

**Spain: IOSCO Objectives and Principles of Securities Regulation—
Detailed Assessment Implementation**

This paper was prepared based on the information available at the time it was completed on May 2012. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Spain or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

**International Monetary Fund
Washington, D.C.**

FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

SPAIN

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES
REGULATION

DETAILED ASSESSMENT OF
IMPLEMENTATION

MAY 2012

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

| Contents | Page |
|--|------|
| Glossary | 3 |
| I. Summary..... | 5 |
| II. Introduction | 5 |
| III. Information and Methodology Used for the Assessment | 6 |
| IV. Institutional Structure | 6 |
| V. Market Structure | 7 |
| VI. Preconditions for Effective Securities Regulation..... | 10 |
| VII. Main Findings..... | 10 |
| VIII. Authorities' Response | 20 |
| Tables | |
| 1. Non-Financial Corporations and Households Financial | 7 |
| 2. Spanish Regulated Markets: BME Group..... | 9 |
| 3. Summary Implementation of the IOSCO Principles | 12 |
| 4. Recommended Action Plan to Improve Implementation of the IOSCO Principles | 18 |
| 5. Detailed Assessment of Implementation of the IOSCO Principles | 21 |

GLOSSARY

| | |
|----------------|---|
| AIAF | Asociación de Intermediarios de Activos Financieros (the fixed income market operated by BME) |
| ATC | Advisory Technical Committee |
| BdE | Banco de España |
| BME | Bolsas y Mercados Españoles |
| BOE | Boletín Oficial del Estado |
| CCA | Capital Companies Act |
| CCP | Central Clearing Counterparty |
| CEMA | Committee of Economic and Market Analysis |
| CESFI | Comité de Estabilidad Financiera |
| CIS | Collective Investment Schemes |
| CNMV | Comisión Nacional de Valores |
| CoC | Code of Conduct |
| CRAs | Credit Rating Agencies |
| DEA | Direct Electronic Access |
| DGSFP | Dirección General de Seguros y Fondos de Pensiones |
| EC | European Commission |
| ESMA | European Securities Markets Authority |
| EU | European Union |
| FOGAIN | Fondo de Garantía de Inversiones, |
| FSAP | Financial Sector Assessment Program |
| GIEF | Grupo Interno de Estabilidad Financiera |
| HF | Hedge Funds |
| IFRS | International Financial Reporting Standards |
| IOSCO | International Organization of Securities Commissions |
| ICAC | Instituto de Contabilidad y Auditoría de Cuentas |
| ISPs | Investment Services Providers |
| IT | Information Technology |
| KII | Key Investor Information |
| LAC | Ley de Auditoría de Cuentas |
| LMV | Ley del Mercado de Valores |
| MAB | Mercado Alternativo Bursátil |
| MCM | Monetary and Capital Markets Department |
| MEC | Ministerio de Economía y Competitividad |
| MEFF | Mercado Español de Futuros Financieros |
| MFAO | Mercado de Futuros del Aceite de Oliva |
| MMFs | Money Market Funds |
| Ministry of EC | Ministerio de Economía and Competitividad |
| MMoU | Multilateral Memorandum of Understanding |
| MMU | Market Monitoring Unit |
| MoJ | Ministry of Justice |
| MTFs | Multilateral Trading Facilities |
| NAV | Net Asset Value |
| PIEs | Public Interest Entities |

| | |
|---------|--|
| PRIP | Packaged Retail Investment Products |
| RESI | Real Decreto 217/2008, de 15 de febrero, sobre el régimen jurídico de las empresas de servicios de inversión y de las demás entidades que prestan servicios de inversión |
| RJAPPAC | Regimen Jurídico de las Administraciones Públicas y del Procedimiento Administrativo Común |
| RMs | Regulated Markets |
| SENAF | Sistema Electrónico de Negociación de Activos Financieros |
| SICAV | Sociedad de Inversión de Capital Variable |
| SRO | Self-Regulatory Organizations |
| VaR | Value at Risk |
| UCITS | Undertakings for Collective Investment in Transferable Securities |

I. SUMMARY

1. **Spain exhibits a high level of implementation of the International Organization of Securities Commissions (IOSCO) principles.** The legal framework is robust and provides the Comisión Nacional de Valores (CNMV) with broad supervisory, investigative and enforcement powers. Arrangements for off-site monitoring of regulated entities are robust. Thematic reviews in selected areas have complemented such monitoring, allowing the CNMV to take a “full industry” perspective on key issues. The CNMV has also developed robust arrangements for market surveillance. A new committee (*the Grupo de Estabilidad Financiera*), biweekly meetings by a management committee and annual strategic reviews allow the CNMV to contribute to the identification and monitoring of emerging and systemic risk and the review of the perimeter of regulation.
2. **Some areas of supervision and enforcement require strengthening.** In particular, the CNMV should make more use of on-site inspections for all types of investment service providers, but in particular in connection with credit institutions given their dominant role in the securities markets and the inherent conflicts of interest that arise from their dual role as issuers and distributors of products. This could be done via spot checks on particular issues, and does not imply the need for full scale inspections. In tandem, the CNMV should continue to use more proactively its sanctioning powers in connection with breaches by regulated entities, in addition to other enforcement mechanisms such as remedial agreements. Successful criminal prosecution of market abuse is a challenge, but positive steps have been taken as the CNMV has become more active in the referral of cases to the criminal authorities.
3. **Certain aspects of the current governance structure of the CNMV raise concerns vis-à-vis independence, although the assessors saw no evidence of interference with day-to-day operations.** The participation of a representative of the—MEC in the board of the CNMV; the fact that certain key decisions (authorizations and the imposition of sanctions for the most serious breaches) are still a responsibility of the Ministro de Economía y Competitividad (MEC); and the requirement of governmental approval to hire additional personnel are threats to CNMV independence. In practice the collegial nature of the board and the “regulated” nature of the authorization and sanctioning processes—which require a recommendation from the CNMV have acted as mitigating factors.

II. INTRODUCTION

4. **An assessment of the level of implementation of the IOSCO Principles in the Spanish securities market was conducted** from February 1 to 21, 2012 as part of the Financial Sector Assessment Program (FSAP) by Ana Carvajal, Monetary and Capital Markets Department (MCM) and Malcolm Rodgers, MCM expert. An initial IOSCO assessment was conducted in 2006. Since then significant changes have taken place in the Spanish market, in terms of market development and upgrading of the regulatory framework. In addition IOSCO approved a new set of Principles in 2010 and a revised Methodology in 2011.

III. INFORMATION AND METHODOLOGY USED FOR THE ASSESSMENT

5. **The assessment was conducted based on the IOSCO Objectives and Principles of Securities Regulation approved in 2010 and the Methodology adopted in 2011.** As has been the standard practice, Principle 38 is not assessed due to the existence of a separate standard for securities settlement systems. A technical note on the oversight framework for clearing and settlement of securities markets was delivered during this mission.

6. **The IOSCO methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice.** The recent global financial crisis has reinforced the need for assessors to take a critical look at supervisory practices, to determine whether they are effective enough. Among other things, such judgment involves a review of the inspection programs for different types of intermediaries, the cycle, scope and quality of inspections as well as how the agency follows-up on findings, including the use of enforcement actions.

7. **The assessors relied on:** (i) a self-assessment prepared by the CNMV; (ii) the review of relevant laws and reports; (iii) review of supervisory files; (iii) meetings with staff from the CNMV, the *Banco de España* (BdE); the *Instituto de Contabilidad y Auditoria de Cuentas* (ICAC); the MEC; and prosecutorial authorities; as well as (iv) meetings with market participants, including issuers, securities firms, fund managers, exchanges, external auditors, credit rating agencies (CRAs) and law firms.

8. **The assessors want to thank the CNMV for its full cooperation** as well as its willingness to engage in very candid conversations regarding the regulatory and supervisory framework in Spain. The assessors also want to extend their appreciation to all other public authorities and market participants with whom they met.

IV. INSTITUTIONAL STRUCTURE

9. **The regulation and supervision of securities markets in Spain is a responsibility of the CNMV.** The CNMV is responsible for the supervision of both securities and derivatives markets. In particular, it has responsibility for the supervision of primary securities markets (issuance); secondary markets (for both securities and derivatives); the disclosure obligations of issuers; the provision of investment services by market intermediaries; and collective investment schemes (mutual funds and investment companies). The authorization of all intermediaries, except financial advisors, to provide services in the Spanish market as well as the authorization of all market infrastructure providers (exchanges and central clearing counterparties (CCP)) is a responsibility of the MEC, based on a recommendation of the CNMV. Regulations can only be issued by the Government or the MEC, but the CNMV can issue binding rules (*Circulares*) where expressly permitted to do so by the relevant Royal Decree or MEC order.

10. **The CNMV is a public law entity with legal personality.** The CNMV is governed by a board (the *Consejo*), composed of seven members, including a President and a Vice President appointed by the government on a recommendation of the MEC,

three members with experience in securities markets, and two ex-officio members, the *Secretary General of the Treasury and Financial Policy* and the Deputy Governor of the BdE. The board has delegated its day to day functions to an Executive Committee which is composed of all but the ex-officio members. Decisions that must be taken at the board level are, among others: the approval of *Circulares* and the imposition of sanctions, as well as the approval of the annual report and the annual plan of activities of the CNMV. While self-funded the CNMV requires government approval to hire additional staff.

