy and the knock-on effects of the sovereign debt crisis. The Ibex 35 traced a prolonged decline, with some fluctuations around mid-year, to close July 30% down on its start-out value. Since then, the index has recovered nearly 37% on the strength of the CNMV's decision (in 23 July) to tackle surging volatility through a new ban on the short selling of Spanish shares, and the ECB's preparedness to purchase European debt securities. That said, the Ibex has shed 4.8% of its value year to date, liquidity conditions have deteriorated and trading has shrunk by 27%.

- Domestic fixed-income markets came under sustained pressure in the year's middle months, producing new highs in yields and credit spreads across all sectors of the economy. Pressures relented a little after the ECB announced in late July that it was ready, under set conditions, to intervene in secondary bond markets, and eased further in September following the release of the monetary authority's detailed plan. Meantime, the volume of debt issues filed year-to-date with the CNMV grew 65% to 267 billion euros led by commercial paper, mortgage covered bonds and government-backed non-convertible bonds.

- Investment fund assets fell by 5.5% in the first six months to 125.1 billion euros, prolonging the downtrend that has continued with only rare interruptions since the start of the crisis. Around 85% of the shrinkage traces to net unitholder redemptions, which summed over six billion euros in the period. The industry outlook is further complicated by competition from high-interest, low-risk products like certain bank deposits or public debt instruments.

- As in previous years, the investment firm sector had to cope with the stressed state of domestic financial markets, which continued to depress revenues from their principal business lines. The result was a first-half slump in aggregate earnings (down 34% to 104 million euros) and a jump in the number of loss-making companies. Despite this, sector capital adequacy ratios conserved a reasonable state of health.

- This report features seven exhibits:

  – The first sets out the main conclusions reached by the IMF in its assessment of the CNMV's progress in implementing IOSCO's new international principles on securities regulation and supervision.

  – The second explains the main characteristics of Royal Decree-Law 24/2012 of 31 August on the restructuring and resolution of credit institutions, with a list of the novelties bearing on the operational framework of the CNMV.

– The third exhibit summarises the European Commission's draft regulation of a new investor factsheet on packaged retail investment products.

– Exhibit four reviews the main points of new, amended legislation on prospectuses for public offers and admissions to trading.

– Exhibit five examines how the downgrades imposed on Spanish government debt have affected the credit ratings of other domestic issuers, with a breakdown by type of borrower and maturity band.

– The sixth exhibit examines the main changes made in the UCITS Regulation following transposition of Directive 2009/65/EC (UCITS IV).

– Finally, exhibit seven looks at the key elements in the European Commission's proposed modification of Directive 2009/65/EC, setting out the eligibility conditions for collective investment schemes to be granted a European passport allowing them to be marketed in any country within the EU.

2 Macrofinancial setting

2.1 International economic and financial developments

The international macroeconomic and financial environment remained generally unsettled during the first-half period in response to Europe's drawn-out sovereign debt crisis and the emergence of slowdown signs in some key emerging economies. In Europe, financial market tensions rekindled in the year's middle months, rivalling with the worst days of end-2011, then abated in September following the announcement of a series of broad-ranging monetary policy measures to be taken by the ECB, along with the details of its bond purchasing programme. For the United States and a large part of Europe, the paramount concern was again to ensure the sustainability of public finances. Meantime, growth in emerging market economies drew rather less on the external sector and more on domestic demand, in a context of some volatility in capital flows.

During the first-half period, the international macroeconomic and financial environment remained generally unsettled...

Against this backdrop, the growth rates of leading world economies were slightly better than expected in the opening quarter and a little worse in the second, with marked disparities from one country to another. Among the advanced economies, the United States, Germany and Japan kept up more robust growth, while several European economies had to deal with new contraction periods, which were nonetheless less severe that in the first throes of the crisis. The biggest GDP falls in the second quarter were recorded in Italy (-2.5%), Spain (-1.3%), the Netherlands (-0.6%) and the United Kingdom (-0.5%). Of the Asian emerging economies, China and India grew just under 8% and 4% respectively to mid-year 2012.

…reflecting the prolongation of the European sovereign debt crisis and signs of deceleration in some emerging economies.

Gross domestic product (annual % change) TABLE 1

	2008	2009	2010	2011	IMF[1] 2012F	2013F
World	2.8	-0.7	5.3	3.9	3.5 (-0.1)	3.9 (-0.2)
United States	-0.3	-3.5	3.0	1.7	2.0 (-0.1)	2.3 (-0.1)
Euro area	0.4	-4.3	1.9	1.5	-0.3 (=)	0.7 (-0.2)
Germany	0.8	-5.1	3.6	3.1	1.0 (0.4)	1.4 (-0.1)
France	-0.2	-2.6	1.7	1.7	0.3 (-0.1)	0.8 (-0.2)
Italy	-1.2	-5.1	1.8	0.4	-1.9 (=)	-0.3 (=)
Spain[2]	0.9	-3.7	-0.3	0.4	-1.5 (0.4)	-0.6 (-0.7)
United Kingdom	-0.1	-4.9	2.1	0.7	0.2 (-0.6)	1.4 (-0.6)
Japan	-1.2	-6.3	4.4	-0.7	2.4 (0.4)	1.5 (-0.2)
Emerging	6.0	2.8	7.5	6.2	5.6 (-0.1)	5.9 (-0.2)

Source: IMF and National Statistics Office (INE).

1 In brackets, change with respect to the last published forecast. IMF, forecast published July 2012 versus April 2012.

2 Growth rates for 2010 and 2011 factor the latest INE revisions..

In the absence of inflationary pressures in major advanced economies...

Inflation rates in major advanced economies continued their retreat from the highs of third quarter 2011 to mid-year rates ranging from 1.4% in the United States to 2.4% in the euro area (the exception being Japan, where rates stayed in negative territory), with commodity prices as the main force driving the descent. The run-up of recent weeks in oil and other commodity prices has yet to work through in full to price indices. Overall, core inflation rates have tended to stabilise due to the growth stall in certain regions.

… official rates were kept at their current lows, the exception being the euro area with a third-quarter cut of 25 bp.

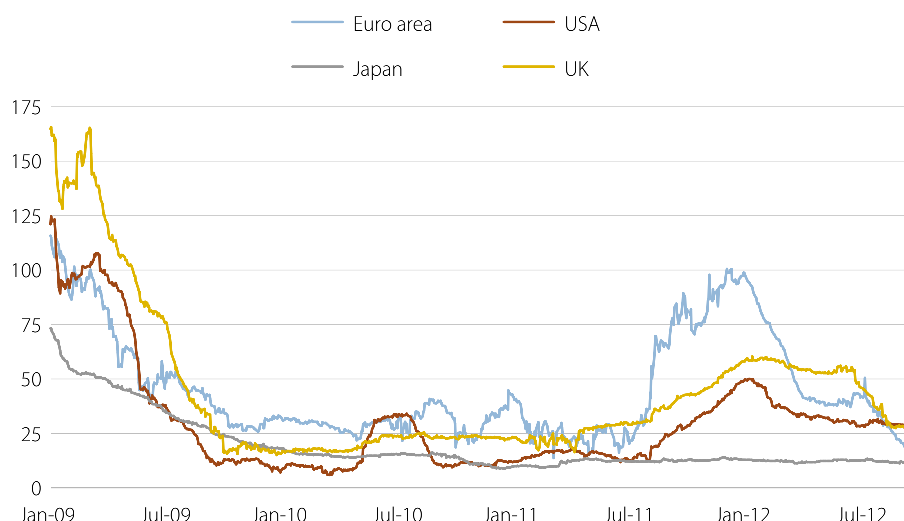
In the absence of inflationary pressures, official rates have so far been left unchanged in the major advanced economies. The exception was the euro area, where in early July the ECB cut its main refinancing rate by 25 bp to 0.75%. Rates in the United States, the United Kingdom and Japan stayed at or near historical lows (0-0.25%, 0.5% and 0.1% respectively). In mid-September, the Federal Reserve announced a new program of quantitative easing (its third), in response to persistent growth weakness and the prevalence of risk – a move that was greeted warmly by the markets.

Debt market turbulence is felt less in interbank deposit markets …

Debt market turbulence affected interbank deposit markets less than on previous occasions. As figure 1 shows, the three-month euro Libor-OIS spread widened slightly in July to just under 50 bp, well short of the 100 bp of earlier flare-ups. This spread has since eased back to under 20 bp in mid-September, below the equivalent readings for the United States and the United Kingdom.

Three-month Libor-OIS spread

FIGURE 1



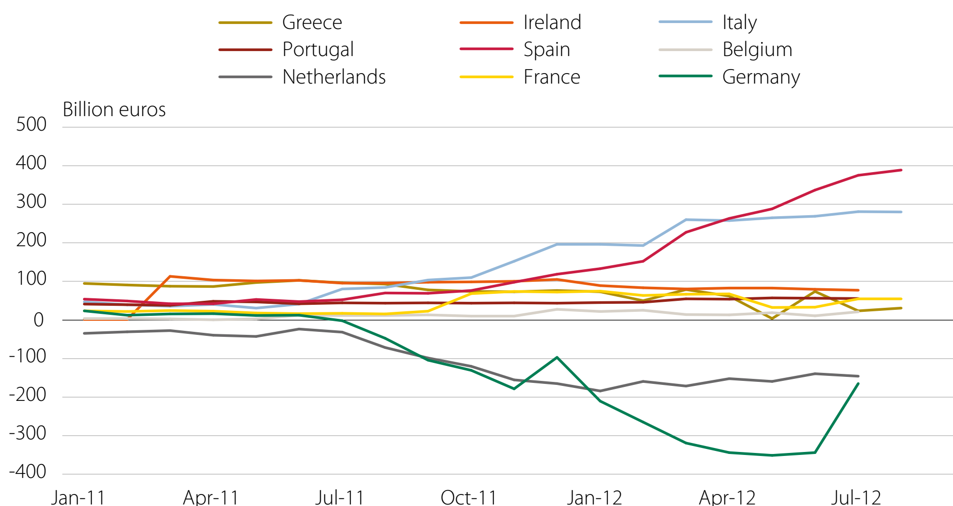
Source: Bloomberg. Data to 14 September.

Even so, the funding difficulties confronting some countries' banks were readily apparent in the year's middle months. As we can see from figure 2, Spanish and Italian financial entities borrowed a record 389 billion and 280 billion respectively from the Eurosystem (net of deposits) in August 2012.

…although the funding problems of some countries' banks were apparent in their recourse to Eurosystem loans.

(Net) Eurosystem funding

FIGURE 2



Source: Bloomberg and Banco de España. Data to August for Spain, Italy, France and Greece. To July for remaining countries.

The behaviour of long-term sovereign bond yields again differed significantly from one group of countries to another. As tends to occur at times of heightened uncertainty like late July, investors rushed into the bonds of those economies that have held up best since the start of the crisis (Germany, the United States and the United Kingdom), pushing their yields to new lows of 1.16% for Germany and 1.40% for the U.S. and UK. Meantime, yields headed lower, with some interruptions, in the

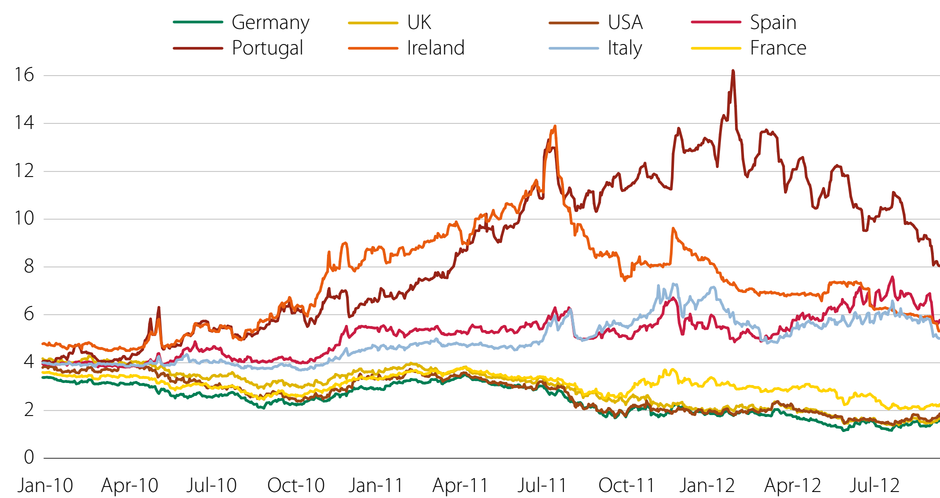
Long-term government bond markets were hit by a new wave of turbulence in late July…

European economies already granted financial assistance, in this case spearheaded by the Irish bond. Finally, yields on Spanish and Italian ten-year bonds climbed to end-July highs of 7.6% and 6.6% respectively. As of early September, however, the release of detailed arrangements for the ECB's conditional sovereign bond purchasing programme sent them falling back to mid-month levels of 5.8% and 5.0% (see figure 3).

…which tended to remit over subsequent weeks after the ECB released the details of its sovereign bond purchasing plan.

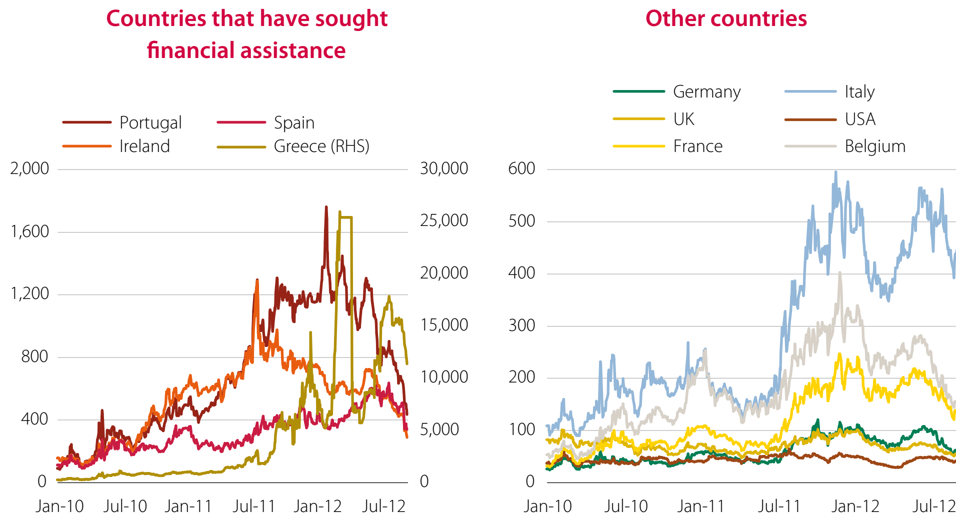
Sovereign spreads traced a similar course to government bond yields. For a large set of Europe's economies, this translated as annual highs at the end of July with debt market tensions surging anew. At this point, the Spanish and Italian bonds were running spreads over the German benchmark of 635 bp and 534 bp respectively. In early September, however, sovereign credits spreads, as derived from CDS premiums (see figure 4) and spreads vs. the German bond, initiated a clear narrowing movement. By mid-September, domestic yield spreads versus Germany were down to 412 bp in Spain, 366 bp in Ireland and 336 bp in Italy, a decrease of 223 bp, 198 bp and 141 bp respectively with respect to the end of July.

Ten-year government bond yields (%) FIGURE 3



Source: Thomson Datastream. Data to 14 September.

Sovereign credit spreads, 5-year CDS FIGURE 4



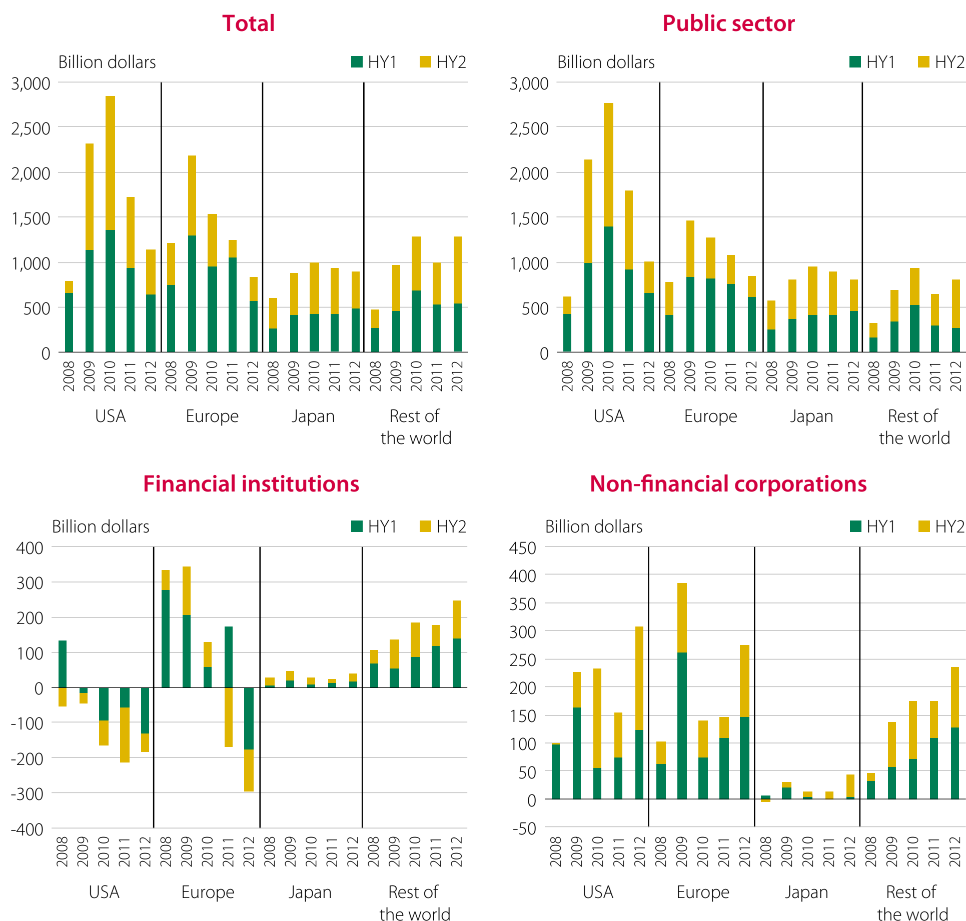
Source: Thomson Datastream. Data to 14 September.