11. **There are no self-regulatory organizations (SROs) in Spain.** Exchanges (in the context of Spain the four exchanges operated by the *Bolsas y Mercados Espanoles* (BME)) are the front line supervisor for the purpose of ensuring orderly trading, but they only have a complementary role to that of the CNMV in what concerns market abuse. The exchanges do not have either a role in securities intermediaries' supervision (beyond ensuring that the rules of the market are being complied with), nor in monitoring compliance of issuers with their disclosure obligations. In connection with multilateral trading facilities (MTFs) (in the context of Spain: *Latibex* and *Mercado Alternativo Bursátil* (MAB)) the MTF operator (BME) has a more direct role in monitoring the market for purposes of detecting market abuse, and it is also in charge of monitoring compliance by issuers with their disclosure obligations. However at present these markets are not of material importance.

V. MARKET STRUCTURE

12. **At 30 September 2011, Spanish savings and investments totalled approximately € 1,758 billion.** 57 percent are held in deposits with credit institutions, but 26 percent are held in mutual funds or direct market investments (see Table 1)

Table 1. Spain: Non-Financial Corporations and Households Financial Assets

| 3Q11, EUR billion | | | | |
|-----------------------|-----------------------------------|-------------------|--------------|-------------------|
| | Non-financial Corporations | Households | TOTAL | % of TOTAL |
| Deposits | 240 | 769 | 1,010 | 57 |
| Mutual funds | 12 | 111 | 123 | 7 |
| Pension funds | 0 | 104 | 104 | 6 |
| Savings insurance | 26 | 162 | 188 | 11 |
| Direct investments | 192 | 142 | 334 | 19 |
| Fixed income | 42 | 50 | 92 | 5 |
| Equities ¹ | 150 | 92 | 242 | 14 |
| TOTAL | 470 | 1,288 | 1,758 | 100 |

Source: BdE (Financial Accounts).

¹Listed equities and investment companies shares.

Issuers

13. **At December 2011, 130 companies were listed on the main (electronic) Spanish equities market operated by the BME Group.** In addition, there were 7 issuers on the second market and 28 issuers listed on the small cap open outcry market. Total market capitalisation was € 421 billion (or approximately 39 of Spain's GDP). Stocks in financial companies account for almost 31 percent of total market capitalization, with banks accounting for over 90 percent of this figure. The market is concentrated, with the top ten companies representing over 60 percent of total market capitalization. The rate of new listings has slowed markedly since the financial crisis, and there were only 6 new listings in 2011 (and 5 de-listings). A small number of companies are listed on other markets, including the BME MAB market (18 companies), and regional exchanges.

14. **At December 2011 there were 611 issuers of fixed interest products and a total of 4,382 issues available for trading on the BME's fixed interest market, Asociación de Intermediarios de Activos Financieros (AIAF).** Total outstanding on these issues was € 882.4 billion.

Intermediaries

15. **At December 2011, 94 investment firms (49 broker dealers and 45 brokers) and 187 banks and other credit institutions were authorized to carry out investment services in Spain.** In addition, 2,377 European firms have notified the CNMV of their intention to provide investment services in Spain. Of these 36 operate through branches and the remainder through the free provision of services (passport) arrangements. There are also 6 authorized portfolio management firms and 82 authorized financial advisors (60 firms and 22 individuals).

16. **Banks dominate the investment services industry, and account for 72 percent of commissions earned from investment services activities.** They account for over 96 percent of placement and underwriting activity, 95 percent of administration and custody, and 92 percent of mutual fund marketing.

17. **As of December 2011, 114 firms were authorized to manage Collective Investment Schemes (CIS).** In addition, 94 firms were authorized to provide depository (custodial) services, although in practice 56 do so, and a small number of banks account for most of the business.

Collective investment schemes

18. **At December 2011, there were 5,460 CIS vehicles registered with the CNMV,** comprising 2,341 investment funds, 3,056 investment companies (sociedad de inversión de capital variable (SICAVs)), 36 hedge funds (HFs) and 27 fund of hedge funds. In addition, there were 14 real estate funds (6 investment funds and 8 SICAVs). There are almost 5 million investors in CIS in Spain.

19. **Total assets under management at November 2011 were € 156 billion, with € 132.4 in investment funds and € 23.6 in SICAVs.** Banks and other credit institutions manage more than 90 percent of the total assets under management. Asset allocation is heavily weighted toward fixed income, with over 60 percent of fund assets in fixed income or guaranteed fixed income funds; and a further 4 percent in mixed fixed interest funds. Guaranteed equity funds account for almost 14 percent of total funds under management. Investment in real estate funds was € 4.8 billion, or about 3 percent of all funds under management.

Markets

20. **The BME Group operates all regulated markets (RMs) in Spain, except for an olive oil futures market and the Spanish Public Debt Market.** BME group equity markets use the same electronic trading platform. They are order driven markets, and market makers are used by Latibex and MAB to provide liquidity. BME also operates a centralised securities depository, IBERCLEAR, and a CCP for repos on Spanish public debt transactions, MEFFCLEAR. The markets the BME group operates are listed in Table 2.

Table 2. Spanish Regulated Markets: BME Group

| Market | Regulated As: | Products Traded | Listed Entities | Comment |
|--|---------------------------|---|-------------------|---|
| BME [comprising the stock exchanges of Barcelona, Bilbao, Madrid and Valencia] | Official secondary market | Spanish equities, ETFs, warrants and certificates | 130 | Market capitalization: € 492 billion [November 2011] |
| MAB | MTF | Small cap stocks; SICAVs | 18 [3,056 SICAVs] | Market capitalization: € 444 million (small cap stocks) [December 2011] |
| Latibex | MTF | Latin American equities (euro denominated) | 34 | |
| AIAF | Official secondary market | Corporate debt | 608 debt issuers | Total outstandings: € 868 billion [November 2011] |
| SENAF | MTF | Public debt | - | |
| MEFF Equities | Official secondary market | Equity derivatives | | |
| MEFF Fixed Income | Official secondary market | Fixed income derivatives | | No activity in 2012 |

21. **Spain has not yet seen the emergence of trading venues competing for trading in BME listed products.** Some BME listed stocks are traded on venues located elsewhere in Europe, such as Chi-X, but overall non-BME trading is estimated at less than 2 percent.

22. **There is also a specialized olive oil futures market authorized as an official secondary market.** Trading volumes are small and appear to be in decline.

23. **The Official Secondary Market for Book-Entry Public Debt is run by the Bank of Spain which is in charge of its supervision and oversight.**

VI. PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION

24. **The preconditions for effective regulation and supervision of securities markets appear to be in place.** Foreign issuers can tap the markets under similar conditions to domestic issuers. The same authorization requirements apply to both domestic and foreign corporations that want to provide investment services, including CIS management, or to operate an RM or an MTF in Spain. In practice, however operational barriers have prevented the establishment of MTFs outside of those managed by the BME. The company law is modern, and the insolvency framework includes restructuring procedures. The judiciary system is perceived as impartial. Accounting and auditing standards do not have major differences with international standards.

VII. MAIN FINDINGS

25. **Principles for the regulator:** The CNMV has a clear mandate imbedded in the Ley del Mercado de Valores (LMV). The organizational structure does not guarantee the CNMV full independence. Authorization requirements in connection with the provision of regulated activities are clear and interested parties can access them through CNMV's website. In addition, the CNMV has developed manuals to support consistent decision making. The development of regulations by both the CNMV and the MEC is subject to public consultation. CNMV staff is subject to robust rules in connection with conflicts of interest, including a detailed framework for securities transactions. The CNMV has established processes to identify and monitor systemic risk, perimeter of regulation and conflict of interest.

26. **Principles for enforcement:** The CNMV has broad powers to request information and inspect regulated entities. It also has broad powers to request information and testimony from third parties. The CNMV has a wide set of enforcement tools at its disposal, including the imposition of money penalties for breaches to the LMV and secondary legislation. Until recently the majority of enforcement cases concern issuers' violations. Since the last three years the CNMV has been more active in investigating compliance by investment firms and credit institutions that provide investment services with their conduct obligations.

27. **Principles for issuers:** Issuers of public offerings and products admitted to trading on an RM are subject to robust disclosure obligations at the moment of registration and on a periodic and on-going basis. In addition, the CNMV has developed a robust program to monitor issuers' compliance with their disclosure obligations. Basic rights of shareholders are imbedded in company law, and additional protections exist in connection with issuers listed in an RM, including the obligation to launch a mandatory tender offer under certain conditions. There are notification obligations for substantial and insider holdings. Different provisions apply to MAB and Latibex however at this time those markets are not material.

28. **Principles for auditors, CRAs and other information service providers:** The ICAC, is in the process of implementing a system of quality control review for auditors of public interest entities (PIEs), which include firms that audit issuers listed in a RM,

whereby such auditors would be subject to inspections by ICAC on a three year cycle. CRAs that provide services in Spain have been subject to a thorough registration process by cross-European colleges of supervisors. European Securities Markets Authority (ESMA) is currently in the process of developing its supervisory program for CRAs. There is a framework in place for sell-side analysts to address potential conflict of interests, which is based on disclosure obligations; and additional disclosure obligations have been imposed in other entities that provide evaluative services

29. **Principles for collective investment schemes:** CIS operators and distributors of CIS are subject to authorization requirements, which include financial, fit and proper, and organizational requirements. The process to review applications is thorough. The supervisory program for CIS relies on off-site monitoring and thematic reviews. On-site inspections are conducted on a limited number of operators, which are selected under a risk-based approach. CIS that are offered to the public are subject to similar disclosure obligations as an issuer. Assets must be entrusted to a depository (custodian). Depositories can be (and in practice are) of the same group, but there are legal and regulatory arrangements in place that provide additional safeguards. In particular special reports are required from the compliance unit of the CIS as well as from the external auditors. Assets must be valued at fair value. The CNMV has developed guidance on valuation of illiquid assets. Conditions of suspensions of redemptions must be disclosed in the offering documents. Suspensions must be notified to the CNMV.

30. **Principles for securities intermediaries:** Investment Services Providers (ISPs) are subject to authorization requirements. Such requirements include financial resources, fit and proper, and organizational requirements. The process to review applications is thorough. The supervisory program for ISPs relies on off-site monitoring, and thematic/horizontal reviews. On-site inspections are conducted on a limited number of operators, which are selected under a risk-based approach. Minimum and ongoing capital requirements apply to ISPs. ISPs must submit monthly and quarterly reporting of their capital adequacy as well as annual audited financial statements. The CNMV uses an estimate of five month losses as an early warning indicator that triggers more intense monitoring. The CNMV has developed manuals to facilitate the process of dealing with the failure of an ISP.

31. **Principles for secondary markets:** RMs and MTFs operators are subject to authorization requirements, which include financial, fit and proper, and organizational requirements. The CNMV has developed robust arrangements for market surveillance. The CNMV has also developed both formal and informal arrangements to oversee BME and MFAO. MEF and Mercado de Futuros del Aceite de Oliva (MFAO) monitor clearing members' exposures on a daily basis and each has powers to request members to post additional margin. Default procedures are transparent. There are reporting obligations in connection with short selling, as well as in connection with failed settlements.

Table 3. Summary Implementation of the IOSCO Principles

| Principle | Grade | Findings |
|---|-------|--|
| Principle 1. The responsibilities of the Regulator should be clear and objectively stated. | BI | The CNMV has a clear mandate stemming from the LMV. The CNMV has established formal and informal cooperation arrangements with the BdE and the DGSP. There appear to be material differences in the regulation of like products, in particular unit-linked insurance products vis-à-vis securities products; and additional cooperation in this area appears to also be needed |
| Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers. | PI | The legal framework does not provide the CNMV with full independence. In particular, the Ministry of EC is part of CNMV's board, certain key decisions are still a responsibility of the MEC and the CNMV requires governmental approval to hire additional resources. In the current environment, where a freeze of resources has been decreed for the whole public sector, this is a source of concern. There are clear mechanisms of accountability of the CNMV to the government and the public, including an annual report and the review of its accounts. |
| Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. | BI | The CNMV has adequate powers; however authorization of ISPs and RMs is still a responsibility of the MEC. While not yet at optimal level, the level of resources of the CNMV has increased in recent years. Governance arrangements to ensure that the CNMV carries its functions effectively are robust. |
| Principle 4. The Regulator should adopt clear and consistent regulatory processes. | FI | The CNMV has adopted a public consultation process for the development of <i>circulares</i> . Requirements for authorization of regulated entities and public offerings are clear and can be accessed through CNMV's website. The CNMV has developed manuals that seek to ensure consistency in its decisions. Enforcement sanctions are disclosed once they are final—except for minor infractions. Due process obligations exist in connection with acts that affect third parties. Individuals can seek redress in the judicial courts against acts of the CNMV, and the MEC (in connection with authorization and sanctioning procedures). |

| | | |
|---|----|--|
| Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality. | FI | The CNMV staff is subject to the duties of loyalty, fairness and confidentiality. The CNMV has issued detailed guidance in connection with personal securities transactions. The Internal Control Department is in charge of monitoring compliance. Cooling off periods exist. |
| Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate. | FI | Through the <i>Grupo Interno de Estabilidad Financiera (GIEF)</i> , the CNMV is able to identify and monitor potential sources of systemic risk consistent with the scope of its mandate , and to contribute to Comité de Estabilidad Financiera (CESFI)'s discussions on financial stability. |
| Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly. | FI | Front-line supervisors have a responsibility to identify potential gaps in the perimeter of regulation within the areas of their responsibilities. Such bottom-up approach is supported by biweekly meetings at the management committee, which allows for an interdepartmental analysis. Findings are reasonably linked to a top down exercise of definition of priorities that the CNMV conducts on an annual basis. |
| Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed. | FI | Regulated entities are required to have in place internal controls and risk management procedures to identify, monitor and address conflicts of interest. Misalignment of incentives affecting issuers is tackled through disclosure obligations. In the area of securitization, retention requirements have also been imposed. All such obligations are monitored via the supervisory programs established by the CNMV for each category of regulated entity. |
| Principle 9. Where the regulatory system makes use of SROs that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities. | NA | There are no SROs in Spain. |
| Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers. | FI | The CNMV has comprehensive powers to request information and conduct inspections on regulated entities. |
| Principle 11. The Regulator should have comprehensive enforcement powers. | FI | The CNMV has broad powers to request information and testimony from third parties, including bank, records. The CNMV can use a wide set of enforcement tools, including the imposition of money penalties for breaches on the LMV and secondary legislation. |

| | | |
|---|-----------|---|
| <p>Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</p> | <p>PI</p> | <p>The CNMV makes limited use of on-site inspections. The CNMV should intensify the use of on-site inspections, in particular in connection with banks due to their dominant role in the Spanish securities market. The CNMV has been active in investigating market abuse and some sanctions have been imposed mainly in connection with insider trading, but cases on market abuse are also in the pipeline. In recent years the CNMV has also become more active in referring market abuse cases to the criminal prosecutors, but only one conviction has been secured. The CNMV has also more actively opened sanctioning procedures against regulated entities, however cases are still in the pipeline.</p> |
| <p>Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.</p> | <p>FI</p> | <p>The CNMV is empowered by the LMV to share information with domestic and foreign regulators.</p> |
| <p>Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.</p> | <p>FI</p> | <p>The CNMV has developed formal and informal cooperation arrangements with the BdE and the DGSP. The CNMV is signatory of the IOSCO Multilateral Memorandum of Understanding (MMoU).</p> |
| <p>Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.</p> | <p>FI</p> | <p>The CNMV regularly collects information on behalf of foreign regulators. Under the IOSCO MMoU no request for assistance has been refused.</p> |
| <p>Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.</p> | <p>FI</p> | <p>Issuers of public offerings must submit a prospectus to the CNMV. Robust periodic and ongoing disclosure requirements apply to issuers admitted to trading on a RM. The CNMV has implemented a robust program to monitor compliance by issuers with their reporting obligations. While less stringent than for RMs, disclosure requirements in MAB are broadly in line with the IOSCO Principles. For Latibex, disclosure requirements of the home country apply, but the BME must verify whether they provide equivalent protection. In any case the size of these venues is not material.</p> |

| | | |
|--|----|--|
| <p>Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.</p> | FI | <p>The Company Act provides a general framework for shareholders' rights. Additional protections exist in connection with issuers admitted to trading in a RM, including the obligation to launch a mandatory tender offer under certain conditions. Substantial and insider holdings must be disclosed. Notification of substantial and insider holdings apply also to issuers admitted to trading in MAB, although the thresholds are different; but tender offer obligations do not apply to MAB. For Latibex, the protections of the home country apply.</p> |
| <p>Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.</p> | FI | <p>Issuers admitted to trading in an RM must submit their consolidated statements according to International Financial Reporting Standards (IFRS). Other issuers can use Spanish GAAP (or national accounting standards of an EEA or U.S. GAAP). Spanish GAAP are largely in line with IFRS. The CNMV monitors compliance with accounting standards through its program of review of issuers' periodic information.</p> |
| <p>Principle 19. Auditors should be subject to adequate levels of oversight.</p> | BI | <p>ICAC is in the process of implementing a system for auditors' oversight of PIE firms, whereby such firms will be subject to direct inspections by ICAC on a three year cycle. Additional resources will be key to achieving such objective.</p> |
| <p>Principle 20. Auditors should be independent of the issuing entity that they audit.</p> | FI | <p>Auditors are subject to strong independence provisions. They must provide an annual report, which among other things provide information on the fees receive for different services. The audit committees of issuers listed in a RM must in turn provide an opinion on such report.</p> |
| <p>Principle 21. Audit standards should be of a high and internationally acceptable quality.</p> | FI | <p>Audits must be conducted based on local auditing standards. These standards are developed by the professional bodies and must be approved ("homologated") by the ICAC. There are no material differences between local standards and IAS.</p> |
| <p>Principle 22. CRAs should be subject to adequate levels of oversight. The regulatory system should ensure that CRAs whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.</p> | BI | <p>All CRAs that provide services in Spain were subject to a thorough registration process, through colleges of European regulators, including the CNMV. ESMA has already conducted on-site inspections on CRAs and has recently released to the public a report with general findings. Adding the staff already approved will be key to the effectiveness of the supervisory program.</p> |