The resurgence of European sovereign debt market turbulence had no great impact on corporate bond spreads either in the United States or Europe, although it did leave its mark on net debt financing by financial institutions. As figure 5 shows, net issuance on international debt markets sums over four trillion euros year to date (in annual terms), 15% less than the total issued in 2011. Looking at the source of these borrowings by issuer and region, we find that the decline owes to lower sovereign debt issuance in the United States and Europe; a consequence, primarily, of countries' ongoing fiscal austerity programmes. Meantime, market tensions continued to hinder financial sector debt financing, which stayed negative in both the United States and Europe, albeit with a significant increase between the first and the second half. Quite another story were non-financial corporations, whose year to date issuance, at 862 billion dollars (in annual terms), was 76% more than in 2011, with the advance extending to all main economic areas.

International net debt issuance contracts as sovereign borrowers in main world areas rein back their issue volumes.

Net international debt issuance

FIGURE 5



Source: Dealogic. Half-year data. Data for the second half of 2012 run to 14 September, but are restated on a semiannual basis to facilitate comparison.

World stock indices return to gains in the third quarter after a second-quarter slide.

After starting the year in bullish form, the stock indices of the major advanced economies deflated in the second under the twin pressure of debt market turmoil and concerns about slower growth in some economic regions. Most leading indices then rallied in the third quarter, with European markets rising faster on the news that the ECB was prepared to purchase European sovereign bonds.

U.S. and German indices have been the best performers …

U.S. stock indices registered year-to-date gains in the interval of 11.3% to 22.2%, while European indices performed more divergently, depending not only on each economy's entanglement in the debt crisis but also the relative strength of its domestic activity. Progress in the first three quarters accordingly ran from the -4.8% of Spain's Ibex 35 to the 25.7% of the German Dax. Meantime, Japanese indices chalked up gains ranging from 3.9% to 8.3%.

International equity markets saw an upswing in volatility in the middle months, particularly in Europe, albeit without repeating the peak levels of previous turbulence rounds.

Performance of main stock indices[1] (%)

TABLE 2

	2008	2009	2010	2011	3Q11	4Q11	1Q12	2Q12	3Q12 (to 14 September)		
									% prior qt.	% Dec	% y/y[2]
World											
MSCI World	-42.1	27.0	9.6	-7.6	-17.1	7.1	10.9	-5.8	9.1	14.0	14.6
Euro area											
Euro Stoxx 50	-44.4	21.1	-5.8	-17.1	-23.5	6.3	6.9	-8.6	14.6	12.0	20.2
Euronext 100	-45.2	25.5	1.0	-14.2	-20.6	6.0	8.3	-4.7	10.2	13.7	18.4
Dax 30	-40.4	23.8	16.1	-14.7	-25.4	7.2	17.8	-7.6	15.5	25.7	33.0
Cac 40	-42.7	22.3	-3.3	-17.0	-25.1	6.0	8.4	-6.6	12.0	13.3	18.2
Mib 30	-48.7	20.7	-8.7	-24.0	-23.8	1.0	7.9	-11.3	16.3	11.4	11.6
Ibex 35	-39.4	29.8	-17.4	-13.1	-17.5	0.2	-6.5	-11.3	14.8	-4.8	-2.8
United Kingdom											
FTSE 100	-31.3	22.1	9.0	-5.6	-13.7	8.7	3.5	-3.4	6.2	6.2	10.2
United States											
Dow Jones	-33.8	18.8	11.0	5.5	-12.1	12.0	8.1	-2.5	5.5	11.3	18.1
S&P 500	-38.5	23.5	12.8	0.0	-14.3	11.2	12.0	-3.3	7.6	16.6	20.5
Nasdaq-Cpte	-40.5	43.9	16.9	-1.8	-12.9	7.9	18.7	-5.1	8.5	22.2	21.4
Japan											
Nikkei 225	-42.1	19.0	-3.0	-17.3	-11.4	-2.8	19.3	-10.7	1.7	8.3	3.3
Topix	-41.8	5.6	-1.0	-18.9	-10.4	-4.3	17.3	-9.9	-1.7	3.9	-1.5

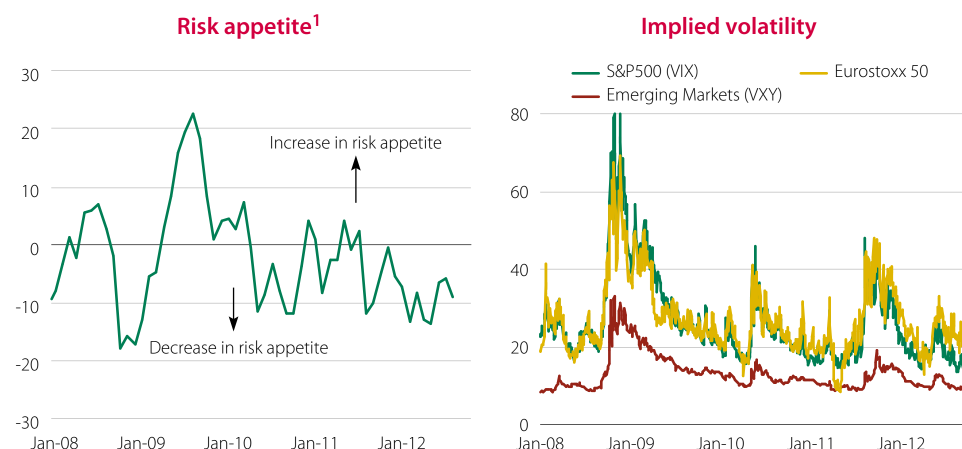
Source: Datastream.

1 In local currency.

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

Financial market indicators

FIGURE 6



Source: Thomson Datastream and CNMV.

1 State Street indicator.

2.2 National economic and financial developments

Spain's GDP contracts 1.3% in the second quarter on domestic demand weakness …

According to the latest Quarterly National Accounts data, Spain's GDP shrank by three decimal points between April and June 2012, one point more than in the preceding quarter, enlarging the year-on-year contraction by six decimal points to 1.3%. The euro, meantime, saw its output recede by two and five decimal points in quarterly and year-on-year terms respectively.

…with further decline in private consumption and investment.

The cause of the Spanish economy's deepening recession was the greater detractive impact of domestic demand compared to a flat positive contribution from the net exports side. The downturn in domestic demand traced primarily to private consumption (down from -1.5% to -2.2% year on year), construction investment (down by an additional 2.3 percentage points to -11.8%) and equipment investment (down from -6% to -7%). The external sector made a flat contribution in the second quarter, with a small rise in export growth offset by slower falling imports.

On the supply side, construction activity fared worst.

From a supply side perspective, the sharpest contraction was again in construction GVA (-7.1% year on year against the -7.3% of the prior quarter). The GVA of the industrial branch slowed its rate of decline (by three decimal points to -3.1%) and the services sector lost ground for the first time since June 2009 (down by three decimal points, against the 0.9% advance of the first quarter).

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

					FUNCAS[1]	
	2008	2009	2010	2011	2012P	2013P
GDP	**0.9**	**-3.7**	**-0.3**	**0.4**	**-1.7**	**-1.1**
Private consumption	-0.6	-3.9	0.6	-0.8	-1.7	-1.5
Government consumption	5.9	3.7	1.5	-0.5	-6.9	-6.5
Gross fixed capital formation, of which:	-4.7	-18.0	-6.2	-5.3	-8.7	-4.4
Construction	-5.8	-16.6	-9.8	-9.0	-10.8	-5.8
Machinery and equipment	-3.1	-24.2	3.1	2.5	-7.2	-2.5
Exports	-1.0	-10.0	11.3	7.6	2.0	4.9
Imports	-5.2	-17.2	9.2	-0.9	-6.3	-1.3
Net exports (growth contribution, p.p.)	1.5	2.9	0.3	2.3	2.5	1.5
Employment (full-time equivalent jobs)	-0.2	-6.3	-2.6	-1.7	-3.6	-2.0
Unemployment rate	11.3	18.0	20.1	21.6	24.4	25.2
Private consumption deflator	4.1	-0.3	1.8	3.2	2.0	1.7
Net lending (+)/borrowing (-) vs. the rest of the world (% GDP)	-9.9	-4.6	-4.5	-3.6	-1.7	-0.2
General government surplus (+)/deficit (-) (% GDP)	-4.5	-11.2	-9.4	-8.9	-6.3	-4.0

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

1 Based on the average consensus of the panel of forecasts for the Spanish economy constructed by this institution through a survey of eighteen research departments. The survey was run in July 2012.

After holding broadly stable at around 2% between January and June, Spanish inflation turned up sharply in August (to 2.7%) and September (to 3.5% according to the leading indicator) on rising fuel prices and the recent hike in VAT. Core inflation stayed flat as far as an August rate of 1.4%. This jump in Spain's inflation has wiped out its negative differential vs. the euro area, in place since the closing months of 2011.

Inflation surges in August and September on rising fuel prices and VAT.

The weakness of the Spanish labour market was starkly apparent in the second quarter in the shape of quickening job destruction (-4.6% against the -3.6% of the preceding quarter) and a rising unemployment rate (to 24.6%, two decimal points more than in the opening quarter). Better news comes from unit labour costs, which fell faster in the second quarter (by six decimal points, to -2.1%) on higher productivity per worker (up by 3.5%, four decimal points more than in the previous quarter) and more moderate growth of employee wages (down two decimal points to 1.3%).

Labour market weakness intensifies in the third quarter, taking unemployment rates to 24.6% of the active population.

According to budgetary execution figures, the central government deficit in national accounts terms was 4.8% in the first eight months of 2012, three decimal points above the full-year target[2] under this head (the objective for general government accounts has been set at 6.3%). The autonomous communities, according to the latest available data to June 2012, closed the period with a deficit of 0.8%, a little over half the target set for regional government (1.5%). Public debt, as estimated by the Excessive Deficit Procedure, amounted to 76% of GDP in June 2012 (69.3% at end-2011), of which 58.3 points correspond to central government (52.6 in 2011), 14.2 to the autonomous communities (13.3 in 2011) and 3.4 to local governments (3.3 in 2011).

Budgetary execution figures to June express the commitment at all levels of government to rein in the public deficit.

Implementation in Spain of the IOSCO principles on securities regulation: IMF recommendations ensuing from the 2012 FSAP report EXHIBIT 1

Last June, the IMF published the results of a comprehensive review of the Spanish financial system conducted over the closing months of 2011 and the first of the current year, as part of its regular analyses of national financial systems under the Financial Sector Assessment Program (FSAP). This programme, established in 1999, examines the different sub-sectors making up a country's financial system, essentially banking, insurance and financial markets, by reference to such indicators as financial soundness, compliance with international regulatory and supervisory standards and ability to contribute to economic growth. To date over 75% of IMF member countries have undergone assessments of this kind. This is Spain's second review, with the first taking place in 2006.

This exhibit considers the FSAP's main conclusions in the area closest to the CNMV's remit: implementation of the international objectives and principles of securities regulation promoted by IOSCO.[1] The first thing to say is that the IMF report finds a high degree of implementation of the IOSCO recommendations. Of the 36 IOSCO principles the Fund subjected to review, 28 were assessed as "fully implemented", five as "broadly implemented" and only three (principles 2, 12 and 31) as "partly implemented". The IMF also stressed that the CNMV had made

2 Many of the recently approved expenditure adjustment measures will be rolled out in the second half, so it seems likely that the central government figure will come back on course in the year's closing months.

more active use of its powers in recent years despite the ongoing financial crisis and its seriously limited human and material resources.

In assessors' judgement, the underlying strengths of the supervisory system employed by the CNMV include the practice of conducting selective reviews in thematic areas, dealing with specific issues or activities from a full-industry perspective, its robust arrangements for market surveillance and its keen commitment to the identification and monitoring of emerging and systemic risk. On this last function, a recent but crucial addition to the IOSCO catalogue, the IMF team remarked that the CNMV, through its *Grupo Interno de Estabilidad Financiera*, is able not only to identify and monitor potential sources of systemic risk, but also to adequately review the perimeter of regulation in securities matters.

Regarding areas in need of strengthening, the IMF urges more attention to the inspection of credit institutions which market investment products and services. It also singles out aspects of Spain's legal framework for securities regulation and supervision which it considers could limit the CNMV's independence and operational efficiency.

In its first recommendations, referring basically to principles 12 and 31, the IMF contends that the CNMV should make more use of on-site inspections involving physical visits to the premises of regulated entities, particularly credit institutions in view of their dominant role in investment product distribution. It should be said here that the CNMV's supervisory practices regarding the financial entities within its jurisdiction, like those of most financial sector supervisors, involve a combination of on-site inspections and off-site or distance supervision comprising the review of information that is mostly provided by or requested from the operators themselves. In their report, the IMF assessors commend the CNMV for the robustness of its supervisory practice in both cases, with particular mention to its thematic reviews.

The CNMV is aware of the banks' importance in the retail distribution of investment products, and has been stepping up its oversight with regard to this activity. Specifically, in the last three years, it has carried out on-site inspections at credit institutions serving 75% of sector clients, at the same time intensifying its off-site monitoring. It conducted, for instance, an off-site review of secondary market selling practices in relation to preference shares, a review that extended to 27 credit institutions accounting for 95%of the total market.

Recommendations regarding the CNMV's institutional framework refer mainly to IOSCO principles 2 and 3, and indeed some were first put forward in the 2006 FSAP report. Firstly, assessors stated that reserving a place on the CNMV board for the Secretary General of the Treasury and Financial Policy and the fact that certain key decisions regarding authorisations and sanctions are still a responsibility of the Ministry of Economy and Competitiveness (MEC) could compromise the regulator's independence. They acknowledge, however, that the collegial nature of the board and the "regulated" nature of authorization and sanctioning processes – which invariably require a recommendation from the CNMV even though the decision falls to the MEC – have, in practice, a strong mitigating force.

Although this is not an issue covered explicitly by the IOSCO principles, the IMF team thought the CNMV should have broader powers in secondary legislation. At present, the Commission can only issue rules when expressly authorised to do so in the higher-order texts making up core legislation, i.e., laws passed by Parliament or regulations approved by the Council of Ministers or the MEC. The assessors saw this limitation as excessive, since it could constrain the CNMV's ability to respond quickly to an emerging problem in the market, and delay a regulatory response. And this, they point out, could prove costly in crisis situations like today's. They also acknowledged that the CNMV seems to deal with this problem by initiatives using its existing powers.

Finally, assessors reiterated the criticism levelled by the 2006 report to the effect that the CNMV was overdependent on government in matters of staff hiring. As things stand, CNMV requires governmental approval to recruit new resources and any vacancies must be announced as part of an annual public sector employment call. They were concerned that such dependence could limit the Commission's ability to attract or retain the required expertise and urge the authorities to explore mechanisms that allow it to compete effectively for staff resources.

While the CNMV does not fully share some of the report's conclusions, it welcomes the work done by the IMF team in assessing Spain's implementation of the IOSCO objectives and principles, and is closely studying its recommendations. The Commission is also convinced that having a rigorous external evaluation conducted through the FSAP by experts equipped with a global view of the financial sector, is an invaluable aid for national authorities, including supervisors.

1 The IMF reports resulting from this process are available at: http://www.imf.org/external/pubs/cat/scr1_sp.aspx?s_year=2012&e_year=2012&brtype=default.

Spanish credit institutions remain immersed in a profound restructuring process backed financially by the EU.

Spanish credit institutions continue to undergo an intense restructuring process, with the prospect that financial assistance from the European Union (up to one hundred billion euros) and the Government's latest legislative measures (see exhibit 2) will provide a firm platform for recovery. With slack domestic activity barring the way to a more rapid recovery, there is little immediate chance of a return to normal lending.

Sector-wide losses in the first half period sum 16 billion euros.

Spanish deposit-taking entities reported pre-tax losses of nearly 16 billion euros in the first six months of 2012 (against the 1.44 billion profits of the year-ago period). This decline reflects fast-rising impairment losses on financial assets (15.98 billion) and remaining assets (7.05 billion). The brighter side of sector income statements was provided by gross margin improvement and operating cost containment.

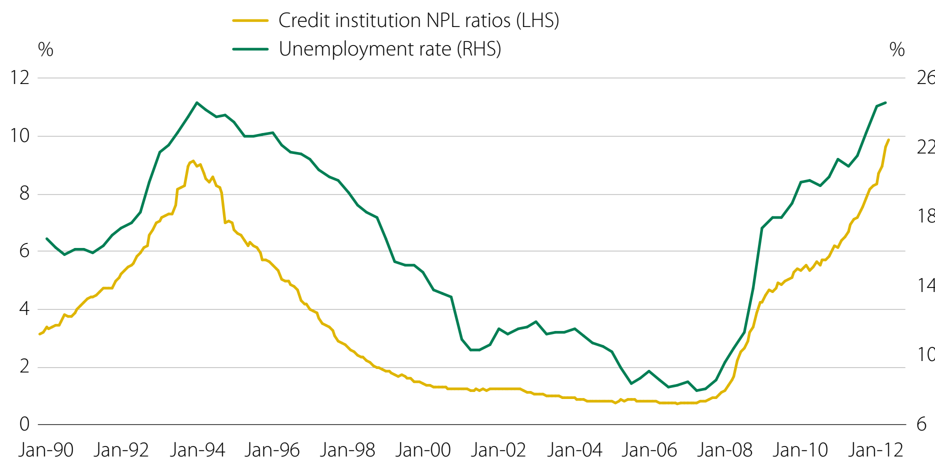
Bank sector lending to non-financial corporations and households decelerates further to mid-year.