| | | |
|--|----|---|
| <p>Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.</p> | FI | <p>The LMV and secondary legislation contain a specific framework in connection with sell side analysts, which is based on disclosure in the corresponding research of potential conflict of interests. Additional disclosure obligations are in place for other evaluative services, including entities that provide valuation services of real estate (<i>sociedades tasadoras</i>).</p> |
| <p>Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.</p> | BI | <p>CIS operators are subject to authorization requirements which include financial resources, fit and proper and organizational requirements. The authorization process is thorough. There is active use of thematic reviews, although only limited use of on-site inspections is made.</p> |
| <p>Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p> | FI | <p>CIS prospectuses contain detailed information on the legal form adopted by the CIS and the rights of investors. The LMV requires that CIS assets be entrusted to a depository. There is no requirement that the depository be of a different group, however information barriers must be developed and specific reports on the robustness of segregation arrangements are required from the compliance unit of the CIS operator and the external auditors.</p> |
| <p>Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p> | FI | <p>CIS that are publicly offered must submit a prospectus for the approval of the CNMV. Secondary legislation contains detailed rules concerning the content of the prospectus which are aimed to ensure the comparability of information available to investors. Periodic disclosure obligations also apply. Material changes must be approved by the CNMV and informed to investors.</p> |
| <p>Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.</p> | FI | <p>CIS must be valued at fair value. There is guidance in connection with valuation of illiquid assets. Suspensions of redemptions must be notified to the CNMV.</p> |
| <p>Principle 28. Regulation should ensure that HFs and/or HFs managers/advisers are subject to appropriate oversight.</p> | FI | <p>HF operators are subject to the same authorization requirements as any other CIS operator. HFs themselves are subject to a process of authorization. HF operators must submit to the CNMV a confidential report on the HFs they operate on a monthly basis. Vis-à-vis investors, HFs are subject to the obligation to prepare a prospectus, and periodic information.</p> |
| <p>Principle 29. Regulation should provide for minimum entry standards for market intermediaries.</p> | FI | <p>ISPs are subject to authorization requirements that include financial resources, fit and proper and organizational requirements. The authorization process is thorough.</p> |

| | | |
|--|----|--|
| <p>Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.</p> | FI | <p>ISPs are subject to minimum and ongoing capital requirements that are adjusted by risk. They have to submit monthly and quarterly reports of their capital adequacy, as well as annual audited financial statements.</p> |
| <p>Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.</p> | PI | <p>ISPs are required to put in place robust internal controls and risk management mechanisms and an annual report must be prepared and submitted to the CNMV. They are also subject to robust information disclosure obligations vis-à-vis clients, as well as to suitability obligations in connection with investment advice. The CNMV makes limited use of on-site inspections. Thematic reviews take place but only in a limited number of topics.</p> |
| <p>Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.</p> | FI | <p>The CNMV uses a calculation of estimated losses over a period of five months as an early warning mechanism. An investor compensation scheme is in place. Resolution of ISPs is governed by the general regime for corporations. The CNMV has developed guidance (a manual) to facilitate dealing with the failure of an ISP. In any case, the business model of investment firms is simple, and in practice banks dominate the market.</p> |
| <p>Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.</p> | FI | <p>RMs and MTFs are subject to authorization requirements, which include financial resources, fit and proper and organizational requirements. Information technology (IT) incidents must be reported immediately. Their regulations are subject to approval by the CNMV.</p> |
| <p>Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p> | FI | <p>The CNMV is the front line supervisor for purposes of detecting market abuse. To this end it has developed an automated system of alerts. The CNMV has developed a set of arrangements to oversee the BME and MFAO.</p> |
| <p>Principle 35. Regulation should promote transparency of trading.</p> | FI | <p>Pre and post trade transparency requirements apply to all markets, equity, debt and derivatives markets managed by the BME and MFAO and the Public Debt Book-entry Market managed by Bank of Spain as well. In comparison to other European markets, the Spanish market has not faced challenges related to market fragmentation.</p> |

| | | |
|---|-----|--|
| Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices. | FI | Insider trading (including front-running) and market manipulation constitute both an administrative infraction and a criminal offense. The CNMV is active in investigating these practices, and sanctions have been imposed mainly in connection with insider trading, and cases on market manipulation are in the pipeline. Recently the CNMV has become active in referring cases to the criminal authorities, but there has only been one conviction. |
| Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption. | FI | MEFF monitors clearing members' positions in the derivatives markets on a daily basis. MEFF has also set up position limits for members' clients. Members are required to notify any breach to such limits by their clients. If a clearing members' exposure becomes a concern, MEFF and MFAO have the power to request additional collateral. There are clear procedures in the event of default which are available to members. Naked short selling is prohibited. Notification of failed settlements to the CNMV is required. Iberclear is empowered to order replacement purchases in the market at the expense of the seller. |
| Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk. | N/A | Not assessed. |
| Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA) | | |

Table 4. Recommended Action Plan to Improve Implementation of the IOSCO Principles

| Principle | Recommended Action |
|-------------|--|
| Principle 1 | A legal reform should be sought to ensure consistent regulation between unit-linked insurance products and securities. In the short term, the CNMV should consider forming a working group with the DGSFP to coordinate approaches to the regulation and supervision of look alike products. |
| Principle 2 | Strengthen the independence of the CNMV by: (i) providing it with the authority to grant and revoke authorizations and to impose sanctions for the most serious violations; (ii) providing it with stronger financial autonomy given its self funded status; and (iii) considering removal of MEC representation on its board. |

| Principle | Recommended Action |
|--------------|--|
| Principle 3 | <ol style="list-style-type: none"> 1) A legal reform should be pursued to provide the CNMV with broader rulemaking powers. 2) The authorities should explore mechanisms to ensure that CNMV can acquire and retain needed expertise, including salaries that are comparable with financial sector. |
| Principle 4 | The CNMV should consider making public the comments received during the consultation process for circulars. |
| Principle 6 | Broader integration of the top down analysis with findings from the bottom up analysis is encouraged. |
| Principles 7 | The CNMV should consider more systematic review of the perimeter of regulation. |
| Principle 8 | The CNMV should continue to monitor actively conflicts of interest that arise from dominance of banks in securities markets. |
| Principle 11 | A legal reform could be pursued to provide the CNMV with the power to access telephone and internet service providers' data. |
| Principle 12 | <ol style="list-style-type: none"> 1) The CNMV should review and expand the coverage of the inspection program. 2) A legal reform should be sought to introduce a more streamlined procedure for "objective" breaches of the law, such as late filing. |
| Principle 16 | The CNMV should continue to actively monitor disclosure by banks in the issuance of financial products in particular when placed to retail investors. |
| Principle 17 | The CNMV should continue to monitor the growth of MAB to determine whether further enhancement to investors' rights is required. |
| Principle 19 | The ICAC should continue implementation of the new approach to PIEs oversight, including by hiring additional expert staff as envisioned. |
| Principle 24 | <ol style="list-style-type: none"> 1) The CNMV should keep under review the balance between off-site, thematic and on-site inspections to ensure sufficient presence in the market place. 2) The CNMV should consider enhancing the authorization process by conducting on-site inspections of newly authorized firms. |
| Principle 29 | The authorities should consider extending competence requirements to all directors, as is the case of integrity requirements. |
| Principle 31 | The CNMV should review the coverage of the inspection program for credit institutions and investment firms. The CNMV should also consider incorporating more systematically investment advisors into its on-site inspection program. |
| Principle 32 | 1) The CNMV should consider implementing an early warning system more directly connected to the solvency requirement. |
| Principle 36 | The CNMV should complete as planned the implementation of its cross market surveillance system. |

VIII. AUTHORITIES' RESPONSE

32. The Spanish Authorities broadly agree with the IOSCO Principles assessment and would like to praise the IMF FSAP team for the excellent work done. The authorities believe the FSAP is an extremely useful instrument for markets and regulators since it provides a transparent picture of how the financial sector does work while at the same time, encourages ways to ameliorate its functioning.

33. Nevertheless the Spanish Authorities do not fully share the IMF's views on the presence of the Ministry in the Board of the CNMV (Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers). The distribution of regulatory competences between the Ministry and the CNMV cannot be interpreted as breaches against the independence principle. Besides, the presence in the Board is of just one vote, provides the best possible channel of communication between the CNMV and the Ministry and enriches the Board's debates bringing points of view of all regulatory bodies just as the Bank of Spain is also member of the CNMV Board. Finally and crucially, day-to-day technical matters are not referred to the Board and therefore the Ministry, as a member of the Board, cannot cast a vote, and legislation is clear about the scope of regulatory measures that the CNMV and the Ministry have to take.

34. Regarding Principle 3, it is worth noting that the IMF considers the current framework—whereby the CNMV only has rulemaking powers in the cases that the law expressly authorize it—may constrain its ability to respond quickly. The Spanish authorities believe this is a natural consequence of our distribution of power and the checks and balances system that is applied in Spain. In addition to this, there are mechanisms that allow for swift reactions to any emerging problem in the market. Besides, the fact that authorization of financial entities and the imposition of sanctions is responsibility of the MEC, having taken into account the compulsory report of the CNMV is also a consequence of the Spanish administrative system, which is based on these checks and balances. The implication of two different authorities aims at preventing any kind of discretionary decision against the interest of the entity and at promoting financial stability.