Lending to non-financial private sectors continued to slide, from year-on-year rates of around -2% in the first months of the year to a July rate of -3.3%. The finance reaching non-financial corporations shrank by 3.3% year on year (-5.9% in loans and -8.7% in non-equity securities) while loans to households dropped by 3.4% (-3.0% in home purchase loans and -4.6% in consumer credit). The contrast was provided by the public authorities whose borrowings grew throughout the year at rates nearing 15%.

With NPL ratios testing 10%, the sector has broken through the record levels of the 1992-1993 crisis.

Credit institutions' NPL ratios have expanded relentlessly on the weakness of domestic economic activity and high unemployment, with rates approaching 25% of the active population (see figure 7). By July, the ratio was testing 10%, its second month running above the record levels of the 1992-1993 crisis (with a peak of 9.15% in February 1994). Most delinquent loans were again linked to real estate development (27.4% in June) and construction (23.9%), while non-performance linked to home purchase mortgages reached a mid-year level of 3.2%.

Credit institution NPL ratios and the unemployment rate[1] FIGURE 7



Source: Banco de España and INE. NPL ratios to July, unemployment rate to June.

1 Of the active population.

Banks again drew the bulk of their funding from the Eurosystem.

Credit institution financing conditions in the second quarter and part of the third were adversely impacted by doubts about the health of Spain's financial sector, for which the Government had sought EU aid in June 2012. For most of the year, the banks have relied partly on easier access to Eurosystem funding (which reached 389 billion euros in August, see figure 2) and partly on non-financial private sector savings, which they tapped primarily through commercial paper. Issues further down the yield curve have been concentrated in mortgage covered bonds and non-convertible bonds (a majority backed by government guarantee), which have mostly been retained on balance sheets for use as collateral in Eurosystem credit operations. The positive note was provided by a series of launches in September, taking advantage of the month's more settled market climate.

Key content of Royal Decree-Law 24/2012 of 31 August on restructuring and resolution of credit institutions EXHIBIT 2

The main purpose of Royal Decree-Law 24/2012 of 31 August on restructuring and resolution of credit institutions is to introduce the measures stipulated in the Memorandum of Understanding associated with the financial assistance Spain applied for last June in order to recapitalise its financial sector. Among the MoU's conditions was that that a restructuring plan should be submitted in the form of a legal commitment before the end of August 2012. In view of the difficulties confronting Spain's financial sector, the text equips public institutions with the tools they need to complete the restructuring process initiated more than three years back, while minimising the burden on public funds and safeguarding the stability of the financial system.

The RD-L regulates three procedures, to be activated according to the seriousness of a bank's situation. These are early-action measures, restructuring and resolution. Early-action measures will be applied when a bank fails to comply with its capital, liquidity, organizational or internal control requirements, or when it is reasonably foreseeable that it will be unable to comply with them, but has the capacity to return to compliance through its own resources or exceptional financial aid based on instruments convertible into shares within two years at most.

Institutions in this situation must submit an action plan to the Banco de España which guarantees their long-term viability with no call on public funds. Also, during this phase, the Banco de España may demand that board members resign or even that the board's powers be provisionally transferred to another body, in cases where the exceptional gravity of its situation could undermine the soundness of its capital base or its stability, liquidity or solvency.

The resolution procedure has been devised for institutions that are unviable or likely to become so in the near-term future, while restructuring applies when public aid is required to guarantee a bank's viability, but there is evidence to indicate that it has the capacity to make repayment within the time stipulated for each of the support instruments envisaged in the RD-L (purchase of ordinary shares or convertible instruments, or contributions to share capital).

The concept of resolution (rather than ordinary insolvency proceedings) is one of the main novelties the RD-L brings to Spanish legislation, with the aim of offering depositors and the financial system better guarantees in the event of a bank's liquidation. The selection of resolution instruments takes on board elements of the draft future European directive, and includes the sale of the bank's business to a third party, the transfer of its assets and liabilities to a bridge bank, or the transfer of its assets and liabilities to an Asset Management Company. In the event that a resolution process is instigated, the bank's governing body will also be replaced.

Banks undergoing restructuring or resolution must draw up an action plan for approval by the Banco de España. The Fund for the Orderly Restructuring of the Banking Sector (FROB) will decide which instruments are most conducive to its orderly execution at the lowest possible cost to the taxpayer.

Another key element of the RD-I is the creation of an Asset Management Company to hold the distressed assets removed from bank balance sheets, facilitating their management. The FROB is empowered to force banks to transfer such assets to the Asset Management Company, which will be incorporated as a public limited company. Detailed arrangements for the transfer and valuation of impaired assets are subject to regulatory development.

The text also sets out voluntary and compulsory mechanisms, based on discharge, for the management of hybrid instruments such as preference shares and subordinated debt. These actions are informed by the principles of responsibility and assumption of risk, which dictate that the costs of restructuring or resolution of an entity should be borne first of all by its shareholders and subordinated creditors. Detailed arrangements for their application will be decided by the FROB.[1]

The Royal Decree-Law strengthens the FROB's powers. In order to avert possible conflicts of interest, credit institutions will no longer serve on its management committee through the Deposit Guarantee Fund. It will also have a Director General with full executive functions, and its resolutions will be of an executive nature, i.e. not subject to approval by the general meeting of shareholders. The text pursues a cooperation and coordination framework for the FROB and other competent national and international authorities along the lines of those in place for institutions like the Banco de España.[2]

Its additional and final provisions introduce an assortment of measures required by the Memorandum of Understanding, whose purpose is to improve the functioning of the financial market. The first set refers to the protection of retail investors. In this respect, the CNMV' is given stronger control over the sale of investment products, especially of complex products like preference shares. Specifically, the marketing or placement with the retail public of complex products qualifying as own funds for the purpose of credit institution capital adequacy requirements will be subject to the following conditions: (i) the issue must reserve at least a 50% tranche for professional investors, whose total number will be no less than fifty, and (ii) in the case of preference share issues,[3] the denomination unit may be no less than 100,000 euros (25,000 euros for remaining issues). Failure to comply with these conditions will constitute a serious breach.

In addition, the CNMV is empowered to require that all pertinent warnings in regard to the financial instrument, including the fact that it is not suitable for retail investors, be inserted in advertising material or the precontractual documents delivered to clients. Investment service providers will also have to give their clients a copy of the report on the appropriateness analysis run, and provide a record in writing or some durable medium of all recommendations made in the light of their investment profile. Another novelty referring to the sale of complex products is that the contractual document should include, along with the client's signature, a written representation in terms to be determined by the CNMV that they have warned that the product is inappropriate or that its appropriateness cannot be judged for lack of data.

The second set refer to the thresholds defined in the Securities Market Law for the publication of a prospectus, and which accordingly determine whether a giv-

en issue is to be treated as a public offer. Also modified in this section are the thresholds above which issuers listed on an official secondary market or other regulated market are bound by periodic reporting requirements.

A major innovation is the transfer of authorisation and sanctioning powers in respect of credit institutions from the Ministry of Economy and Competitiveness to the Banco de España.

A final feature of this RD-L is the change in the core capital requirements applicable under Royal Decree l 2/2011 of 18 February on the strengthening of the financial system.[4] Specifically, the current requirements will be replaced by a single standard of 9% of risk-weighted exposures, to be met by all banks from 1 January 2013. The definition of core capital is also aligned with the definition used by the European Banking Authority as regards both qualifying elements and charges.

1 The Royal Decree-Law clarifies that, in accordance with the principle of responsibility and of assumption of risk, the fact that a bank has received public financial aid as a matter of urgency prior to a decision being made about its restructuring or resolution will not deter the FROB from subsequently imposing management measures on such instruments in order to minimise costs to the taxpayer.
2 For instance, the CNMV must issue a prior report when securities deposited at a FROB-administered entity are transferred to another entity authorised to conduct this activity.
3 Also applicable to the convertible debt instruments of entities that are not listed companies.
4 Eight percent as the standard level and 10% for banks which have limited access to the markets and for banks whose funding is mainly wholesale.

The aggregate profits of non-financial listed companies slide by 40% in the first six months to 8.35 billion euros…

The aggregate profits of non-financial listed companies dropped 39.9% in the first six months to 8.35 billion euros (see table 4), in tune with the faltering progress of domestic economic activity. Although all the sectors followed shared in the decline, construction and real estate came out particularly badly, with net profits of over one billion euros in the first half of 2011 turning to 2.10 billion losses one year later. Also losing out was retail and services, whose profits fell from 5.20 billion to 3.02 billion euros in the same twelve months. Profits decline, finally, was more moderate in absolute terms in energy and industry.

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

	EBITDA[2]		EBIT[3]		Net profit	
Million euros	**1H11**	**1H12**	**1H11**	**1H12**	**1H11**	**1H12**
Energy	14,227	14,222	9,652	9,235	6,129	5,827
Industry	3,468	3,892	2,332	2,656	1,539	1,524
Retail and services	15,972	14,792	8,997	7,521	5,199	3,019
Construction and real estate	3,641	3,850	2,409	2,113	1,006	-2,093
Adjustments	-85	-4	-30	45	13	71
AGGREGATE TOTAL	**37,223**	**36,752**	**23,360**	**21,570**	**13,886**	**8,348**

Source: CNMV.
1 Year to date.
2 Earnings before interest, taxes, depreciation and amortisation.
3 Earnings before interest and taxes.

...while financial leverage ratios ticked up from 1.4 to 1.5.

Non-financial listed companies reported aggregate debt levels in June 2012 of 312.9 billion euros, 1.3% more than in December last year, breaking with the downtrend initiated in 2010 and lifting average leverage (debt to equity) from 1.4 to 1.5. In relative terms, the increase was steepest in industry, up 6.0% to 18.6 billion euros, while in straight-money terms it was retail and services which recorded the biggest leap (up by 4.39 billion to 117.5 billion euros). Companies' debt coverage ratio, measuring the years needed to repay existing debt assuming constant EBITDA, and interest cover (EBIT/interest expenses) held flat overall between December 2011 and June 2012 (see table 5), with the deteriorating ratios of retail and services – a consequence of their higher debt – offset by stable or slightly improved readings across all remaining sectors.

Gross debt by sector: listed companies TABLE 5

Million euros		2008	2009	2010	2011	1H12
Energy	Debt	82,608	100,572	98,283	95,853	94,602
	Debt/Equity	0.89	1.08	0.95	0.92	0.89
	Debt/EBITDA[1]	2.82	3.46	2.81	3.27	3.33
	EBIT[2]/Interest expenses	3.67	3.38	4.15	3.30	3.31
Industry	Debt	15,645	15,953	14,948	17,586	18,634
	Debt/ Equity	0.69	0.69	0.58	0.63	0.68
	Debt/EBITDA	2.71	3.05	2.11	2.54	2.39
	EBIT/Interest expenses	3.41	3.15	5.00	3.90	4.25
Construction and real estate	Debt	119,788	104,762	99,917	83,716	83,434
	Debt/Equity	3.77	4.08	3.42	2.98	3.29
	Debt/EBITDA	31.87	22.48	11.18	15.00	10.84
	EBIT/Interest expenses	0.01	0.31	0.98	0.52	0.86
Retail and services	Debt	112,322	108,579	115,413	113,142	117,535
	Debt/Equity	2.14	1.78	1.60	2.01	2.14
	Debt/EBITDA	3.58	3.70	3.38	3.78	3.97
	EBIT/Interest expenses	2.86	3.28	3.94	2.45	2.17
Adjustments[3]		-20.802	-1.908	-1.792	-1.404	-1.323
AGGREGATE TOTAL	**Debt**	**309,561**	**327,958**	**326,769**	**308,893**	**312,882**
	Debt/Equity	1.63	1.63	1.43	1.44	1.47
	Debt/EBITDA	4.63	4.82	3.84	4.29	4.26
	EBIT/Interest expenses	2.01	2.42	3.12	2.30	2.32

Source: CNMV.

1 Earnings before interest, taxes, depreciation and amortisation.

2 Earnings before interest and taxes.

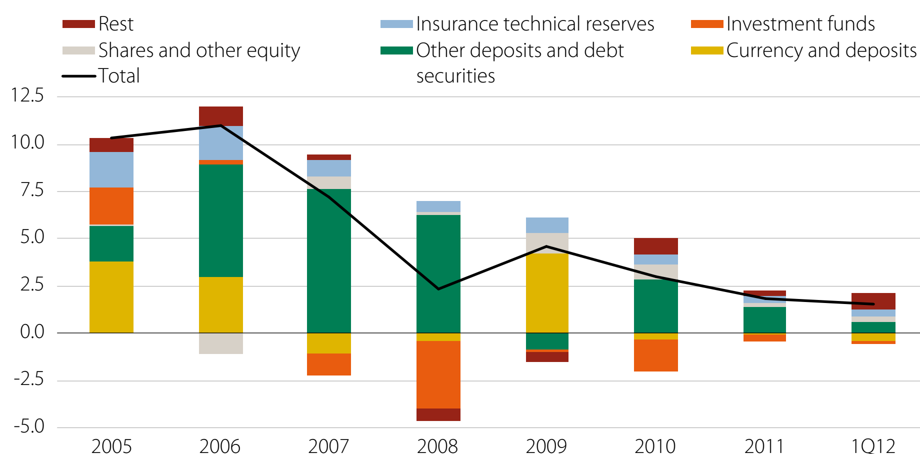
3 In drawing up this table, we eliminated the debt of issuers consolidating accounts with some other Spanish listed group. The figures in the adjustments row correspond to eliminations from subsidiary companies with their parent in another sector.

In a context of overall decline in household financial leverage, financial investments, primarily in debt securities and insurance products, have dropped to recent-year lows.

Household asset indicators for the first quarter of 2012 say that indebtedness has fallen to 120% of disposable income due to lower debt and flat household income. The sector's net wealth also contracted, primarily on depreciating real estate. As to investment decisions, households' net financial asset purchases came to 1.5% of GDP (cumulative four-quarter data), four decimal points less than in full-year 2011. Invest-

ment in currency and deposits was negative to the tune of -0.4% of GDP, while investment in time deposits and debt securities was a positive 0.6%. Net acquisitions of shares and other equity also generated a positive outcome, although the figures are very small, while investment fund outflows continued apace (see figure 8).

Households: financial asset acquisitions (% GDP) FIGURE 8



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

Proposed regulation of a new investor information document for packaged retail investment products EXHIBIT 3

In July 2012, the European Commission presented its Proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products. If approved, the Key Investor Information Document (KIID) will be compulsory in all sales of what the text refers to as packaged retail investment products (PRIPs).

The aim of this legislative initiative is to ensure that the precontractual information given to retail investors is comparable across different products, plainly worded and follows a standard structure. The idea, ultimately, is for investors to be able to base their decisions on a more solid understanding which allows them to compare products of a similar economic purpose, even when they may come wrapped in different legal forms.

The Regulation, as currently formulated, will be binding in all respects and automatically applicable in Member States two years after its entry into force. This term is extended to five years in the case of investment funds, which meantime can go on using the key investor information document introduced by Directive 2009/65/EC.

Below we summarise the key points of the draft Regulation:

1. *Scope of application*. The Regulation will apply to all investment products where the return to the investor varies according to the performance of one

or several underlying assets or securities other than an interest rate; what the draft calls packaged products. The term extends, moreover, to products incorporating full or partial capital protection, investment funds addressing retail investors, all structured products, derivative instruments and insurance contracts with investment elements.

2. *Responsibility for producing KIIDs.* Because investment product manufacturers know their investment products best and are responsible for creating them, the text proposes that they should be responsible for producing the KIID. Each eligible product will have its own KIID, which will be published before it goes on sale to retail investors. Any party introducing changes in the product that alter its risk-return profile or its costs will be considered a co-manufacturer. The product's creator may decide to delegate the KIID's preparation (to the distributor for instance), but this will have no impact on its responsibility.

3. *KIID form and content.* The document should meet the following conditions: i) be a stand-alone publication clearly separate from advertising material, ii) be short, clearly expressed and easy to understand, iii) avoid use of jargon and iv) cover all essential information. The essential elements to be covered are as follows: 1) identification of the product and its manufacturer, 2) the nature and objectives of the product (including where appropriate different performance scenarios), 3) a brief indication of whether loss of capital is possible, 4) the recommended minimum holding period, 5) expected liquidity (including the possibility and conditions for any disinvestments before maturity), 6) risks and costs and 7) past performance (where relevant). The European Commission is empowered to adopt delegated acts specifying the details of the presentation and content of KIIDs. Further, marketing communications may not include any statement that contradicts the information contained in the KIID or diminishes its significance. They should also indicate that a key information document is available and supply information on how to obtain it. The product's manufacturer must ensure that the KIID is regularly updated, in accordance with the review conditions and frequency established in delegated acts of the European Commission. When a KIID does not comply with the articles of the Regulation, retail investors may claim damages from the investment product manufacturer for any losses that result from relying on its content. The burden of proof in such cases will lie with the manufacturer.

4. *Obligation to provide the KIID.* The product's distributor or manufacturer, if sales are direct, must provide retail investors with the KIID free of charge well in advance of the transaction. However, when the retail investor wishes to conclude the transaction by some means of distance communication where it is not possible to deliver it beforehand, the seller may provide the KIID immediately afterwards, having first informed the investor of this fact. In this case too, the European Commission will adopt delegate acts establishing the timing of delivery. The KIID can be provided on paper or some other durable medium, or else through the manufacturer or distributor's website.

5. *Other measures: complaints and sanctions.* The investment product manufacturer must establish procedures and arrangements which ensure that retail investors who have submitted a complaint in relation to the KIID receive a substantive reply in a timely and proper manner. Member States should ensure that the competent authorities have the power to impose at least the following sanctions: an order prohibiting or suspending the marketing of an investment product, the issue of public warnings on breaches of the regulation, and ordering publication of a new version of the KIID. Equally, they should ensure that the competent authorities have the power to issue or require the manufacturer or seller of the investment product to issue a direct communication to the investor concerned, informing them of the administrative measure or sanction, and where they can lodge complaints or submit claims for redress. The competent authorities should also disclose administrative measures and sanctions to the public, identifying the breach and those responsible for it, unless such disclosure would seriously jeopardise the financial markets or cause disproportionate damage to the parties concerned. This information should also be reported to the three European supervisory authorities (EBA, EIOPA and ESMA).

2.3 Outlook

The latest IMF forecasts say the world economy will grow 3.5% in 2012 and 3.9% in 2013, with emerging economies as the main motor.

In its latest forecasts, published July 2012, the IMF augurs growth this year of 3.5% and 3.9% in 2013, on a par with 2010. The advanced economies, it projects, will expand 1.4% this year, a little below the 2011 rate, and just under 2% in 2013, while the emerging market economies will manage a 5.6% advance this year followed by 6% in 2013, compared to the 6.2% approximately of 2011.

Forecasts are predicated above all on the success of management measures put in place for the European sovereign debt crisis.

The main risks for these projections are tilted to the downside. They are, primarily, the fear that the mechanisms deployed to manage Europe's sovereign debt crisis will fail to work effectively or arrive too late. On this score, the pledge by Member States to advance towards fiscal and banking union in the zone, along with the ECB's release of detailed arrangements for its conditional sovereign bond purchasing programme would seem to be steps in the right direction. Another risk facing some advanced economies, especially the U.S. and Japan, concerns the need to consolidate public accounts looking to the medium term. In the case of the emerging market economies, downside risks for the baseline growth scenario are loss of external sector growth momentum and more slowly expanding credit.

Spanish GDP will contract around 1.5% this year and 0.6% in 2013, with financial market tensions and prolonged labour-market weakness as the main brakes on the economy.

The IMF's July projections for the Spanish economy point to a slowdown in domestic economic activity extending to 1.5% in 2012 and 0.6% in 2013. These estimates mark a revise-up of four decimal points and a revise-down of seven decimal points respectively against its previous forecasts, released in April this year. This baseline macro scenario is, moreover, hedged by uncertainty, given the tensions persisting in domestic financial markets, which are choking off finance to all economic sectors, and the country's prolonged state of labour-market weakness. That said, financial assistance from the European Union, earmarked to rebuild a domestic financial system engaged in a root-and-branch restructuring, and the adoption of structural and fiscal reforms may help mitigate some of the risks looming over Spain's economy.

3 Spanish markets

3.1 Equity markets

The Ibex 35 has shed 4.8% of its value year to date,…

Throughout July, domestic stock markets felt the full force of the European sovereign debt crisis and the problems besetting Spain's banks, against a backdrop of faltering economic activity. Share price falls were a constant, accompanied by a sharp deterioration in liquidity conditions and volatility at annual highs. From the closing days of the month, however, the announcement and subsequent publication of the ECB's latest plan to intervene in sovereign debt markets ushered in a calmer period during which stocks rallied strongly. Also relevant was the CNMV's decision on 23 July to impose an immediate ban on trades involving the creation or increase of net short positions on Spanish shares.[3] Finally, the Ibex 35 gained 14.8% in the third quarter after two previous quarterly falls (-6.5% and -11.3%) thanks to a late rally in the month of September, but still ended the quarter 4.8% down versus the 2011 close. Along the way, the index hit a July low that sent it tumbling back to the price levels of March 2003.

… while other national indices have performed more unevenly.

Small cap stocks performed roughly in line with the Ibex 35 by way of a steeper first-half fall (-27.6%) followed by a more muted recovery (12.1%) in the third quarter, leaving it 18.8% down in the nine-month period. Conversely, the strong first- and third-quarter progress of other major Spanish indices (tracking medium caps and Latin American companies trading on domestic platforms) offset the price dip of the second quarter, leaving some at least in positive territory year to date – the Ibex Medium Cap and FTSE Latibex Top with 5.3% and 3% respectively versus the -1.3% of the FTSE Latibex All-Share.

All sectors managed a sturdy third-quarter advance that nonetheless failed to offset first-half losses.

Closer analysis shows that third-quarter gains extended across the board, in contrast to the losses endured by most sectors over the first-half period. The real estate sector was at the forefront of the third-quarter rally (up 39.6% after a first-half slide of 38.6%, for a year-to date fall of 14.3%), followed by insurance (35.1% after -30.4% respectively leaving it down by 6%), oil and gas (27.8% after -44.2% for a decline of 28.7%) and the banks (23.2% after -19.4% returning prices to more or less their startout levels). Remaining sectors posted more modest third-quarter rises running from the 4.7% of basic consumption to the 16% of health. This last sector plus discretionary consumption were the only ones managing a straight rise across all three quarters, as far as year-to-date gains of 60% and 35.1% respectively. The biggest year-to-date fall, of 53.8%, corresponded to chemicals whose 14% third-quarter advance could do little to counter the 59.5% slide of the first-half period.

3 This measure resembles the curb imposed by the CNMV on 11 August 2011 and lifted 16 February 2012, albeit with three basic differences. Firstly, the new ban was specifically intended to maintain order in vulnerable markets, so was taken up by fewer countries (only Spain and Italy). Secondly, the ban has been imposed for an initial period of three months against the two weeks of its forerunner, though with extensions available as needed. Finally, the earlier measure was confined to financial shares, while this one is a blanket ban. See http://www.cnmv.es/portal/AlDia/Comunicaciones.aspx.

Performance of Spanish stock market indices and sectors (%)

TABLE 6

Index	2008	2009	2010	2011	1Q12[1]	2Q12[1]	3Q12 (to 15 September)		
							% prior qt.	% Dec	% y/y
Ibex 35	-39.4	29.8	-17.4	-13.1	-6.5	-11.3	14.8	-4.8	1.4
Madrid	-40.6	27.2	-19.2	-14.6	-5.9	-11.0	14.6	-4.0	1.5
Ibex Medium Cap	-46.5	13.8	-5.6	-20.7	8.0	-10.0	5.3	2.4	1.8
Ibex Small Cap	-57.3	17.6	-18.3	-25.1	-10.3	-19.3	12.1	-18.8	-26.7
FTSE Latibex All-Share	-51.8	97.2	9.0	-23.3	5.7	-11.7	5.7	-1.3	-0.2
FTSE Latibex Top	-44.7	79.3	9.7	-17.1	10.1	-7.7	1.4	3.0	8.7
Sector[2]									
Oil and gas	-30.8	-20.1	0.3	23.2	-20.7	-29.6	27.8	-28.7	-13.6
Chemicals	-67.8	3.4	-60.0	-15.7	-31.1	-41.2	14.0	-53.8	-64.1
Basic materials	-45.4	23.1	-5.6	-22.5	2.5	-11.3	12.2	2.0	2.4
Construction materials and construction	-51.0	25.5	-14.4	-13.0	-12.1	-11.7	12.0	-13.1	-12.8
Industrial goods and services	-41.9	29.3	-1.9	-7.6	6.0	-3.0	6.7	9.7	15.2
Health	-45.0	17.7	-22.2	-0.8	21.4	13.6	16.0	60.0	58.7
Utilities	-31.0	-7.8	-14.3	-13.8	-6.6	-9.7	10.3	-7.0	-5.2
Banks	-47.9	46.3	-32.3	-18.3	-9.0	-11.4	23.2	-0.7	11.1
Insurance	-25.0	19.8	-26.8	13.8	-0.4	-30.2	35.1	-6.0	2.2
Real estate	-58.6	-43.8	-53.2	-42.4	-19.3	-24.0	39.6	-14.3	-23.2
Financial services	-44.3	20.8	12.8	3.5	0.3	-17.4	11.3	-7.7	-8.4
Telecommunications and media	-31.4	23.5	-13.4	-22.7	-7.5	-13.7	11.4	-11.1	-12.3
Discretionary consumption	-39.2	37.0	20.6	1.4	12.0	9.5	10.1	35.1	38.0
Basic consumption	-22.5	-8.4	15.8	-12.1	4.3	-4.6	4.7	4.2	18.7

Source: Thomson Datastream.

1 Change vs. previous quarter.

2 Classification according to Thomson Datastream.

The P/E ratio of the Ibex 35 surges above 10 in the third-quarter period…

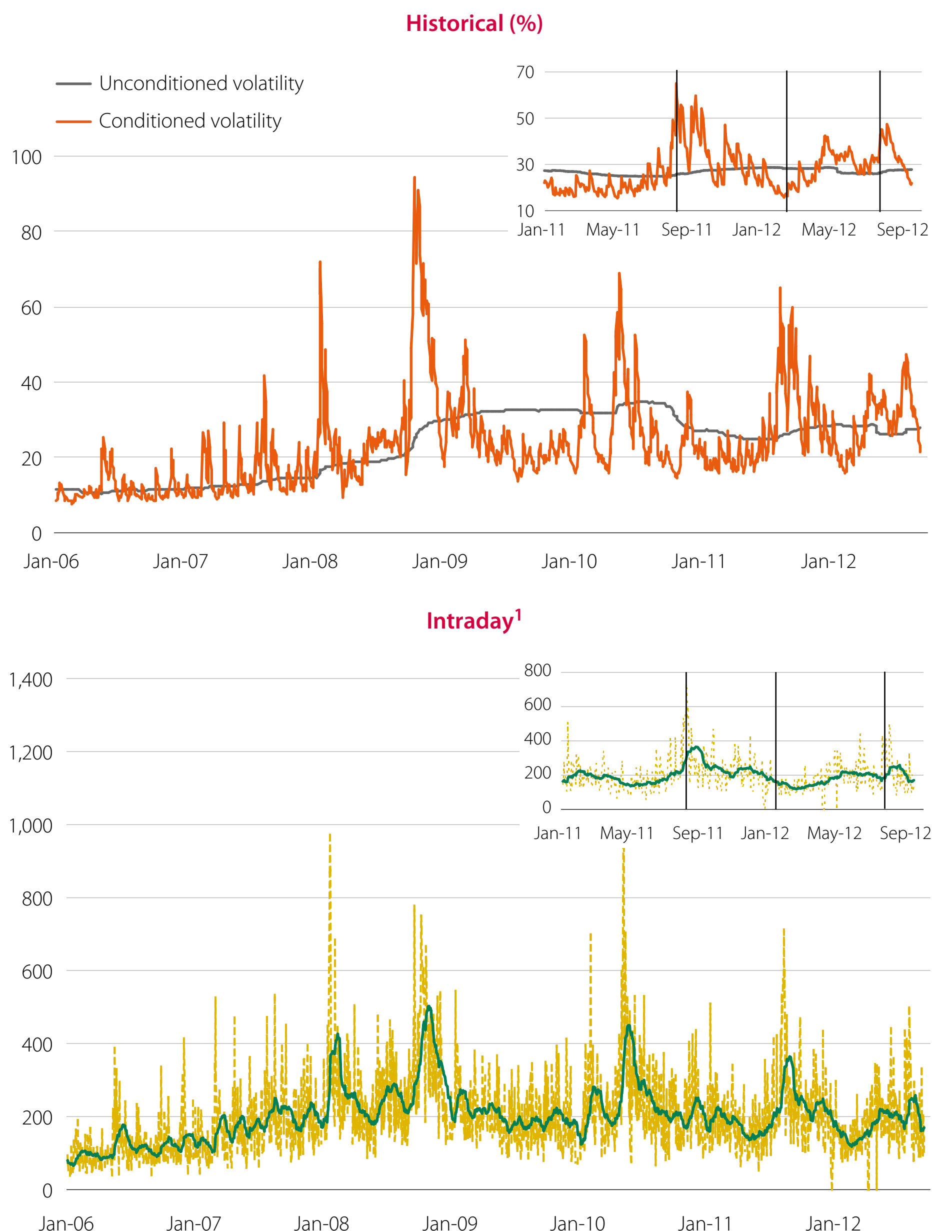
The price-earnings ratio[4] (P/E) of the Ibex 35 jumped from 8.6 to 10.6 in the third quarter of 2012, ahead of the levels of the first-quarter close (9.7) and end-December 2011 (9.2). This increase – one of the largest among advanced economy indices – offset the second-quarter fall, which likewise extended to all major stock markets.

…while the earnings yield gap narrows.

The earnings yield gap, which reflects the return premium required to be invested in equity versus long-term government bonds, fell sharply in the third quarter, August particularly, after holding more or less stable over the first six months. This decrease would have been steeper but for the run-down in Spanish bond yields starting in late July. The result was a mid-September gap of 3.7%, below the 5.5% of end-2011 and not far off the 3.2% average recorded since 1999.

4 On one-year forward earnings.

Ibex 35 volatility FIGURE 9



Source: Thomson Datastream and CNMV. Data to 15 September. 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, and the new ban published 23 July 2012.

1 Depicting the difference between the daily price highs and lows of the Ibex 35 in each session and the monthly moving average.

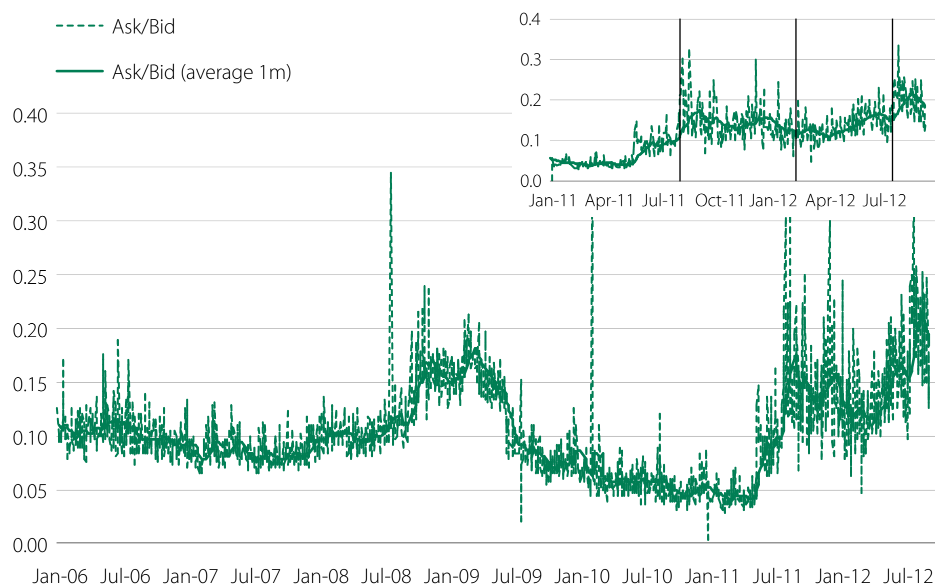
Market volatility dies down to 20% in mid-September after the peak levels of late July.

Ibex 35 volatility swung back to nearly 50% in the month of July, banishing the considerably more settled climate that had followed last April's outbreak of turbulence. This extreme volatility, as remarked earlier, was behind the CNMV's decision on 23 July to impose a new ban on the short trading of listed Spanish shares for an initial period of up to three months. This measure, and the ECB's announcement that it was prepared to purchase the sovereign bonds of countries applying formally to the EU for financial assistance, prompted a marked reduction in the volatility of Spanish shares as far as mid-September levels near 20%.

The liquidity conditions of the Ibex 35 (measured through the bid/ask spread), which had been deteriorating slightly since mid-April, continued to do so through the third quarter in the wake of the CNMV's precautionary curb on the creation or increase of net short positions in Spanish listed shares. However, improvement set in from early September which returned the indicator to a mid-month level of 0.18% from the 0.21% of the August close – the highest level since the series was begun in 2003, and remote from both its average value (0.10%) and the levels of end-2011 (0.16%).

Market liquidity has been thinning for a large part of the year …

Ibex 35 liquidity. Bid-ask spread (%) FIGURE 10



Source: Thomson Datastream and CNMV. Data to 15 September. 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, and the new ban published 23 July 2012.

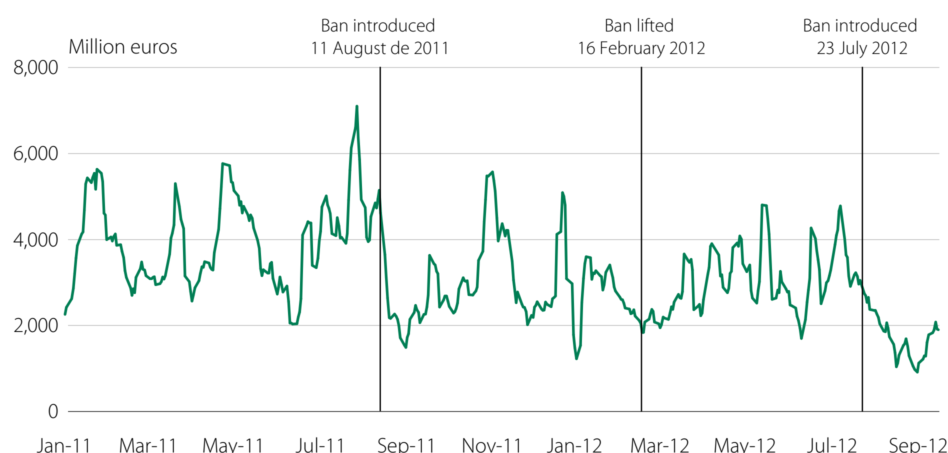
Trading on the Spanish stock market contracted 27.1% year-on-year to September, as far as 499.15 billion euros, prolonging the downward trend initiated in late 2010. Average daily volumes in the third quarter stood at 2.24 billion euros against the 2.96 billion of the first six months and 3.62 billion of full-year 2011.[5] The third-quarter trading slump can be presumed to partly reflect the regulator's ban on short trading. As figure 11 shows, following activation of this measure in August 2011 and July 2012, market trading volumes shrank for a period lasting from around twenty to thirty trading days, after which the trend reversed.