35. With regard to Principle 1, the authorities agree about the need to avoid regulatory gaps between products with potential substitutability properties and commit themselves to make all the necessary efforts to improve the cooperation between the competent domestic supervisory authorities in this area. The authorities would like to stress that they support the current European Commission (EC)'s Packaged Retail Investment Products (PRIP) initiative, which is expected to produce harmonized legislation at European level on investment-like products sold to retail investors in the near future. Also, it is worth noting that the material relevance of the particular issue raised by the assessors is limited in practice, given the small size of the market for the relevant unit-linked insurance products in comparison with the segment of the securities markets that would be a close substitute for them (insurance technical reserves associated to unit-linked products and invested in CIS roughly amount to 3 percent of total CIS assets).

36. With regard to Principles 12, 24, and 31, the authorities observe that these principles have been assigned a lower grade in comparison with the equivalent principles in the 2006 FSAP. The authorities would like to clarify that the current assessment is based on a change of the required standards. It should therefore not be interpreted as an indication that the supervisory framework exhibits a lower level of observance compared to the 2006 FSAP. On the contrary, supervision has been strengthened over the last years. In particular, in the area of supervision of entities, the CNMV has carried out new relevant supervisory tasks from 2006 on, mainly in connection with the activities performed by credit institutions.

37. Regarding the supervision of ISPs and concerning the conduct of business rules applied by the credit institutions, the IMF recommends the use of more on-site inspections. Nevertheless, the authorities want to emphasize, firstly, that the approach for the supervision of the business rules requires a different balance between on-site inspections and off-site reviews than prudential supervision. Moreover, it is important to stress that on-site inspections carried out by the CNMV have reached 75 percent of the total number of clients in the last three years (considering as inspected, in equivalent terms, one big credit institution which has been subject to three thorough and specific off-site reviews).

Table 5. Detailed Assessment of Implementation of the IOSCO Principles

| Principles Relating to the Regulator | |
|---|---|
| Principle 1. | The responsibilities of the regulator should be clear and objectively stated. |
| Description | <p>Structure of the securities regulation regime</p> <p>Regulation of the financial services industry in Spain is, in broad terms, organized along sectoral lines, with different regulatory authorities for each of:</p> <ul style="list-style-type: none"> • the securities sector— the CNMV; • the banking sector— the BdE; and • the insurance and pension funds sectors—the DGSFP. <p>The MEC has formal responsibility for the authorization of market intermediaries (other than financial advisers) and collective investment scheme operators, and the imposition of administrative sanctions for the most serious breaches of securities laws. The MEC is also responsible for the authorization of official secondary markets and some decisions on other approvals or interventions relating to those markets (such as approval of significant shareholdings, or the replacement of the board of directors).</p> <p>Authorities in Spain's Autonomous Regions also have securities market regulatory responsibilities, but these are limited to securities that are listed only on markets located within their territory, and to those markets and their associated clearing and settlement systems.</p> <p>There is also a specialist regulatory authority, the ICAC, with responsibility for accounting and audit standards and the oversight of the audit profession. The CNMV is responsible for monitoring compliance by issuers with their financial reporting obligations, including obligations to prepare financial statements in accordance with accounting standards.</p> |

CNMV responsibilities, powers and authority

CNMV is responsible for the supervision of both securities and derivatives markets. In particular it has responsibility for primary securities markets (issuance); secondary markets (for both securities and derivatives); the disclosure obligations of issuers; the provision of investment services by market intermediaries; and collective investment schemes (mutual funds and investment companies).

These responsibilities and the powers of the CNMV to carry them out are conferred by legislation. The most important of these laws is the Securities Market Law, *Ley 24/1988, de 28 de julio, del LMV*. Collective investments are regulated by the Collective Investments Law—*Ley 35/2003, de 4 de noviembre, de instituciones de inversión colectiva* (CIS Law).

These and other laws governing securities market activity are supplemented by regulations, including Royal Decrees (*Real Decretos*) approved by the government and executive orders issued by the Minister (previously *Ordenes del Ministerio de Economía y Hacienda* and now *Órdenes del Ministerio de Economía y Competitividad*).

Article 15 of the LMV gives the CNMV power to issue binding rules (*Circulares*) where expressly permitted to do so by the relevant Royal Decree or MEC order. CNMV rules become effective when published in the Official State Journal (*Boletín Oficial del Estado*, BOE), subject to operation of the principle of *vacatio legis*.

CNMV is a public law entity with its own legal personality and full public and private capacity (Article 14 of the LMV). It is bound by the legislative regime applying to public authorities generally, in particular by Law 30/1992, Legal Regime of Public Authorities and the Common Administrative Procedure (*Regimen Jurídico de las Administraciones Públicas y del Procedimiento Administrativo Común*—Title X) (RJAPPAC) and Law 6/1997, Organization and Operation of the General Administration of the State).

Discretion to interpret its authority

CNMV can only exercise powers expressly conferred on it by the relevant legislation. It is bound by the principles of interpretation provided for in the Spanish Civil Code and in particular by Law 30/1992, which requires that interested parties must be given an opportunity to state their case to a decision maker, and that administrative decisions must be soundly based and communicated to the interested party.

The CNMV provides guidance to regulated entities in the form of information on its website, including detailed manuals for the authorization of intermediaries and operators of CIS, guidance on compliance and legal issues and questions and answers on matters likely to be of interest to regulated entities.

Gaps or overlaps

The responsibilities of the financial sector regulators are defined in legislation designed to minimize the possibility of gaps or overlaps.

Credit institutions are regulated by the BdE in relation to their banking activities and the CNMV in relation to their securities market activities. Their prudential regulation is the sole responsibility of the BdE.

The LMV makes local authorities in Autonomous Regions responsible for the regulation of securities traded only on a single market located within the relevant region. Authorities are responsible for supervision, inspection and disciplinary proceedings relating to the trading of these securities and the associated markets and clearing and settlement systems. Thus, they are responsible for market surveillance in connection with market abuse (Article 84.7 LMV) but only in connection with the transactions in securities listed in the markets located in their territory. In practice, this applies to

securities traded on local markets in Catalonia, the Basque Country and Valencia. However the number of securities that are only listed in one regional market is limited.

Different regulatory regimes apply to managed funds (the CIS Law) and unit linked insurance products (single premium products where the investors make a single lump sum investment) (insurance legislation), and different regulators (the CNMV and DGSFP) administer these regimes. However, these classes of products are in many respects functionally equivalent, though they are subject to different taxation treatment in some respects. The assessors were told that approximately 25 percent of single premium life insurance products were unit linked, or about 10 percent of all regular premium business.

For insurance products, the regulation of disclosure, advice and selling practices is arguably at a lower standard than that applying to managed funds. There are no specific training requirements for agents or brokers selling unit linked business. They are required to inform customers that customers bear investment risks. This raises the question of whether like investment products are subject to like regulation, administered in a like way.

Coordination and cooperation between regulatory authorities

CNMV is subject to general rules for collaboration, assistance and cooperation between authorities under Title I of the Régimen Jurídico de las Administraciones Públicas y del Procedimiento Administrativo Común (RJAPPAC).

The LMV and related legislation also contain specific provisions envisaging cooperation and communication between regulators and authorities where more than one regulator or authority has a role in regulation, such as in relation to clearing and settlement facilities (Article 44(3)); stock exchange supervision (Article 50); or the supervision of credit institutions providing financial services (Article 65.1).

Article 88 of the LMV requires CNMV and BdE to coordinate their supervisory activities where there is potential overlap between their areas of responsibility and to enter into agreements to ensure this occurs.

The CNMV has entered into a number of collaboration agreements with other regulators and authorities. These include:

- An agreement with the BdE dated June 2004 (updated in June 2009). This agreement provides for information communication and coordination in supervising firms, the registers of these firms, markets in financial instruments and the exercise of supervisory powers.
- An agreement with the DGSFP dated June 2004. This agreement provides for general collaboration between the CNMV and DGSFP in analogous terms to the agreement between CNMV and the BdE.
- A 2006 agreement with the MEC and BdE relating to financial stability and the prevention of crises with potentially systemic effects. This agreement creates a CESFI, comprising the State Secretary for the Economy (as chair), the Deputy Governor of the BdE, the Vice Chairman of the CNMV, the Director-General of DGSFP, and the Secretary-General of the Treasury and Financial Policy.