…while trading volumes are sharply down vs. 2011, with some fluctuations.

5 Average daily trading in 2008, 2009 and 2010 stood at 4.89 billion, 3.49 billion and 4.05 billion euros respectively.

Daily trading on the Spanish stock market[1]

FIGURE 11



Source: CNMV.

1 Moving average of five trading days.

Equity issuance year to date is 3.7% less than in 2011, at 13.83 billion euros.

Equity issuance on domestic markets to end-September was just 3.7% down in year-on-year terms versus the same period in 2011, at 13.83 billion euros (see table 8). But while much of the cash raised last year derived from the subscription of shares in *caja de ahorro* initial public offerings, the source this year was mainly the conversion to ordinary shares of hybrid instruments issued beforehand by the banks (mandatorily convertible bonds, preference shares and other kinds of subordinated debt) as a means to strengthen their regulatory capital.

Turnover on the Spanish stock market

TABLE 7

Million euros

	2008	2009	2010	2011	1Q12	2Q12	3Q12[1]
All exchanges	**1,243,387**	**886,135**	**1,037,284**	**925,667**	**176,948**	**198,709**	**123,493**
Electronic market	1,235,330	880,544	1,032,447	920,879	175,640	197,536	122,604
Open outcry	207	73	165	48	17	7	7
of which SICAVs[2]	25	20	8	6	0	0	0
MAB[3]	7,060	5,080	4,148	4,380	1,218	1,104	806
Second Market	32	3	3	2	0	0	0
Latibex	758	435	521	358	73	62	76
Pro memoria: non-resident trading (% all exchanges)							
	66.0	64.5	75.5	81.5	73.9	n.a.	n.a.

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

1 Cumulative data from 1 July to 15 September.

2 Open-end investment companies.

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

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

Capital increases and public offerings[1]

TABLE 8

	2008	2009	2010	2011	1Q12	2Q12	3Q12[2]
CASH AMOUNTS[3] (million euros)	16,349	11,391	16,013	17,317	3,374	5,409	5,049
Capital increases	16,340	11,389	15,407	17,221	3,374	5,359	5,049
Of which, through POS	292	17	959	6.441	881	1.580	118
National tranche	292	15	62	6.032	881	1.580	118
International tranche	0	2	897	410	0	0	0
Public offerings	10	2	606	96	0	51	0
National tranche	10	2	79	95	0	51	0
International tranche	0	0	527	1	0	0	0
NUMBER OF FILINGS[4]	**54**	**53**	**69**	**92**	**24**	**26**	**23**
Capital increases	53	53	67	91	24	25	23
Of which, through POS	2	2	12	8	5	1	1
Of which, bonus issues	1	11	15	22	2	6	8
Public offerings	2	1	3	2	0	1	0

Source: CNMV.

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

2 Data to 15 September 2012.

3 Excluding amounts recorded in respect of cancelled transactions.

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

Reform of legislation on the prospectus to be published when securities are offered to the public or admitted to trading

EXHIBIT 4

Community rules on the prospectus mandatory for public offers of securities and their admission to trading have recently been amended on various occasions, with the idea primarily of giving small- and medium-sized issuers more efficient access to capital markets by means of more flexible filing requirements. This is particularly the case with Directive 2003/71/EC (Prospectus Directive), which has since been modified by Directive 2010/73/EU of the European Parliament and of the Council and by Regulation 809/2004 on the information contained in prospectuses, as amended in turn in diverse respects by Commission Delegated Regulation (EU) 486/2012 of 30 March 2012.

The changes introduced by Directive 2010/73/EU have now been partially implemented into Spanish law by Royal Decree-Law 24/2012 of 31 August on restructuring and resolution of credit institutions, whose third final provision amends articles 27, 28 and 30 bis of the Securities Market Law (SML). The most significant of these changes are outlined below:

– An increase in the threshold denomination per unit and minimum subscription exempting the issuer from the obligation to publish a prospectus. The minimum denomination per unit (or maximum consideration at which an investor may acquire it) to take advantage of this exemption is raised from 50,000 to 100,000 euros.

– More flexible rules for smaller offers. The threshold triggering the prospectus requirement is raised from 2,500,000 to five million euros (total consideration for the offer). Regarding exemptions in the case of offers directed at only a small number of investors, the threshold for a mandatory prospectus is raised from 100 to 150 persons.

– The summary of the prospectus is not required to include the "key information" set out in Article 27 of the SML.

As well as the foregoing changes to the Securities Market Law, the transposition of the amending text of the Prospectus Directive will also call for changes in Royal Decree 1310/2005 on admission of securities to trading on official secondary markets and public offerings, which implements the SML's provisions in this regard. The future amendment of this Royal Decree will complete transposition as well as rounding out the partial changes already written into the SML. Novelties will include:

– Unification of the concept of qualified investor with that of professional investor as defined in the Directive on Markets in Financial Instruments (MiFID).

– The possibility for financial intermediaries to make successive public offerings of securities already placed on the primary market without the need to publish a new prospectus, provided the issuer consents to such re-use.

– A more flexible application of some exemptions from the prospectus requirement: an increase in the threshold whereby small offers of plain vanilla securities by credit institutions can dispense with a prospectus (from 50 million euros to 75 million) and no requirement to produce a prospectus in offers by EU resident companies addressed to their employees (whether or not the securities in question are admitted to trading on a regulated market).

Regarding the amendment of the Prospectus Regulation, the changes implemented by Commission Delegated Regulation 486/2012 of 30 March 2012, of direct application to national law, came into force on 1 July 2012. The main changes it makes are briefly described below:

– A proportionate disclosure schedule for certain operations. Specifically, disclosure requirements are lessened in the case of rights issues by EU-based companies with shares already admitted to trading on a regulated market or a multilateral trading facility (providing they do not exclude preferential subscription rights), as well as the raising of capital and admission applications by small and medium-sized enterprises and companies with reduced market capitalisation.

– Summary of the prospectus and final terms. Harmonised requirements are set out in relation to the format of the summary and key information, which must be set out in a specifically approved manner. Regarding the fi-

nal terms supplementing the base prospectus, their content is simplified and certain information excluded. It is also stipulated that the summary of each operation should combine information from the base prospectus summary that is pertinent only to that operation with the relevant excerpts from the final terms.

Note, finally, that the reform of EU prospective legislation will continue shortly with the approval of a new regulation covering, among other matters, the way in which issuers can give their consent for financial intermediaries to resume sale of their securities without a new prospectus, and also qualifying the requirement for an auditors' report containing profits forecasts.

3.2 Fixed-income markets

Domestic debt market tensions mount intensely to end-July …

Between end-March and end-July, yields on Spanish government and private debt securities surged to their highest levels since the launch of the euro, particularly in the case of longer-dated instruments. The trend then reversed following the ECB's announcement of a new intervention, under the terms of its mandate, in Europe's sovereign debt markets. The details of this intervention, published early September,[6] provided a fresh impetus that sent government bond yields falling more steeply, especially in the one- to five-year band, and helped reduce the interest rates being demanded of Spanish corporate issuers.

…before easing on the ECB's announcement that it would intervene in sovereign debt markets under strict conditionality.

Short-term Treasury bill rates registered mid-September levels of 0.6%, 1.8% and 2.5% in three-, six- and twelve-month maturities respectively, between 59 bp and 159 bp lower than last June (see table 9). The fall was larger still for bills of over one year's maturity albeit without approaching the levels of last March (an average 86 bp higher).

6 This intervention, known as an outright monetary transaction (OMT), will take the form of a new purchasing programme on secondary sovereign bond markets, with transactions focused on the shorter part of the yield curve, particularly maturities of between one and three years. A prior condition is an application from the Government on behalf of the country as a whole to the appropriate European financial assistance mechanism (currently the European Financial Stability Facility, EFSF, and, from 2013 onwards, the European Stability Mechanism, ESM) under strict conditionality regarding future reform efforts. See http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html.

Short-term interest rates[1] (%)

TABLE 9

	Dec 09	Dec 10	Dec 11	Mar 12	Jun 12	Sep 12[3]
Letras del Tesoro						
3 month	0.41	1.60	2.20	0.38	1.20	0.61
6 month	0.65	2.71	3.47	0.64	2.53	1.81
12 month	0.88	3.09	3.27	1.33	4.09	2.50
Commercial paper[2]						
3 month	0.76	1.37	2.74	2.49	2.69	2.80
6 month	1.25	2.52	3.52	3.21	3.40	3.44
12 month	1.63	3.04	3.77	3.55	3.64	3.58

Source: Thomson Datastream y CNMV.

1 Monthly average of daily data.

2 Interest rates at issue.

3 Data to 15 September.

Spanish sovereign yields top 7.5% at the height of tensions before narrowing to 6% in September.

At end-July, long government bond yields were at their highest levels since the introduction of the euro, running from 7.2% in the three-year maturity to 7.5% at ten years. This peak then gave way to a substantial run-down which was most intense in the band up to five years (175 bp and 141 bp at three and five years respectively as far as 3.9% and 4.9%) and less so in ten-year instruments (79 bp to 6%). As with short-term rates, the downtrend of August and September stopped short of restoring yields to the lows of last March, by 100 bp on average.

Medium and long corporate bond yields[1] (%)

TABLE 10

	Dec 09	Dec 10	Dec 11	Mar 12	Jun 12	Sep 12[2]
Government bonds						
3 year	1,95	3,87	4,01	2,76	5,39	3,86
5 year	2,67	4,65	4,65	3,83	6,07	4,88
10 year	3,75	5,38	5,50	5,17	6,59	6,01
Corporate bonds						
3 year	3,14	4,31	5,63	3,77	5,82	5,49
5 year	4,30	5,44	6,35	4,86	6,79	6,67
10 year	4,88	6,42	9,24	8,14	9,43	9,52

Source: Thomson Datastream, Reuters and CNMV.

1 Monthly average of daily data.

2 Data to 15 September.

Sovereign spreads move in tandem with yields, from an end-July peak to the more moderate levels of September.

On this performance, Spain's sovereign risk premium, as derived from 5-year CDS, pulled back from its end-July peak of 640 bp, more slowly at first and more firmly in September as far as 340 bp in the middle of this last month (see figure 12). Likewise the ten-year bono/Bund spread narrowed from just under 635 bp at the end of July to a September level of 412 bp.

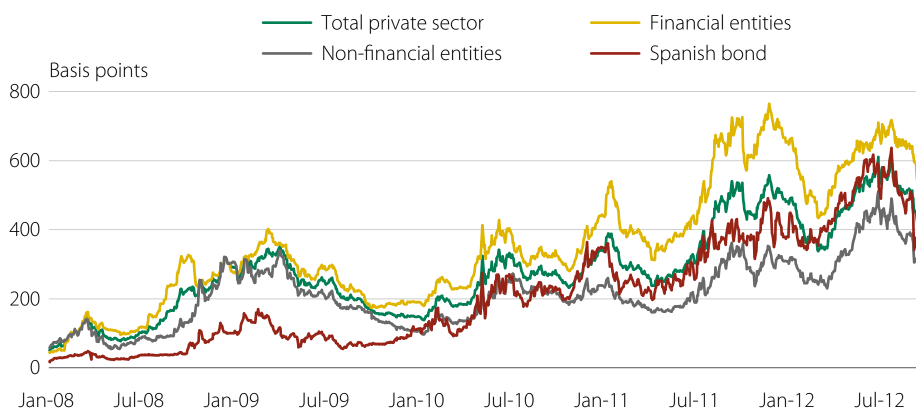
Rates on short-term corporate debt, as measured by commercial paper, continued on the upward course initiated last March. The rise was in any case considerably smoother than for Treasury bills – just 19 bp as far as September rates from 2.8% to 3.6% depending on the curve point (see table 10). Conversely, long-term corporate debt yields, which had risen more sharply in the second quarter, felt the indirect benefit of the ECB's third-quarter announcement and subsequent publication of a new action plan, albeit less so than sovereign instruments. The resulting fall extended to maturities to five years (-30 bp at three years to 5.5% and over -10 bp at five to 6.7%), but bypassed ten-year maturities where yields kept climbing as far as 9.5% in mid-September.

Corporate bond yields trace a similar course to governments with fewer fluctuations.

After a spike beginning in late March, the credit spreads of the financial and non-financial private sector began narrowing tentatively towards the end of July and more intensely since the start of September (see figure 12). Spreads of non-financial corporations widened to end-June highs of over 510 bp, though this was mild compared to the 710 bp endured by financial corporations. Spreads in the latter case were penalised by a magnified feedback between financial and sovereign risk after the Spanish Government sought assistance for domestic banks. The end-July levels of bank credit spreads rivalled with the record highs of November last year, prior to the ECB's first three-year refinancing operation. By mid-September, these spreads had settled back to 510 bp, against the 525 bp of end-March, while those of non-financial corporations had dropped below 290 bp, against March levels bordering on 270 bp.

Private sector credit spreads reach mid-year highs coinciding with the peak levels of sovereign risk and ease back thereafter.

Aggregate risk premium[1] based on the five-year CDS of Spanish issuers FIGURE 12



Source: Thomson Datastream and CNMV.

1 Simple average. Data to 15 September.

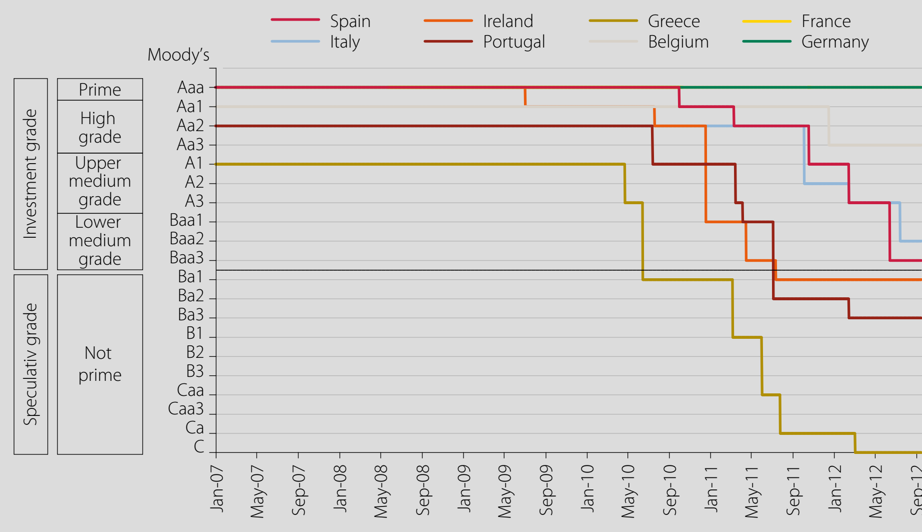
The impact of sovereign debt downgrades: the 'cascade' effect

EXHIBIT 5

Since end-2010, the Kingdom of Spain has seen its credit rating revised down on several occasions from the top quality category (AAA or Aaa depending on the agency) as far as its current position on the lower rungs of investment grade. As we can see from figure E5.1, other euro area countries have suffered similar or worse fortunes.

Sovereign ratings in Europe

FIGURE E5.1



Source: Bloomberg. Moody's credit rating of long-term sovereign debt in local currency.

The transmission of credit risk between the public sector of the economy and the private sector, essentially the banks, is a phenomenon which has gathered force since the onset of crisis, though the strength and even direction of the contagion has varied intermittently. Internationally, we can say that at the start of the crisis, credit risk contagion was spread from the financial sector to remaining sectors of the economy, whereas in recent years, in Europe especially, the public sector has been the main source of contagion. The transmission and feedback channels linking sovereign and financial credit risk are essentially three:

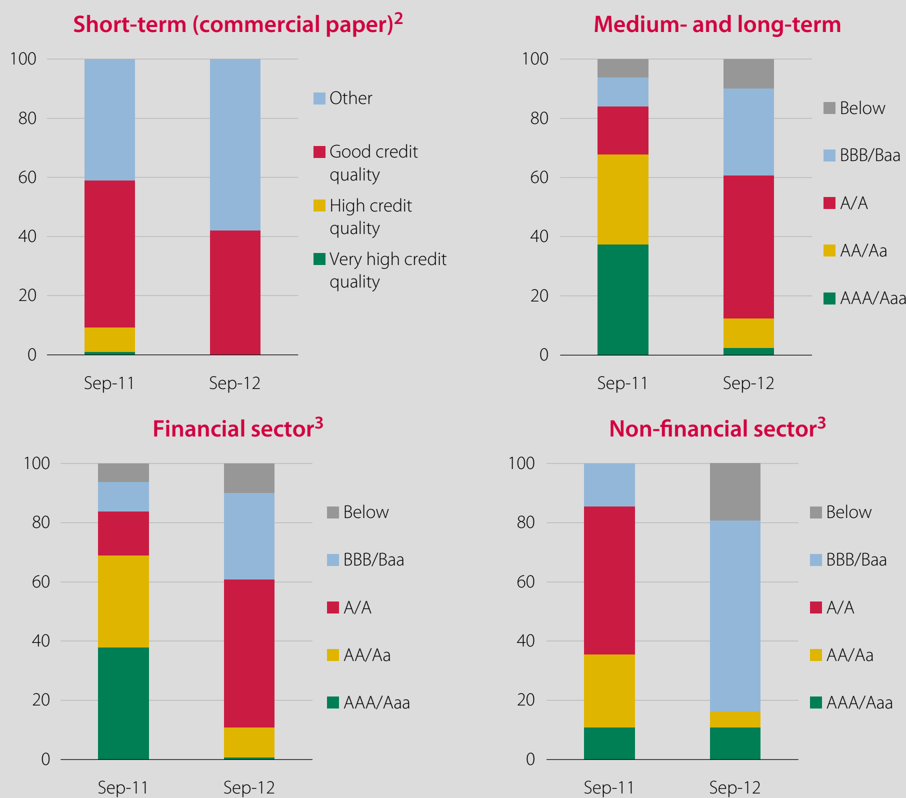
(i) Firstly, rating agencies factor sovereign risk in their financial risk calculations, i.e. they use it as a direct input in working out the credit ratings of remaining sectors. In fact, each time the Kingdom of Spain rating has been lowered, revise-downs have followed of all other national issuers, particularly the banks.[1,2]

(ii) Secondly, the deterioration in the credit quality of Spanish sovereign debt impacts directly on the assets that comprise banks' exposure to the public sector (their portfolio of debt securities and loans to public authorities). In particular, a deteriorating sovereign bond rating constrains banks' capacity to borrow from the Eurosystem and interbank markets using these instruments as collateral.

(iii) Finally, the erosion of financial sector credit quality, which in Spain's case derives from the upswing in loan delinquency and the volume of impaired assets, can also affect the public sector's if agents start discounting some kind of financial assistance (or guarantees) from the public sector to domestic banks.

The "cascade" effects of the revise-down in Spanish sovereign debt ratings on private sector debt are illustrated in figure E5.2. Starting at the short end, if we look at issues outstanding in mid-September 2012, we find that the proportion within the prime and high grade brackets (see footnote 2 of figure E5.2), which summed 9% in September 2011, was non-existent one year later. In longer maturities too, the weight of top-quality debt has dwindled considerably. Specifically, the percentage of prime and high grade debt (AAA/Aaa and AA/Aa respectively) dropped from 69% to 13%, while that of upper-medium grade debt (A) and debt on the lowest notch of the investment grade range climbed from 26% to 80%. Meantime, debt rated below BBB/Baa (i.e., speculative grade) or with no rating assigned moved up from 6% to 10%. By type of instrument, revise-downs have cut deepest in mortgage covered bonds and asset-backed securities.

Distribution of Spanish corporate debt ratings[1] FIGURE E5.2



Source: Thomson Reuters, Bloomberg and CNMV.

1 Outstanding balances of debt instruments traded on the AIAF market as at 15 September 2012.

2 Very high: A-1+, F1+ or P-1 of S&P, Fitch and Moody's respectively. High: A-1 or F1 of S&P or Fitch. Good: A-2 and A-3, F2 and F3 or P-2 and P-3 of S&P, Fitch and Moody's. Others: lower rated or unrated issues.

3 Medium-and long-term debt.

The decline in issue credit quality affects both borrowers and investors. For the former, the most obvious setback is their diminished capacity to capture funds on capital markets.[3] For the latter, a brusque drop in ratings not only erodes the value of their portfolios, it can also hinder certain investment strategies. For instance, institutional investors (investment funds, investment banks, insurance companies and pension funds) will often have an investment policy or mandate that obliges them to hold financial instruments of a minimum credit quality. And an abrupt revise-down can trigger a significant movement to close out positions in instruments that have fallen though this threshold. In fact, the latest data from the Bank for International Settlements (BIS) shows a sharp worldwide decrease in banks' exposure to the debt securities issued by the countries worst hit by the European debt crisis.[4]

In the case of Spanish investment funds, the CNMV addressed the problem in a communication dated 20 July 2012. It said, specifically, that when a fund's investment policy is modified to adjust the credit ratings of the assets in its fixed-income portfolio, but all other eligible asset requirements are retained and neither its objective nor vocation are altered in any material respect, this will not be considered a substantive change in the said policy, giving rise to the disclosure and exit rights envisaged in article 14 of the Regulation of UCITS Law 35/2003, so long as a minimum level of soundness is maintained (corresponding to that of the Kingdom of Spain). However, the scheme must disclose this adjustment as a material event, using the CNMV form provided, and report it in the corresponding prospectus and key investor information document or simplified prospectus the next time they are updated.

1 It bears mention here that only one domestic financial institution has a credit rating higher than the Kingdom of Spain, assigned for its diversified balance sheet and income streams and lesser exposure to Spanish sovereign debt.
2 This cascade phenomenon also occurs at international level. For example, on 13 February 2012 Moody's lowered the sovereign debt credit rating of nine European economies and three days later lowered the ratings of 114 financial institutions.
3 See ECB (2012), *Assessing the financing conditions of the euro area private sector during the sovereign debt crisis*, in *Monthly Bulletin* (August).
4 See BIS (2012), *Quarterly Review* (September), available at: http://www.bis.org/publ/qtrpdf/r_qt1209.pdf

Banks have relied on commercial paper, mortgage covered bonds and government-guaranteed debt instruments for the bulk of their 2012 issuance …

The narrowing of private debt yields over the third quarter, especially in the one- to five-year segment, ushered in a more favourable climate for financial issuers to place their debt. However, some institutions have kept issuance activity low-key since March. This was partly a result of the ECB's two special long-term refinancing operations in December 2011 and February 2012, which did much to reduce financial costs for the economy as a whole in the second and third quarter of the year. Most third-quarter issuance took the form of mortgage covered bonds and commercial paper (45% and 44% of the total respectively).

…which has climbed 65% overall as far as 267 billion euros.

The volume of fixed-income issues registered with the CNMV over the first three quarters of 2012 (to 15 September) came to 266.70 billion euros, 65% up on the same period last year. Driving the increase was a step-up in financial sector issuance

of commercial paper, mortgage covered bonds and government-backed non-convertible bonds, offsetting the issuance slump in asset-backed securities.

Commercial paper accounts for 41% of total issuance,…

More specifically, commercial paper sales in the first three quarters amply surpassed the full-year total for 2011 at 109.41 billion euros, accounting for 41% of issuance in the period, 5 points more than in 2011. Since the fourth quarter of last year, banks have increasingly placed these instruments through their branch networks.

…mortgage covered bonds for 31.4%…

Mortgage covered bond issuance also topped last year's total. The 83.85 billion euros sold to date account for 31.4% of total issuance compared to 23.3% in 2011. Sales of territorial bonds, secured on credit institution loans to public authorities and entities, were 8.97 billion euros or 3.4% of the total volume against 7.40 billion in the first three quarters of 2011. In a reversal of last year's pattern, issuance of these instruments thinned out considerably in the third quarter after a busy first-half period.

…and non-convertible bonds for 18.4%, with almost 87% carrying a government guarantee.

Issuance of non-convertible bonds summed 49.13 billion euros in the first three quarters, more than doubling last year's 20.19 billion total and accounting for 18.4% of nine-month issuance. Their expansion owed mainly to government-backed bonds, which made up 86.8% of sales in the period, after a slack 2011 when issuance dropped to 7.36 billion euros. Half of all government-backed bond sales year to date went through in February, in the days preceding the ECB's second three-year refinancing operation.

Issuance of asset-backed securities slumps by 72% …

The 12.61 billion in asset-backed securities issued year to date was 72% less than in the equivalent period in 2011. Note that no ABS were placed with international investors in the second and third quarters, true to the now standard practice whereby these instruments are almost all retained by the domestic originator or seller.

…while that of fixed-income instruments tied in with regulatory capital has ceased almost completely.

Turning finally to instruments qualifying as regulatory capital, no mandatorily convertible bond issues took place in the third quarter in contrast to a fairly busy first-half period. Likewise, preference share issuance has dried up entirely in 2012.

Spanish banks reduce their foreign debt financing 44% in the first seven months of 2012.

Foreign debt financing by domestic institutions fell to just under 49.80 billion euros to July (last available data), 44% less than in the year-ago period. Issuance was particularly low in July itself, being confined entirely to commercial paper (see table 11). Over the first six months, however, long-term issues continued to account for the bulk of foreign sales (54% compared to 43% one year before).

Gross fixed-income issues

TABLE 11

filed[1] with the CNMV	2008	2009	2010	2011	2012 1Q	2012 2Q	2012 3Q[2]
Number of ISSUES	**337**	**512**	**349**	**356**	**117**	**99**	**44**
Mortgage bonds	47	75	88	115	27	22	22
Territorial bonds	8	1	9	42	8	8	2
Non-convertible bonds and debentures	76	244	154	87	48	50	14
Convertible/exchangeable bonds and debentures	1	6	3	9	1	4	0
Asset-backed securities	108	76	36	48	15	2	1
Commercial paper facilities	88	73	59	53	18	13	5
Securitised	2	2	2	2	0	0	0
Other commercial paper	86	71	57	51	18	13	5
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	9	37	0	2	0	0	0
NOMINAL AMOUNT (million euros)	**476,276**	**387,476**	**226,449**	**288,992**	**119,537**	**91,425**	**54,535**
Mortgage bonds	14,300	35,574	34,378	67,227	26,000	33,350	24,500
Territorial bonds	1,820	500	5,900	22,334	3,200	4,100	1,674
Non-convertible bonds and debentures	10,490	62,249	24,356	20,192	31,305	15,231	2,591
Convertible/exchangeable bonds and debentures	1,429	3,200	968	7,126	1,128	1,592	0
Asset-backed securities	135,253	81,651	63,261	68,413	9,195	1,535	1,884
Domestic tranche	132,730	77,289	62,743	62,796	7,810	1,535	1,884
International tranche	2,522	4,362	518	5,617	1,385	0	0
Commercial paper[3]	311,738	191,342	97,586	103,501	48,708	35,617	23,886
Securitised	2,843	4,758	5,057	2,366	616	630	190
Other commercial paper	308,895	186,583	92,529	101,135	48,092	34,987	23,696
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	1,246	12,960	0	200	0	0	0
Pro memoria:							
Subordinated issues	12,950	20,989	9,154	29,277	2,772	1,788	267
Covered issues	9,170	4,794	299	10	0	0	0

abroad by Spanish issuers	2008	2009	2010	2011	2012 I	2012 II	2012 III[4]
NOMINAL AMOUNT (million euros)	112,366	149,686	127,731	120,043	37,524	10,094	2,223
Long-term	39,894	47,230	51,107	51,365	23,065	3,417	301
Preference shares	0	3,765	0	0	0	0	0
Subordinated debt	70	2,061	0	242	0	307	0
Bonds and debentures	39,360	41,404	50,807	51,123	23,065	3,110	301
Asset-backed securities	464	0	300	0	0	0	0
Short-term	72,472	102,456	76,624	68,677	14,458	6,678	1,922
Commercial paper	72,472	102,456	76,624	68,677	14,458	6,678	1,922
Securitised	425	108	248	322	0	27	0

Source: CNMV and Banco de España.

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

2 Data to 15 September

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

4 Data for the month of July.

4 Market agents

4.1 Investment vehicles

Financial UCITS[7]

Investment fund assets shrink 5.5% in the first six months as the redemption drain continues.

Assets under management in investment funds fell by 5.5% in the first half of 2012 to 125.10 billion euros, prolonging the downtrend that has persisted with few respites since the start of the crisis (see table 13). Almost 85% of asset shrinkage traced to investor net redemptions, which exceeded six billion euros (see table 12). As in previous quarters, the largest outflows were from the categories of fixed income (2.71 billion euros) and guaranteed equity fund (1.60 billion euros). Returns on these products were positive in the first quarter and negative in the second, due to resurgent tensions in domestic financial markets over the year's middle months.

Net investment fund subscriptions TABLE 12

			2011			2012	
Million euros	2010	2011	2Q	3Q	4Q	1Q	2Q
Total fondos de inversión	**-25,580.8**	**-10,838.6**	**-4,094.9**	**-2,683.5**	**-3,287.2**	**-1,652.4**	**-4,412.2**
Fixed income[1]	-27,149.9	-10,428.5	-2,258.8	-1,229.8	-1,530.7	-727.0	-1,987.0
Balanced fixed income[2]	-1,417.0	-1,925.7	-374.8	-320.8	-449.6	-237.9	-264.5
Balanced equity[3]	-90.0	-320.5	-100.7	-148.0	-74.8	-134.0	-131.5
Euro equity[4]	-696.9	152.0	70.5	53.3	47.9	-151.5	12.5
International equity[5]	1,152.1	-816.9	-79.2	-520.7	-185.3	-13.9	-165.0
Guaranteed fixed-income guaranteed	4,716.0	7,228.4	371.8	1,046.8	393.3	584.1	-540.7
Guaranteed equity[6]	-2,500.1	-3,061.5	-1,095.3	-604.9	-565.2	-731.7	-874.6
Global funds	323.6	945.4	237.7	-59.2	-260.4	157.9	-73.5
Passively managed[7]	-790.3	-274.4	41.0	-104.0	-195.2	29.3	113.3
Absolute return[7]	871.7	-2,336.9	-907.1	-796.2	-467.2	-427.7	-501.2

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 9. Absolute return funds were previously classed as global funds.

7 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	2009	2010	2011	2011 3Q	2011 4Q	2012 1Q	2012 2Q
Total investment funds inversión	**2,536**	**2,408**	**2,310**	**2,341**	**2,310**	**2,300**	**2,255**
Fixed income[1]	582	537	508	520	508	491	479
Balanced fixed income[2]	169	160	140	146	140	140	132
Balanced equity[3]	165	138	128	130	128	130	122
Euro equity[4]	182	172	148	153	148	143	135
International equity[5]	242	232	220	222	220	222	220
Guaranteed fixed-income	233	276	351	335	351	375	385
Guaranteed equity[6]	561	499	420	436	420	404	384
Global funds	187	192	203	204	203	200	198
Passively managed[7]	69	61	59	59	59	64	75
Absolute return[7]	146	141	133	136	133	131	125
Assets (million euros)							
Total investment funds	**170,547.7**	**143,918.2**	**132,368.6**	**134,033.7**	**132,368.60**	**131,994.5**	**125,120.7**
Fixed income[1]	84,657.2	56,614.6	46,945.5	48,228.6	46,945.50	45,101.8	42,837.8
Balanced fixed income[2]	8,695.5	7,319.0	5253.6	5,715.8	5,253.60	5,686.9	5,430.9
Balanced equity[3]	3,879.6	3,470.5	2,906.1	2,897.5	2,906.10	3,234.2	3,040.3
Euro equity[4]	6,321.6	5,356.8	4,829.2	4,610.8	4,829.20	4,815.6	4,516.5
International equity[5]	5,902.4	8,037.3	6,281.2	6,028.4	6,281.20	6,813.2	6,373.7
Guaranteed fixed-income	21,033.4	26,180.2	35,058.0	34,241.7	35,058.00	36,677.0	35,421.7
Guaranteed equity[6]	25,665.8	22,046.5	18,014.5	18,699.9	18,014.50	17,408.5	15,943.0
Global funds	3,872.5	4,440.3	5,104.7	5,154.3	5,104.70	4,545.5	4,272.1
Passively managed[7]	3,216.6	2,104.8	1,986.2	2,060.0	1,986.20	2,053.9	2,190.9
Absolute return[7]	7,303.0	8,348.1	5,989.7	6,396.8	5,989.70	5,657.8	5,093.9
Unit-holders							
Total investment funds	**5,475,403**	**5,160,888**	**4,834,062**	**4,942,074**	**4,834,062**	**4,759,241**	**4,634,762**
Fixed income[1]	2,041,487	1,622,664	1,383,813	1,419,006	1,383,813	1,362,441	1,326,494
Balanced fixed income[2]	290,151	270,341	206,938	227,046	206,938	204,653	195,137
Balanced equity[3]	182,542	171,336	145,150	151,551	145,150	145,472	141,784
Euro equity[4]	299,353	266,395	237,815	247,166	237,815	224,886	225,774
International equity[5]	458,097	501,138	448,539	465,814	448,539	442,753	432,816
Guaranteed fixed-income	570,963	790,081	1,042,658	1,019,905	1,042,658	1,071,544	1,070,002
Guaranteed equity[6]	1,188,304	1,065,426	912,298	946,448	912,298	874,249	832,332
Global funds	88,337	105,719	127,336	130,519	127,336	113,396	105,966
Passively managed[7]	85,403	90,343	100,416	95,948	100,416	101,901	108,166
Absolute return[7]	270,766	277,445	229,099	238,671	229,099	217,946	196,291
Return[8] (%)							
Total investment funds	**5.73**	**0.35**	**-0.08**	**-2.37**	**1.35**	**2.41**	**-1.75**
Fixed income[1]	1.91	0.11	1.56	0.01	0.58	1.51	-0.47
Balanced fixed income[2]	6.85	-0.54	-1.34	-3.47	1.2	2.30	-1.55
Balanced equity[3]	16.47	-0.98	-5.64	-10.13	3.02	3.25	-2.90
Euro equity[4]	32.41	-2.94	-11.71	-19.67	4.05	3.34	-6.34
International equity[5]	37.28	14.22	-10.83	-15.70	7.53	8.91	-3.63
Guaranteed fixed-income	3.81	-0.67	3.28	1.28	0.71	2.48	-2.32
Guaranteed equity[6]	3.56	-1.79	0.14	-0.76	0.68	1.63	-2.43
Global funds	10.90	3.22	-4.64	-8.10	2.9	3.56	-1.23
Passively managed[7]	–	-2.36	-7.33	-13.94	4.11	1.97	-4.31
Absolute return[7]	–	1.53	-1.87	-2.71	0.93	1.68	-1.04

Source: CNMV. As a result of the reclassifying of investment fund objectives, in force as of 1 April 2009, some changes have taken place in the variables of this table.

* 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.

The number of investment funds in operation again fell significantly in the first six months of 2012. Fifty-five schemes left the register in this period (36 guaranteed equity and 29 fixed-income funds) leaving an end-June total of 2,255. Again, most of the decline was down to inter-fund mergers.

A parallel decline in the number of funds …

Unit-holder numbers fell by 200,000 to a mid-year total of 4,634,000. As with fund assets and numbers, this first-half decline was most notable among guaranteed equity funds (80,000 unit-holders) and fixed-income products (57,000 unit-holders). Only guaranteed fixed-income funds and, to a lesser extent, passively managed funds, managed to expand their investor base (by 27,000 and 7,700 respectively).

… and unit-holders.

Preliminary figures for July suggest more of the same, with fund assets likely to go on falling as the redemption drain continues. However, higher portfolio returns delivered by a third-quarter rally in equity prices could partly counter the outflow of cash from these investment products.