Collaboration between authorities also exists by virtue of the cross membership on the boards of the BdE and the CNMV (the Vice Chairman of the CNMV is a member of the BdE board, and the Deputy Governor of the BdE is a member of CNMV's board). A representative of the Autonomous Regions, which have regulatory responsibilities under the LMV, also sits on the CNMV's Advisory Committee (Article 22 of the LMV).

| | |
|------------|---|
| | <p>CNMV and its staff are subject to professional secrecy obligations (Article 90.3 of the LMV), but are expressly permitted to share confidential information with other regulators and administrative authorities and competent judicial authorities, including relevant Autonomous Regions, the BdE, the DGSFP and market authorities (Article 90.4.f).</p> <p>Conversations with the authorities indicate that at an operational level cooperation between the CNMV and the BDE takes place on a regular basis. In practice the CNMV shares with the BdE its plans for inspections of credit institutions, and the findings from these inspections. The BdE in turn shares findings from its inspections on credit institutions that conduct investment services when the findings have an impact on conduct obligations.</p> <p>There are also quarterly meetings with the DGSP. There is less cooperation at the operational level between the CNMV and the DGSFP, which the authorities attribute to the fact that insurance companies are not allowed to carry out investment services, while credit institutions are. However, as indicated above there appears to be need for additional cooperation in the area of regulation and supervision of distribution of investment- like products that are in the form of insurance products.</p> |
| Assessment | Broadly Implemented |
| Comments | <p>The CNMV is exclusively responsible for supervising all aspects of the securities markets, with the minor exception of the roles played by the autonomous regions in regulating markets that operate wholly within one region. The regional markets are so small as to be immaterial for the purposes of this assessment. The CNMV's role and responsibilities are clearly defined by legislation.</p> <p>The issue that leads to the assessment of broadly implemented is the fact that there are material differences in the regulatory regimes for managed funds (CIS) and unit linked insurance products. In economic terms, these types of products are functionally similar or equivalent. This is particularly true of managed funds where the principal invested is guaranteed. At December 2011 total assets in funds of this kind was a little over € 53 billion (including both guaranteed equity funds and guaranteed fixed-income funds). By comparison, technical reserves associated to unit linked insurance products and invested in CIS is estimated to be currently 4.4 billion (unit links invested in CIS and venture capital funds both domestic and foreign).</p> <p>The differences in the regulatory regimes have implications vis-à-vis investors. This is most important from the perspective of the initial disclosure investors receive and in respect to obligations connected to the advice and selling functions— that is the process that leads to the investor's decision to make the investment, and how they are supervised. It is highly desirable that a consistent regulation between CIS products and unit linked products be achieved, and that the practices of the regulators result in the same level of supervision being applied, regardless of the form the investment takes. This in turn will mean the need for a much closer level of cooperation between the CNMV and the DGSFP than currently appears to exist.</p> <p>In the opinion of the CNMV the existence of different regimes for these products is not a material concern, due to the limited amount invested in these insurance products. The CNMV staff highlighted that selling of unit linked products had its peak in the late 1990s due to a more favorable tax treatment for this product than for CIS whereby investors in unit link products had the right to change their portfolio without paying taxes, while moving from one CIS to another was subject to tax. A reform in the late 1990's changed the situation for CIS investors, who currently can move from one fund to another without paying taxes. As a result the importance of unit-linked products in Spain has decreased. In this regard, in the opinion of the CNMV it is more illustrative to compare technical reserves of unit-linked products invested in CIS against the whole CIS industry (rather than only guaranteed funds) to estimate the importance of unit-linked products as an investment vehicle. According to CNMV data as of September 2011 CIS assets amounted to € 165.5 billion compared to € 4.4 billion for technical reserves of unit linked products invested in CIS). Total insurance premiums collected in unit linked and invested</p> |

| | |
|---------------------|--|
| | <p>in CIS in 2011 were around € 1.5 billion, while total CIS inflows (gross subscriptions) amounted to 58.1 billion. Finally, CNMV staff indicated that if there were complaints brought by investors to the DGSP, these complaints would be raised by the DGSP in the meetings held between the CNMV and the DGSP.</p> <p>The assessors acknowledge that the overall value of retail investors' holdings in unit linked products appears to be small relative to the size of the mutual fund industry; and that the unit linked products appear now to be less attractive to retail investors than they were a decade ago. These developments make differences in regulation less significant than they might otherwise be.</p> <p>In addition, the assessors recognize that the CNMV supports the EU's initiative with regards to PRIPs. A proposal is expected for 2012, which will include harmonized rules concerning disclosure, advice and distribution for unit linked notes, as a product that requires a harmonized horizontal approach at the European level. Spain is committed, if required, with its transposition in due time.</p> |
| Principle 2. | The regulator should be operationally independent and accountable in the exercise of its functions and powers. |
| Description | <p>Independence</p> <p>CNMV is a public law entity with its own legal personality and full public and private capacity (Article 14 of the LMV). Article 14.6 expressly states that the Government and the MEC can only exercise their powers with respect to the CNMV with strict respect for the CNMV's autonomy.</p> <p><i>Governance</i></p> <p>The CNMV's governing body is its Commission (Article 17 of the LMV). The Commission consists of seven persons:</p> <ul style="list-style-type: none"> • a President and a Vice President appointed by the government on a proposal from the MEC. Both must have recognized competence in securities market issues; • the Secretary General of the Treasury and Financial Policy, ex officio; • the Deputy Governor of the BdE, ex officio; and • three persons appointed by the Minister who have recognized competence in securities market issues. <p>A committee of the Parliament scrutinizes candidates for the position of President, especially in relation to potential conflicts of interest.</p> <p>The President, Vice President and the three members appointed by MEC are appointed for a term of four years, renewable once (Article 19). CNMV board members can only be removed for serious breaches of their obligations, permanent disability, incompatibilities arising after appointment, or conviction for a fraudulent offence (Article 20). In case of conflict of interest the members of the board have a duty of non intervention (Article 28 of the Law 30/1992). The members of the board could be removed in the case they breach seriously the rules regarding conflict of interest (Article 20.c) of LMV).</p> <p>The CNMV Commission meets monthly. Members of the board other than the ex officio members are full time devoted to CNMV work.</p> <p>Article 14.10 of the LMV requires the CNMV Commission to adopt regulations relating to the internal management of the CNMV. The CNMV Internal Regime Regulation adopted in 2003 sets out detailed requirements for the structure, procedures and management of the CNMV. This is supplemented by a Code of Conduct (CoC), also adopted in 2003, governing the conduct of CNMV members and staff.</p> <p>The CNMV has three Directorate Generals (Entities, Markets and Legal Affairs), a Department of Research, Statistics and Publications and a Department of Internal</p> |

| | |
|--|---|
| | <p>Control (see other departments in Principle 3 “staff resources”). The President’s Office has staff in Barcelona as well as Madrid.</p> <p>For day-to-day decision making, the CNMV has an executive committee comprised of all full time members of the board. This committee meets weekly and its meetings are attended by the three Directors General who participate in a non-voting capacity.</p> <p>The functions of the CNMV board, the President and the Vice President and the executive committee are set out in detail in the Internal Regime Regulation. This Regulation sets out which decisions are made by which governance organ and empowers the Commission to delegate some of its functions to the Executive Committee. Overall day- to- day operations have been delegated to the Executive Committee while the Board retains decisions on: (i) circulars, (ii) review of significant shareholdings for market infrastructure, (iii) approval of the annual report and annual plan of activities; (iv) appointment of Directors General, and (v) imposition of sanctions.</p> <p>Article 22 of LMV establishes a consultative committee (<i>Comité Consultivo</i>) to advise the CNMV board. Royal Decree 303/2012 sets out the composition and procedural rules for this committee. The Committee is comprised of (i) 17 representatives from sectors affected by the CNMV’s activities, including 3 representing markets and infrastructure providers, 2 representing issuers, 4 representing investors, 3 representing credit institutions, 3 representing professional groups, and 1 representative of each of insurance companies and the investment guarantee fund, and (ii) one member representing each Autonomous Region with authority in securities markets. This Committee is required to meet at least quarterly and in practice meets once a month.</p> <p>The Committee provides formal advice to the CNMV on proposed Circulars, and informal advice on other matters relating to the operation of the CNMV such as its annual plan. Until recently the Committee provided formal advice on proposed sanctions but this is no longer the case.</p> <p>Conversations with CNMV staff and market participants lead to conclude that the consultation is not a mere formality, and that the Committee’s opinions have considerable weight in the final decision on circulars.</p> <p><i>Interaction with government</i></p> <p>The decisions CNMV makes on a day-to-day basis are not subject to a requirement to consult with other authorities, or for another authority to approve them. In some circumstances, the LMV requires the CNMV to consult with other authorities before issuing a Circular, for example with the ICAC (Article 86), and with the BdE and DGSFP (Article 87.4). Although not required to do so by legislation, the CNMV provides the Ministry of Economy and Competitiveness with advance notice of proposed Circulars and the opportunity to comment on them. CNMV and MEC staff indicated this informal consultation is fluid, and that in practice there are usually no substantive issues raised by the MEC.</p> <p>Some decisions are made by the Minister of Economy and Competitiveness rather than by the CNMV. These include:</p> <ul style="list-style-type: none"> • the authorization of official secondary markets (stock markets, Article 45 LMV), futures and options markets, Article 59); • the authorization of ISPs (Article 66 LMV); • the authorization of a collective investment scheme management company (Articles 41 and 44 of the CIS Law); • the removal of authorization of ISPs and CIS management companies (Articles 49 y 50 CIS Law); and • the imposition of administrative penalties for the most serious offences (Article 97 LMV and Article 92 CIS Law). |
|--|---|

When the Minister makes an authorization decision, he or she does so following a proposal by CNMV. CNMV and MEC staff indicated that in practice the MEC has not deviated from the proposals of the CNMV. Similarly, CNMV has responsibility for investigating very serious breaches, and the files also contain a recommendation. CNMV and MEC staff indicated that in practice the MEC has followed such recommendation.