The industry contracts further to July, despite good returns.

Key modifications to the Regulation on UCITS EXHIBIT 6

The novelties introduced by Royal Decree 1082/2012 of 13 July, which amends the Regulation implementing the UCITS Law derive from the full transposition of Directive 2009/65/EC, commonly known as UCITS IV (whose first provisions were written into Spanish legislation through Law 31/2011 of 4 October) and its implementing provisions.[1] The most relevant changes are described below.

Regarding UCITS management companies, the new text incorporates a series of rules to ensure the correct operation of the manager's passport allowing Spanish management companies to run schemes domiciled in other Member States and Spanish UCITS to be run, in turn, by companies from elsewhere in the EU. Its innovations are accordingly geared to facilitating such cross-border management. Hence one block of measures seeks to homogenise the rules governing management companies to provide an even playing field in such matters as risk management, conflicts of interest, organisational structure and capital requirements, while other clauses deal with technical arrangements like the structure of agreements between manager and depositary.

The Regulation also completes the implementation of Directive 2009/65/EC with respect to the notification of foreign scheme passports by incorporating the provisions of Directive 2010/44/EU (including the information the CNMV must make available on its website regarding legislation outside the scope of the Directive which affects the marketing in Spain of UCITS from other Member States), and representing compliance with Regulation (EU) No. 584/2010.

On the particular subject of master-feeder structures, the Regulation takes up the relevant provisions of Directive 2009/65/EC and Directive 2010/44/EU, whose essence is to harmonise their structures in such a way that master UCITS and feeder UCITS can henceforth have their registered offices in different Member States. The main novelties in this respect are:

(i) Master UCITS, which under the definition given may be neither funds nor companies, are obliged to specify feeder schemes in their rules or instruments of incorporation, while feeder UCITS must identify their master scheme.

(ii) Specific procedures are laid down for the authorisation of feeder UCITS, the transformation of a feeder into an ordinary scheme, and vice versa, and switching from one to another master UCITS. Applicants for such authorisations must also submit additional documents to the CNMV.

(iii) Change in the minimum percentage of assets that a feeder must hold in its master UCITS.

(iv) Change in the choice of assets in which a feeder UCITS can invest the portion not held in its master UCITS.

(v) Arrangements are specified for the liquidation, merger or demerger of master UCITS, along with the different alternatives open to their feeders.

Still in the interests of facilitating cross-border transactions, the new Regulation presents the following novelties with regard to UCITS mergers:

(i) The most far-reaching is the possibility of concluding cross-border mergers between EU Member States. The merger operation must be authorised by the competent authority in the home state of the merging UCITS, which will centralise all paperwork and will also undertake to notify the competent authority in the home state of the receiving UCITS, who need only check that the information to be given to the unit or shareholders of the receiving scheme is sufficient to the purpose.

(ii) The new Regulation extends the scope of application of directives 65/2009 and 44/2010 by establishing a single merger regime which is equally applicable to mergers between domestic UCITS without a European passport, regardless of their legal form, i.e., whether they are funds or companies.

(iii) Another innovation is the exhaustive listing of the information to be given to unit and shareholders once a merger has the go-ahead. Investors can by this means reach a founded judgement on how the operation may affect their investment and the exercise of their rights.

(iv) Finally, the text departs from commercial practice in removing the obligation to engage an independent expert to issue a report on the merger project when the resulting UCITS is an investment fund.

Another goal of the Regulation is to strengthen investor protection. Hence one of the provisions of Directive 2009/65/EC, in force as of 1 July 2011, was that they should be provided with a document containing key investor information (KIID) in place of the old simplified prospectus. The KIID harmonises at EU level the essential facts an investor needs to reach an informed decision about UCITS in-

vestment, presented in a clear and concise manner. Its introduction to Spanish legislation was effected through Law 31/2011 of 4 October amending the relevant terms of the Law on Collective Investment Schemes to make the KIID requirement extensive to all Spanish UCITS, harmonised or otherwise.

Finally, legislators took the occasion to introduce technical improvements and streamline administrative procedures and formalities. On the technical side, steps were taken to clarify the differentiating features of investment fund asset classes and the rules for calculating authorisation response times, while the wording of various articles was adapted to reflect other regulatory changes.

Procedural simplification is viewed as a way to speed up administrative processing without detriment to investor protection. Hence the requirement to publish a notice of fund dissolution or liquidation in daily newspapers is replaced by a material event filing accompanied, as the case may be, by posting on the management company's website. Further, the CNMV is empowered to exempt managers as appropriate from filing minor documents that have no bearing on investor protection, and publicity requirements are softened or rationalised in cases like, for instance, a change of manager or corporate control.

1 In particular, Commission Directive 2010/44/EU of 1 July 2010, as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure and Commission Directive 2010/43/EU of 1 July 2010, as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and management company

Liquidity conditions of private fixed-income portfolios continue their recovery.

The liquidity conditions of funds' private fixed-income portfolios went on improving in both straight and relative terms through the opening half of 2012. As we can see from table 14, the volume of less-liquid assets dropped by more than one billion euros, from 7.46 billion euros in December 2011 to a mid-year figure of 6.45 billion. In relative terms, less-liquid assets amounted to 5.2% of total fund assets in June 2012 compared to 5.6% in December 2011. Note also that the mix has undergone a substantial shift, with the bulk of less-liquid assets displaced from prime and high grade instruments (AAA/AA) to below AA. This reflects the cascade effect on private-sector debt of revise-downs in Spanish sovereign debt ratings (see exhibit 5 of this report).

Estimated liquidity of investment fund assets

TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	Dec 11	Mar 12	Jun 12	Dec 11	Mar 12	Jun 12
Financial fixed income rated AAA/AA	2,195	521	466	23	31	24
Financial fixed income rated below AAA/AA	3,448	5,268	4,443	18	20	19
Non-financial fixed income	164	121	165	6	4	6
Securitisations	1,654	1,488	1,374	52	53	50
AAA-rated securitisations	383	75	65	92	95	95
Other securitisations	1,271	1,413	1,309	46	52	49
Total	**7,461**	**7,398**	**6,448**	**21**	**20**	**19**
% of investment fund assets	**5,6**	**5,6**	**5,2**			

Source: CNMV.

Proposal for the amendment of UCITS Directive 2009/65/EC

EXHIBIT 7

On 3 July 2012, the European Commission adopted a new proposal to amend Directive 2009/65/EC, which sets out the rules whereby a collective investment scheme can benefit from a European passport and be marketed in any country within the European Union. The schemes regulated by this directive receive the name "undertakings for collective investment in transferable securities" or UCITS.

The European Commission's draft seeks to amend the Directive to three main purposes: (i) to provide detailed rules on the duties of UCITS depositaries and their liability regime, (ii) to establish rules for employee remuneration policy which inhibit excessive risk-taking, and (iii) to harmonise the administrative sanctions supervisors can apply for breaches of UCITS rules.

The rules on depositaries in the current UCITS Directive consist of a number of generic principles. This has led to diverging interpretations about the scope of depositary liability, as came glaringly to light in the aftermath of the Madoff fraud. For this reason, the text contains detailed provisions on depositaries' duties, liability standards, and responsibilities regarding the selection and appointment of a sub-custodian. The main changes advocated are listed below:

– Each UCITS should appoint a single depositary, as evidenced by a written contract. This depositary must be a credit institution or investment firm complying with the capital requirements of Directive 2006/49/EC which provides the ancillary service of safe-keeping and administration of financial instruments.

– Regarding custody duties, the text distinguishes between two types of assets: those subject to custody in the strictest sense and those for which the custodian must verify ownership and maintain an updated register. The depositary, it states, shall be liable for the loss of any asset held in custody

(in the strict sense), unless it proves that the loss was due to an external event beyond its reasonable control. Such liability may not be discharged by entrusting custody tasks to a third party.

– The depositary may delegate custody tasks where objectively justified, exercising due diligence in the appointment of sub-custodians and monitoring their performance. The text also establishes eligibility criteria for an institution to act as sub-custodian.

– In overseeing the manager's activity, the depositary must verify that the scheme's net asset value is calculated correctly and that the handling of subscriptions and redemptions complies with the applicable national rules. To this end, it should monitor movements in the UCITS' cash accounts. These oversight functions may not be delegated to a third party.

Here, as in other realms of the financial sector, the call is for remuneration policies that discourage excessive risk-taking at odds with UCITS' stated investment policies. Management companies should accordingly establish and maintain remuneration policies and practices that are consistent with sound and effective risk management. These policies should apply to all staff whose professional activities have a material impact on the risk profiles of UCITS or the management company, and be duly disclosed to investors in the corresponding annual report.

Finally, the Commission's analysis of sanction procedures showed a number of divergences and weaknesses. It has accordingly put forward a set of minimum common standards for national sanctioning regimes to ensure that they are effective, fair and dissuasive. Innovations include a common catalogue of breaches and listing of the sanctions and other measures available to national authorities.

Real estate investment schemes

Real estate schemes again had to operate in an adverse environment …

Real estate schemes continued to struggle against the tide. Of the six funds registered at mid-year 2012, the same number as at end-2011, only five can be considered fully operative, since one was in the process of dissolution. The number of real estate investment companies remained unvaried, with eight in operation.

...characterised by diminishing assets and unit-holder numbers.

In the fund segment, both assets and unit-holder numbers continued to decline. Assets under management fell 2.4% vs. their end-2011 total to 4.39 billion euros, while unit-holder numbers dropped by 6.8% to 27,716 (see table 15). As in previous quarters, the bulk of fund assets were in possession of investors belonging to the manager's financial group.[8] Fund returns remained mired in negative terrain, as they have been since 2009. First-half losses were, however, a little less severe.

8 Over 84%, on data to May.

Main real estate scheme variables

TABLE 15

	2008	2009	2010	2011	2011		2012	
					3Q	4Q	1Q	2Q
FUNDS								
Number[1]	9	8	7	6	6	6	6	6
Unit-holders	97,390	83,583	75,280	29,735	31,412	29,735	29,754	27,716
Assets (million euros)	7,407	6,465	6,116	4,495	4,597	4,495	4,447	4,386
Return (%)	0.69	-8.31	-4.74	-3.24	-1.03	-0.93	-0.85	-1.23
COMPANIES								
Number	9	8	8	8	9	8	8	8
Shareholders	937	928	943	943	944	943	939	939
Assets (million euros)	372	309	322	313	1663	313	311	301

Source: CNMV.

1 Funds filing financial statements.

Assets under management in real estate companies fell by 3.8% between January and June as far as 301 million euros, while shareholder numbers held more or less flat.

Hedge funds

A gap continues to open between hedge funds and of hedge funds,…

The recent progress of the hedge fund sector has differed little from what went before, namely a divergent performance between funds of hedge funds, which saw further decline, and pure hedge funds, in frank expansion.

…the latter saw further decline in assets and unit-holder numbers over the year's middle months, along with more schemes entering liquidation…

Both types of vehicles enjoyed a boom period from the time they were first authorised in Spain, at end-2006, until the middle of 2008, when they felt the first impact of the gathering recession. Since the low point of March 2009, however, their fortunes have been very different. Funds of hedge funds, which for various reasons are more vulnerable to the crisis, have yet to recoup either the assets or the investor base of their mid-2008 heyday. In fact, by mid-2012, their managed assets were down to 560 million euros, 8.4% less than at end-2011 and a long way away from the 1.43 billion of mid-2008. Unit-holder numbers, meantime, were 3,576 in the second quarter of 2012, compared to 4,043 at end-2011 and around 9,800 in June 2008. Twenty-six funds of hedge funds were registered in June 2012, but many of their number are currently in liquidation.

…while the former have continued to recover strongly across all key variables from the trough levels of March 2009.

Conversely, hedge funds have been growing both assets and unit-holders, with few interruptions, since the trough reached in March 2009. By mid-2012, the sector was sitting on 782 million euros assets, 7.1% more than in December 2011, while unit-holder numbers had climbed from 2,045 to 2,113.

Main hedge fund and fund of hedge fund variables								TABLE 16
					2011		2012	
	2008	2009	2010	2011	III	IV	I	II[2]
FUNDS OF HEDGE FUNDS								
Number[1]	40	38	28	27	27	27	26	26
Unit-holders	8,151	5,321	4,404	4,043	4,046	4,043	3,592	3,576
Assets (million euros)	1,021.3	810.2	694.9	611.2	617.4	611.2	568.0	560.1
Return (%)	-17.8	7.85	3.15	-1.70	-1.50	0.85	1.15	-0.24
HEDGE FUNDS								
Number[1]	24	29	33	36	36	36	36	35
Unit-holders	1.589	1.917	1.852	2.045	2.057	2.045	2.077	2.113
Assets (million euros)	539.4	652.0	646.2	729.8	703.9	729.8	775.3	781.8
Return (%)	-4.82	14.94	5.37	-2.60	-6.81	2.16	3.66	-0.61

Source: CNMV.

1 Funds filing financial statements.

2 Data to April 2012. The return stated corresponds to the month of April.

Foreign UCITS marketed in Spain

Investment in foreign UCITS climbs 15% in first-half 2012.

After the slump of 2011, investment in foreign UCITS bounced back strongly in the first months of 2012. From December 2011 to June 2012, assets under management in foreign schemes built up by 15% to more than 34.50 billion euros. Investor numbers expanded by a rather more modest 3.6% to just under 790,000.

Outlook

Industry prospects remain troubled in the face of falling household investment and competition from other financial products.

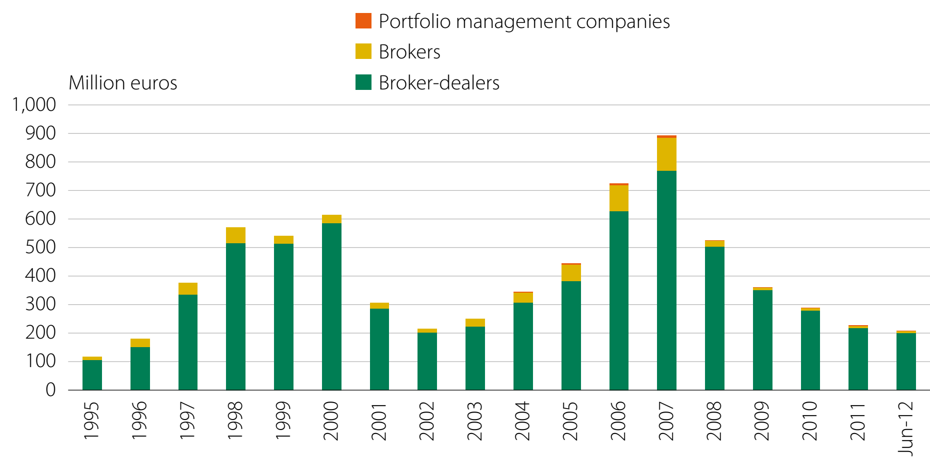
The outlook for the Spanish collective investment industry remains clouded by uncertainty. Among the factors ranged against we can cite households' dwindling investment in financial assets as the crisis eats deeper into disposable income, and stiff competition from other lower-risk financial products, like commercial paper or certain government debt instruments, which are also offering attractive yields. The ongoing restructuring of Spanish credit institutions, which manage and market a large share of investment fund assets, will likely continue having a knock-on effect on the organisation of management companies as well as their product offering.

4.2 Investment firms

Investment firms again had to cope with the fallout from financial market tensions.

Investment firms had to operate, as in previous years, under the negative influence of domestic financial market turbulence, which continued to drive down revenues from their main business lines. The result was a sharp stall in aggregate earnings and a substantially higher number of firms reporting first-half losses. That said, most intermediaries in this sector remained comfortably compliant with capital standards.

Investment firm pre-tax profits[1,2] FIGURE 13



Source: CNMV.

1 Except IAFs.

2 2012 earnings on an annual basis.

Broker-dealer profits drop 33% as fee income goes on contracting .

Broker-dealers obtained pre-tax profits of 100.6 million euros, a fall of 33% versus the same period in 2011, with the decline tracing to gross income and insufficient savings at the operating expenses line (see table 17). Gross income, specifically, receded 16.2% to 303 million euros on sharply falling fee income[9] (-21%), its main component, and an uneven showing by other items. Hence net gains on proprietary investments expanded strongly in the second quarter as far as 92.4 million euros (more than double the total for 2011), whereas net interest income contracted 38.4% and net exchange losses ran significantly deeper.

9 14.8% in net terms.

Aggregate income statement (2012)

TABLE 17

	Broker-dealers			Brokers			Portfolio managers		
Thousand euros	jun-11	jun-12	% var.	jun-11	jun-12	% var.	jun-11	jun-12	% var.
1. Net interest income	52,973	32,651	-38.4	1,144	946	-17,3	293	390	33.1
2. Net fee income	275,520	234,842	-14.8	50,423	46,665	-7,5	3,840	3,832	-0.2
2.1. Fee income	419,375	331,330	-21.0	57,899	53,625	-7,4	9,123	8,864	-2.8
2.1.1. Order processing and execution	285,047	200,721	-29.6	19,345	17,993	-7,0	–	–	–
2.1.2. Issue placement and underwriting	2,830	4,089	44.5	1,181	1,620	37,2	–	–	–
2.1.3. Securities custody and administration	10,887	10,091	-7.3	191	311	62,8	–	–	–
2.1.4. Portfolio management	7,911	6,881	-13.0	6,760	5,487	-18,8	8,323	8,115	-2.5
2.1.5. Investment advising	37,047	23,684	-36.1	2,634	2,445	-7,2	800	749	-6.4
2.1.6. Search and placement	184	25	-86.4	538	0	-100,0	–	–	–
2.1.7. Margin trading	4	6	50.0	13	14	7,7	–	–	–
2.1.8. UCITS marketing	31,359	23,113	-26.3	11,097	9,881	-11,0	0	0	–
2.1.9. Others	44,104	62,720	42.2	16,141	15,874	-1,7	0	0	–
2.2. Fee expense	143,855	96,488	-32.9	7,476	6,960	-6,9	5,283	5,032	-4.8
3. Result of financial investments	38,782	92,439	138.4	-54	786	–	233	-52	–
4. Net exchange income	-5,344	-61,398	-1.048.9	-225	25	–	-14	23	–
5. Other operating income and expense	171	5,043	2.849.1	-1,081	-978	9,5	-5	25	–
GROSS INCOME	**362,102**	**303,577**	**-16.2**	**50,207**	**47,444**	**-5,5**	**4,347**	**4,218**	**-3.0**
6. Operating expenses	212,791	205,085	-3.6	43,433	43,785	0,8	3,616	3,528	-2.4
7. Depreciation and other charges	6,538	5,705	-12.7	1,209	1,022	-15,5	54	53	-1.9
8. Impairment losses	-1	501	–	-3	45	–	0	0	–
NET OPERATING INCOME	**142,774**	**92,286**	**-35.4**	**5,568**	**2,592**	**-53,4**	**677**	**637**	**-5.9**
9. Other profit and loss	8,100	8,348	3.1	275	129	-53,1	0	0	–
PROFITS BEFORE TAXES	**150,874**	**100,634**	**-33.3**	**5,843**	**2,721**	**-53,4**	**677**	**637**	**-5.9**
10. Corporate income tax	29,472	22,174	-24.8	554	361	-34,8	187	200	7.0
PROFITS FROM ONGOING ACTIVITIES	**121,402**	**78,460**	**-35.4**	**5,289**	**2,360**	**-55,4**	**490**	**437**	**-10.8**
11. Profits from discontinued activities	0	0	–	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**121,402**	**78,460**	**-35.4**	**5,289**	**2,360**	**-55,4**	**490**	**437**	**-10.8**

Source: CNMV.

Brokers, meantime, saw their pre-tax profits slide to 2.7 million euros in the first-half period, just half the total of June 2011 (5.8 million). Net fee income, which accounts for over 98% of their combined gross income, slipped by 7.5% to 46.7 million euros. And despite an intense cost-cutting effort in the past few years, the fall in gross income was so abrupt that it just barely covered operating expenses (47.4 million euros as against 43.8 million).

Broker earnings slump to lows to the extent that gross income barely covers operating expenses.

Finally, **portfolio management companies** closed the first six months with 637,000 euros profits, 5.9% less than in the year-ago period. Their gross income fell by 3% to 4.2 million euros, due to losses on financial transactions. Net fee income, the item contributing most at the gross income line, held relatively stable at 3.8 million euros. Operating expenses, finally, reduced by 2.4% to 3.5 million euros.

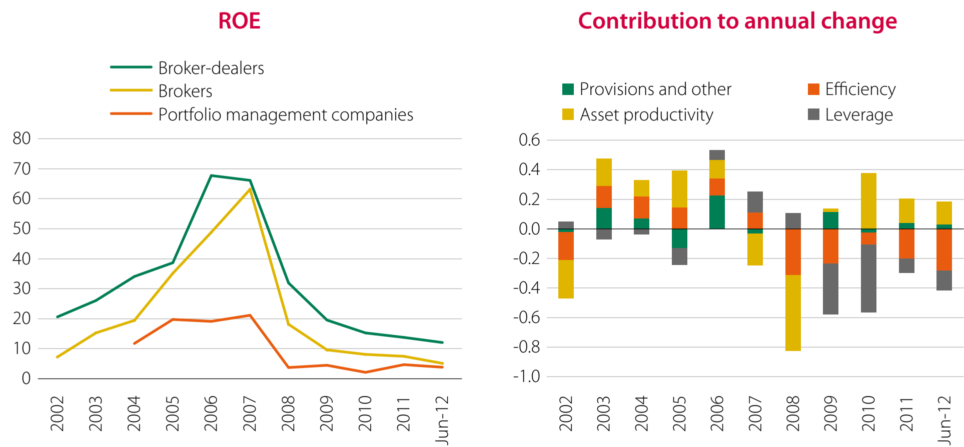
Portfolio management companies get off more lightly, thanks to their relatively stable fee income.

Sector-wide return on equity (ROE) sank from 15% to 11.6%, in line with the year-to-date fall in investment firm earnings. By type of enterprise, the ROE of broker-

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

dealers shrank three full points to 12% and that of brokers by five points to 5.2%, while portfolio managers kept their ratio at a more or less even 3.8%. Examining the components of the six-month variation in investment firm ROE, we find a prolongation of the trends in place through 2010 and 2011, albeit with some changes in their relative intensity. As we can see from the right-hand panel of figure 14, the positive contribution of higher asset productivity and provisions failed to offset the damping effect of firms' efficiency losses and, less so, their lower leverage.[10]

Pre-tax ROE of investment firms FIGURE 14

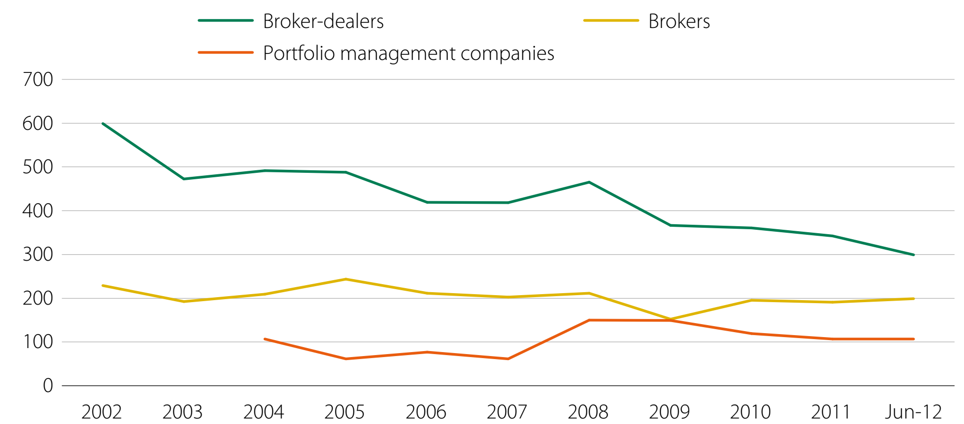


Source: CNMV.

.. which lifted the number of loss-making companies from 30 to 38.

The number of loss-making entities (before taxes) rose to 38 in June 2012 (30 in June 2011 and 31 at the annual close). Of this total, 12 were broker-dealers (13 in June 2011), 23 brokers (16 in June 2011) and 3 portfolio management companies (one in June 2011). Losses in the six-month period year amounted to 12.8 million euros, an increase of 38% in year-on-year terms.

Investment firm capital adequacy (surplus of qualifying equity to the minimum requirement, %) FIGURE 15



Source: CNMV.

10 For a fuller description of how to interpret the elements in this equation, see the exhibit "ROE breakdown" in *Securities markets and their agents: situation and outlook* in the CNMV Bulletin for first quarter 2008.

Investment firms remained comfortably compliant with capital standards, though margins have tended to narrow in the fast few years. As figure 15 shows, broker-dealers obtained a mid-2012 surplus equal to 3 times the requirement (3.9 in June 2011). Brokers, meantime, had a surplus of two times the prescribed minimum, the same level as in mid-2011. Finally, portfolio management companies maintained their ratios unchanged at just above the statutory level. Only one firm (a broker) was carrying a capital deficit at the end of the first-half period.[11]

Sector capital ratios remain comfortably clear of minimum requirements despite some narrowing of the surplus.

Investment advisory firms (IAFs) continued their expansion. Of the 97 figuring on the CNMV register at mid-year 2012, as many as 33 had joined in the preceding twelve months. However, financial market unrest meant key business figures failed to match this dynamic growth. Hence the number of advisory contracts outstanding rose by 3.6% to 3,279, but assets under advice slipped back 11% to 14.66 billion euros. Note that this decline was confined to the professional client segment (down 16% to 12.20 billion euros), while assets under advice in the retail client segment grew 27% to 2.41 billion euros, raising their relative weight in the IAF mix from 11.5% to 16.5%.

The IAF segment continues to advance by the measure of competitors and contracts, but loses ground in assets under advice …

Key investment advisory firm variables TABLE 18

				2011		2012	% annual
Thousand euros	2009	2010	2011	1H	2H	1H	change
NO. OF FIRMS	**16**	**52**	**82**	**64**	**82**	**97**	**51.6**
ASSETS UNDER ADVICE[1]	**1,410,985**	**15,802,743**	**16,033,109**	**16,498,265**	**16,033,109**	**14,663,856**	**-11,1**
Retail customers	364,284	1,715,084	2,181,943	1,894,771	2,181,943	2,415,002	27,5
Professional customers	1,046,702	13,995,206	13,831,973	14,501,823	13,831,973	12,205,216	-15,8
Others	0	92,453	19,193	101,671	19,193	43,638	-57,1
NO. OF CONTRACTS[1]	**317**	**2,431**	**3,677**	**3,158**	**3,677**	**3,279**	**3,8**
Retail customers	293	2,345	3,542	3,037	3,542	3,099	2,0
Professional customers	24	79	126	109	126	164	50,5
Others	0	7	9	12	9	16	33,3
FEE INCOME[2]	**3,183**	**20,745**	**31,053**	**14,131**	**31,053**	**13,940**	**-1,4**
Fees received	3,183	20,629	30,844	14,080	30,844	13,855	-1,6
From customers	2,776	17,132	26,037	11,720	26,037	11,668	-0,4
From other entities	407	3,497	4,807	2,360	4,807	2,186	-7,4
Other income	0	116	209	51	209	85	66,7
EQUITY	**1,500**	**10,057**	**12,184**	**10,444**	**12,184**	**13,098**	**25,4**
Share capital	1,043	3,014	3,895	3,386	3,895	4,328	27,8
Reserves and retained earnings	36	242	950	2,889	950	5,904	104,4
Profit/loss for the year[2]	421	6,801	7,338	4,169	7,338	2,866	-31,3

Source: CNMV.

1 Period-end data at market value.

2 Cumulative data for the period.

11 The firm concerned has submitted plans to merge with another in its group, which should restore it to compliance.

…and therefore aggregate earnings.

The first-half fees earned by IAFs came to 13.9 million euros, 1.4% less than in the same period last year, while net profits, at 2.9 million, were 31% down with respect to June 2011.

Investment firms will continue to suffer until domestic financial markets return to something like calm.

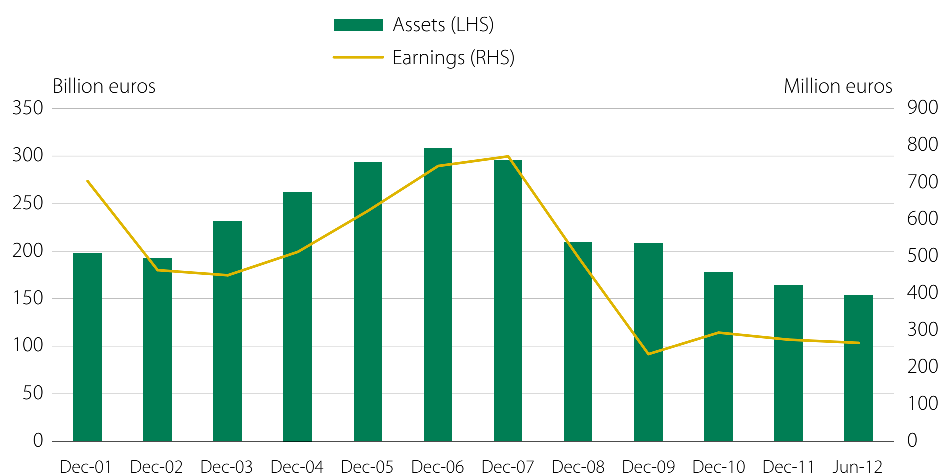
Investment firms' adversities are likely to persist due to the tensions dominating Spain's financial markets, which have thinned traditional revenue streams like order processing and securities placements, and the deterioration suffered by the collective investment industry. Although business lines like advisory services have been rather less affected, there is little chance of a quick end to the sector's woes. Many firms, moreover, may shortly face reorganisation as part of the broader restructuring of the Spanish financial system.

4.3 UCITS management companies

Fund manager assets contract 6.4% in the first half to 154 billion euros…

Assets under management in UCITS management companies fell by 6.4% in the first-half period to 154 billion euros. As figure 16 shows, the decline has not let up since the start of the crisis, though the rate has tended to slow. In all, the sector has lost around half its assets (in nominal terms) since 2006, when they were running at around 300 billion euros a year.

UCITS management companies: assets under management and pre-tax profit FIGURE 16



Source: CNMV. Figures for June 2012 on an annual basis.

…dando lugar a un descenso de los beneficios agregados del sector del 3%.

The fall in managed assets was mirrored by a small decline at most income statement lines. Hence revenues from UCITS management fees fell by 5.7% to an annualised 1.48 billion euros, and aggregate pre-tax profits (again annualised) came to 266 million, 3% less than at end-2011. Sector-wide return on equity (ROE) held more or less flat at around 20%. Finally, the number of loss-making entities edged up from 32 in December 2011 to 34 in June 2012, while their combined losses were broadly unchanged at just over eleven million euros (in annual terms).

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	203,379	1,702	0.84	68.6
2010	177,676	1,622	0.91	68.1
2011	164,125	1,479	0.90	66.6
Jun-12[2]	153,587	1,394	0.91	65.1

Source: CNMV.

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

2 Fee income and average management fees are stated on an annual basis.

Organisationally, the sector continued to feel the effects of the restructuring of the Spanish banks, the owners of most UCITS management companies registered with the CNMV. Their numbers, specifically, reduced by four to 110 in first-half 2012, after one entry and five retirals, four of which ensued from parent group reorganisation.

The number of UCITS management companies continued to fall.

4.4 Other intermediaries: venture capital

The number of venture capital entities (VCEs) increased slightly in the first eight months of 2012, from 336 to 341 (see table 20). Of this total, 143 were venture capital companies (VCCs), 117 venture capital funds (VCF)s and 81 VCE management companies. Sixteen entities joined the register (eight VCCs, five VCFs and three VCE managers) against 11 retirals (eight VCCs, two VCFs and one VCE manager).

The number of venture capital entities rises slightly in the first eight months of 2012.

Movements in the VCE register in 2012

TABLE 20

	Situation at 31/12/2011	Entries	Retirals	Situation at 31/08/2012
Entities	336	16	11	341
Venture capital funds	114	5	2	117
Venture capital companies	143	8	8	143
Venture capital management companies	79	3	1	81

Source: CNMV.

Between December 2010 and December 2011, VCEs grew their combined assets by around 6% to upwards of 8.40 billion euros. However, as table 21 shows, while VCF assets increased (15.3% to 4.32 billion euros) those of VCCs contracted slightly (by 2.3% to 2.09 billion euros). At least part of this shift seems to reflect a change in investor preferences among the different venture risk vehicles. In particular, both

Sector assets grew 6% in 2011 to 8.40 billion euros, with substantial gains among the funds and a small loss on the companies side.

Spanish and foreign VCEs have scaled back their holdings in VCCs, as have non-financial corporations, in favour of increased investment in VCFs. Looking at venture capital investors by type, we find that individuals are still a minority, while among investing entities, there has been a shift in weight from the *cajas de ahorro* to the banks, as a result of the mergers taking place in the last few years. Overall, credit institutions reduced their share of VCF assets from 20.6% to 18.7% between 2010 and 2011, and scaled up from 31.8% to 32.4% among VCCs, where they are still the dominant investor group. Other major investors in VCFs (over 13% of the total) were non-financial corporations, public authorities and foreign entities.

Sector investment and funding run into trouble in the first half of 2012 …

According to preliminary data furnished by industry association Asociación Española de Entidades de Capital Riesgo (ASCRI), venture capital investment in Spain receded 43% in the first half of 2012, as far as 1.17 billion euros. This was better than first-half 2009, when investment plummeted, but nonetheless takes the sector back to about the levels of 2006. Of the 494 transactions closed to June, 2% more than in first-half 2011, 84% were small (below one million euros), against eleven in the medium bracket (ten to 100 million euros) and three large-scale (over 100 million euros). The sectors attracting most investment were "other services", medicine and health, industrial products and services, and consumer products. Funds raised by the sector contracted 37% to 934 million euros.

Venture capital assets by type of investor TABLE 21

	VCFs		VCCs	
Million euros	**2010**	**2011**	**2010**	**2011**
Natural persons				
Residents	183.89	212.74	86.35	80.83
Non-residents	2.54	2.81	0.68	0.76
Legal persons				
Banks	226.40	526.39	402.42	1.183.46
Savings banks	547.46	281.81	929.81	143.68
Pension funds	413.29	417.55	26.18	23.62
Insurance undertakings	95.02	111.15	16.20	25.96
Broker-dealers and brokers	0.00	0.00	0.00	0.00
Collective investment schemes	26.02	27.18	8.52	10.72
Domestic venture capital entities	68.46	100.01	69.92	56.11
Foreign venture capital entities	296.70	393.96	44.87	3.74
Public authorities	494.53	588.38	142.75	165.19
Sovereign funds	33.17	38.22	0.00	0.00
Other financial corporations	292.51	309.14	671.79	675.99
Non-financial corporations	538.34	594.10	1,579.94	1,541.07
Foreign entities	395.53	563.31	44.45	46.83
Others	137.22	157.30	166.39	134.84
TOTAL	**3,751.08**	**4,324.05**	**4,190.27**	**4,092.80**

Source: CNMV.

The short-term outlook for the venture capital sector is fairly complicated, given the difficulties involved in raising funds and closing operations. Not only do operators face tougher access to bank finance, but funding from abroad has thinned on concerns about the risks facing the Spanish economy, while the domestic investor base is either caught up in bank sector restructuring or having to contend with budgetary constraints. There is little chance then of any immediate revival of the industry's fortunes.