With regard to credit institutions, the CNMV must provide prior notice to the BdE (Article 85.2 the LMV) before adopting certain measures (requiring cessation of an illegal practice, the temporary ban on activity, suspension or limitation of activities in securities markets or a request for information from auditors). A report from the BdE is required before imposing serious or very serious penalties on a credit institution (Article 97.1.c) LMV), as is the exercise of the CNMV's power (Article 85.2) to seek the freezing of a credit institution's assets. In practice, the CNMV has not exercised its powers under Article 85.2 in relation to a credit institution.

A reform enacted in 2007 requires the BdE to consult the CNMV in connection with the authorization of a credit institution, in cases where they plan to conduct investment services. This provision has been tested satisfactorily in a relatively large number of recent cases of establishment of new credit institutions over the course of the ongoing process of restructuring of the Spanish financial sector.

CNMV funding

The CNMV is self-financed by fees imposed on regulated entities. Although the legislation (Article 24 of the LMV) permits the CNMV budget to be supplemented by a transfer from the government budget, in practice this has not occurred and fees collected regularly result in a substantial surplus. Fees are set by the Government but the CNMV provides advice to it on what level of fees is required to meet the CNMV's proposed operating commitments. In spite of being self-funded the budget law establishes every year the maximum number of employees that the CNMV can have. For more detail on the CNMV's funding, see under Principle 3.

Legal protection

Under the Spanish legal framework, the Administration is liable for damages caused by actions of its employees (Article 139 of Law 30/1992). Accordingly any suit for damages must be brought against the Administration, and employees cannot be sued directly as they are only acting on behalf of the Administration (Article 145 of Law 30/1992). However, the Administration could, afterwards, file an internal action against those employees who have acted with willful intent or negligence to obtain a reimbursement from them.

Concerning criminal liability, CNMV's employees can be directly prosecuted as a result of actions that constitute crimes or misdemeanors. In this case, within a criminal suit, the plaintiff can claim liability for damages to the employee and subsidiary to the Administration.

Article 55 of the CNMV's Internal Regime Regulation guarantees free legal defense for CNMV members and staff in connection with such type of actions , even after they cease to work with the CNMV. These protections do not apply when the CNMV itself is the claimant. The CNMV has signed an agreement with the State Attorneys (Abogacía del Estado) to guarantee the legal defense of any CNMV's employee. It is important to mention however that to date no employee has been subject of a criminal case.

Accountability

Article 13 LMV requires the CNMV to submit an annual report to the Economy, Trade and Finance Committee of the Congress of Deputies on the performance of its activities and on the markets. The annual report must contain information about the CNMV's supervisory activities, and include a report from the Internal Control Body which t

| | |
|------------|---|
| | <p>assesses the suitability of the decisions issued by the CNMV's Board and their compliance with the procedures applicable in each case.</p> <p>The CNMV's President is required to appear before the Committee once a year to explain the report, and the President must also appear as often as required. CNMV staff indicated that such requests are not common.</p> <p>The CNMV's accounts are audited by the Comptroller and Auditor-General.</p> <p>Almost all CNMV resolutions must appear in the public registries that the CNMV is required to maintain by Article 92 LMV. The exceptions are with respect to internal procedural matters. These registries include a registry setting out the disciplinary penalties imposed in the last five years for serious and very serious breaches (Article 92.h).</p> <p>Procedural safeguards</p> <p>Article 54 of RJAPPAC requires administrative acts and decisions to be properly based on an analysis of facts and law. Article 35ff of RJAPPAC also sets out procedural safeguards for a person affected by CNMV's regulatory actions. In particular it states the right to access and copy all documents relating to the proceeding and to present documents at any stage of the proceeding prior to the hearing or decision making.</p> <p>Decisions by the CNMV that affect third parties, including for example refusal of an authorization or imposition of an administrative sanction, are subject to administrative appeal. Most appeals follow the procedure set out in the general administrative legislation (RJAPPAC and Law 6/1997). In practice, this means that decisions made by the Board of the CNMV have first a <i>recurso de reposicion</i> (review) by the same Board. This decision then becomes "final" and is subject to judicial review, in administrative courts. The same applies to decisions made by the MEC in regard to refusals for authorization.</p> <p>A special appeal mechanism is established against sanctions imposed by the CNMV (Articles 98 and 107 of the LMV - minor and serious sanctions). These can be appealed to the Minister of Economy and Competitiveness who can overturn a CNMV decision or reduce the amount of the sanction. The Minister's decision can in turn be appealed to the administrative courts.</p> <p>Confidentiality</p> <p>Special provision is made in Article 90.1 LMV for the provision of otherwise confidential information to Parliament. The CNMV Chairman may request that the relevant parliamentary body meet in a secret (closed) session or apply the procedures used for access to classified information. Members of the relevant parliamentary committee are required to take steps to guarantee that the information remains confidential.</p> <p>An internal rule reinforces the confidentiality required of staff and the Board. (See Principle 5).</p> |
| Assessment | Partly implemented |
| Comments | <p>The CNMV is a public entity in its own right and there are obligations on the Government to respect its autonomy. However, it does not make all the decisions that a fully independent securities regulator might be expected to make, which under the legislation are reserved for the Minister of Economy and Competitiveness.</p> <p>This is the case for:</p> <ul style="list-style-type: none"> • the authorization of ISPs (excluding MTFs) CIS operators and depositories, and the revocation of authorization for these firms; • decisions to impose sanctions for the most serious breaches of the legislation; and • and the authorization of operators of official secondary markets and for some other |

| | |
|---------------------|---|
| | <p>decisions relating to these markets.</p> <p>In addition, the participation of the Ministry in the board of the CNMV in itself raises questions. In terms of the formal structure of the regime in Spain, the assessors find it difficult to conclude that regulatory decision making is fully independent of the political process.</p> <p>In practice, however, a number of considerations need to be taken into account:</p> <p>In terms of decisions taken by the Minister:</p> <ul style="list-style-type: none"> • the legislation is precise in setting out the conditions under which an authorization can be granted or removed, and quite tightly constrains the exercise of discretion in the imposition of penalties; • the legislation requires that a proposal (recommendation) from the CNMV go to the Minister of Economy and Competitiveness in relation to all the decisions he makes under the LMV. This adds transparency to the process and limits the potential for political or other considerations to displace regulatory ones; • in practice, there seem to be no examples where the Minister has made a decision other than that recommended by the CNMV; and • decisions of the MEC can be appealed to the Courts. <p>In terms of the participation of the Ministry in the board:</p> <ul style="list-style-type: none"> • by internal regulations most of the day to day decisions are actually taken by the Executive Committee, and • all decisions taken at board level are on the basis of a recommendation from the Executive Committee. <p>These factors indicate that de facto, if not de jure, the CNMV functions as an independent regulator.</p> <p>A further consideration is the level of control that can be exercised over financial decisions of the CNMV. In this regard the requirement of approval by the Government of the number of staff limits the financial autonomy of the CNMV. Furthermore in the current environment—where there is a freeze in public sector recruitment—such requirement creates uncertainty as to the ability of the CNMV to continue to implement its plan to hire sufficient personnel to carry out its functions in an effective and efficient manner. A distinction should be made between the freedom to use available resources, and accountability, which can be achieved by means other than direct control.</p> |
| Principle 3. | The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. |
| Description | <p>Power and authorities</p> <p>The LMV and the CIS Law and related secondary legislation give the CNMV extensive powers to gather information, conduct supervisory activities and inspections, conduct investigations and impose sanctions for minor and serious breaches of the legislation it administers. More detail is contained under Principles 10 and 11.</p> <p>As noted under Principle 2, the Minister of Economy and Competitiveness exercises regulatory powers with respect to authorization of regulated entities, and imposing sanctions for the most serious breaches. Many misconducts are both in the list of very serious versus serious breaches, the differences being whether the misconduct constitutes an isolated event or not, or the materiality/economic impact of the misconduct.</p> <p>CNMV also has authority to make binding rules by issuing circulars, although this power to issue binding norms is limited to situations where the legislation or implementing regulations expressly empower it to do so.</p> |

Funding and resources

CNMV fees are calculated so that they cover the cost of the services which the CNMV provides, in accordance with the principles established in Law 8/1989 on Fees and Prices.

Article 24 of the LMV sets out how CNMV's profits are to be used, including by creating reserves to ensure the availability of working capital sufficient for operational needs, and the necessary reserves for funding the investments the CNMV needs to make to guarantee adequate compliance with its objectives and functions provided by law.

Although Law 8/1989 on Fees and Prices contemplates that fees are set to match the funding needs for specific activities, CNMV can use surplus revenue received in one area of activity to fund activities in another area. Usage of this kind must be justified when presenting accounts to the Government.

For the 2011 year, the CNMV's revenue and expenses were:

| Category | Euros million |
|--|---------------|
| Total fees | 53.0 |
| Registration of prospectuses and market participants | 9.7 |
| Market supervision | 34.8 |
| Market participant supervision | 8.5 |
| Other revenue | 3.4 |
| | |
| TOTAL REVENUE | 56.4 |
| | |
| TOTAL EXPENSES | 46.2 |

Staff resources

As of 31 December 2011, CNMV had a total of 395 staff members:

| Organizational Unit | Staff numbers |
|---------------------------------------|---------------|
| Directorate General – Entities | 114 |
| Directorate General – Markets | 97 |
| Directorate General – Legal Affairs | 47 |
| President's Department | 22 |
| Internal Control | 3 |
| Research, Statistics and Publications | 24 |
| International Relations | 9 |
| General Secretariat | 36 |
| Information Systems | 32 |
| President's Office | 11 |

CNMV senior management and professional staff have a high level of qualifications, with the majority (approximately two thirds) having at least a five year degree and others a three year degree, and over 60 percent of staff having more than one qualification. The dominant disciplines are business management (around 70 percent of staff have such a qualification); trained lawyers (20 percent); economics (approximately 10 percent) or other technical qualifications.

Over half of senior managers and almost 70 percent of professional staff have had direct experience in the markets the CNMV regulates before joining the Commission.

Salary levels for CNMV staff are pegged to those for public employees generally. The assessors were told that there are significant differentials between the salaries the CNMV pays its staff and those available for similarly qualified people in the market and that this differential is growing. CNMV salaries are also lower than those available for

some other regulators, notably the BDE, especially for middle management and technical roles. In spite of these limitations, the assessors did not identify any areas where limitations on the ability of the CNMV to meet market salaries meant that it did not have the expertise and professionalism required to carry out its regulatory and enforcement functions. The major exception was the ability to attract and retain, the expertise required to contribute to financial stability analysis. Turnover is low.

In recent years, the CNMV carried out an analysis of the number of staff that it needs to carry out its functions in an effective and efficient manner. The plan indicated the need to hire 80 additional staff, of which the CNMV has already hired 40. These staff would largely contribute to increasing the amount of direct on-site oversight the CNMV could perform and would enhance the intensity of its supervision activities generally. Governmental approval would be required to hire the additional personnel, as indicated in Principle 2.

Governance arrangements

The CNMV has developed multiple arrangements to ensure that its functions are being discharged properly.

At an operational level, the CNMV has adopted internal procedures covering many of its functions, both in the regulation of securities markets and in internal administration and management. These include processes for dealing with applications, the processing and review of documents, and the carrying out of monitoring and inspection activities. The CNMV's Executive Committee approves internal operational procedures on a proposal from its President, following a report from the Directorate General of Legal Affairs.

In addition CNMV applies, the "four eyes" principle to many of the functions assigned to the different departments. To communicate information among various departments and to plan oversight, there are also regular meetings between the directors of the different departments. In addition, the CNMV has created a management committee (further discussed in Principle 7), which meets biweekly and follows up on issues of particular concern for the Directors.

At a strategic level, the Directors have a meeting on an annual basis that serves as the basis for identifying priorities for the upcoming year. Such priorities are crystallized in the Annual Plan of Activities which is first discussed at the Executive Committee Level and is approved by the Board. The Plan contains priorities both in regard to regulation and supervision.

Finally, the CNMV has established an Internal Control Department, with two main responsibilities: (i) Overseeing that functions, especially those of supervision, inspection and sanctions, are being performed adequately, in particular that internal procedures are being followed, and (ii) reporting specifically on compliance with decisions adopted by the CNMV's governance bodies in accordance with the relevant procedural rules ("certification" that decisions are according to law).

To perform its first responsibility the Internal Control Department develops an annual plan which must be approved by the Board. In practice, its oversight role is performed through the review of a sample of files for each function. Staff indicated that such reviews have led to recommendations that departments have been obliged to implement. A report on the audit work the Internal Control Department has performed is included in the CNMV's Annual Report. The Internal Control Department currently has three staff.

Training

The CNMV facilitates the attendance of its staff on courses and seminars which allow them to update and improve their knowledge. The CNMV has also organised internal courses on new products and innovations in supervision. Part of the CNMV's budget is assigned to staff training.

| | |
|---------------------|--|
| | <p>Investor education</p> <p>The CNMV plays an active role in investor education and education of the general public about financial issues. These activities are carried out by a special investor education unit in the Department of Research, Statistics and Publications.</p> <p>The CNMV pursues:</p> <ul style="list-style-type: none"> • an education program directed at investors in securities and other financial instruments and. • a broader program designed to promote better financial education in the Spanish population as a whole. <p>With respect to the former program, the CNMV produces investor fact sheets and guides, and uses an investor portal on its website for this purpose. It also participates in domestic and international forums designed to increase investor awareness and education. The latter, Financial Education Plan is carried under an agreement in 2008 between CNMV and the BdE. Among CNMV's activities, are: a financial education portal with a range of educational content; in 2010–2011 commencement of a pilot program to introduce financial education in the secondary schools curriculum; and preparation of a collection of fact sheets with basic tips for household finances.</p> |
| Assessment | Broadly Implemented |
| Comments | <p>The assessors have assessed this Principle as broadly implemented, based on three considerations.</p> <p>First, the public sector employment framework under which CNMV operates may limit its ability to attract staff with expertise in the markets it regulates. This applies both to the limitations on the salaries it can offer, and on the rigidity of public sector recruitment processes.</p> <p>Second, given the comments made on Principles 12, 24, and 31 about the need for additional on-site supervision, the authorities need to consider whether this could be done by reallocations of existing resources or whether further resources are required. In this context, the need for governmental approval creates uncertainty as to the ability of the CNMV to complete its recruitment program.</p> <p>Finally, the CNMV does not have the power to authorize ISPs and RMs. The assessors note that in other European jurisdictions the Ministry of Finance has usually retained the authorization of RMs. However as indicated above in the case of Spain the MEC retains additional decisions.</p> <p>The IOSCO principles do not require that a supervisory authority has independent rulemaking power. Thus, the lack of this power by the CNMV has not been considered for the grade. However, the current framework—whereby the CNMV only has rulemaking powers in the cases that the law expressly authorize it—may constrain its ability to respond quickly to an emerging problem in the market, and delay a regulatory response until the relevant legislation or regulation is amended. That could potentially be as lengthy process. There are examples where the CNMV seems to deal with this problem by initiatives using its existing powers, such as not approving prospectuses for complex preferred shares offered by banks if they are not accompanied by an independent valuation. But these examples illustrate the need to put this intervention on a more robust footing.</p> |
| Principle 4. | The regulator should adopt clear and consistent regulatory processes. |
| Description | <p>Clear and equitable procedures</p> <p><i>Procedures rules and regulations</i></p> <p>CNMV must act in accordance with the legislation it administers, including in particular</p> |

the LMV and the CIS Law. It is also bound by a variety of laws that apply generally to public administration and decision making by public authorities, such as, RJAPPAC and Law 6/1997, on the Organization and Functioning of the General Government Administration, Law 47/2003, on the General Budget and Law 30/2007 on Public Sector Procurement.

Consultation and transparency

The process for the preparation of Circulars is governed by Article 35 of the CNMV's Internal Regime Regulation. The CNMV consults publicly on proposed Circulars by placing consultation documents on its website. It also sends draft rules to industry associations to seek comment.

The CNMV submits proposed rules to the Consultative Committee for comment, and seeks advice from the Committee on other regulatory issues. Conversations with the authorities and market participants lead the assessors to conclude that the consultation to this Committee is not a mere formality; rather its opinion carries significant weight.

The CNMV is not obliged under Spanish domestic law to carry out specific analyses on the cost of compliance with proposed Circulars, and in practice does not do a separate cost-benefit analysis in preparing Circulars. It does, however, take account of comments it receives in the consultation process to prepare its legal analysis and technical analysis of proposed Circulars, and the technical analysis often contains an industry impact analysis. The authorities highlighted also that a cost-benefit analysis is carried out at the European level, when a Directive or regulation of the EC is being considered.

Comments submitted by the public or the consultative committee are not displayed by the CNMV on its website. Nor does the Commission provide general feedback on the reasons for accepting or rejecting proposals made by the public, the committee or other interest groups.

The process for making regulations relating to securities markets by MEC and the Government is governed by Articles 22ff of Law 50/1997 on Government. These provisions envisage a public hearing process which gives interested parties advance notice of a proposed regulation and the opportunity to make comments.

Draft legislation and regulations are, when appropriate, published in the official bulletin and available to the public (Article 86 of Law 30/1992). All rules which make up the legal system must be published in the Official State Journal, BOE. In addition, all regulations that affect securities markets are made available on the CNMV's website.

The CNMV also uses its website to publish interpretative criteria when it considers that they are significant or useful to market participants. The CNMV's annual plan of activities is also available through the CNMV website.

Information about ongoing investigations is not made public.

Procedural fairness

Article 54 of that RJAPPAC—described under Principle 2—sets stringent procedural fairness standards for CNMV's regulatory decision making with respect to decisions affecting individual person or entities.

Article 42 also requires public authorities to make decisions on any application, and to record administrative decisions, in writing.

The CNMV provides reasons for all decisions it makes.

| | |
|---------------------|---|
| | <p>Confidentiality</p> <p>CNMV staff are subject to the general limitations established in Article 81 of the LMV regarding the appropriate use of inside information. In addition, Article 90 of the LMV requires the CNMV to maintain professional secrecy in relation to information and data it receives in carrying out its duties. Such provisions are described more in detail in Principle 5.</p> <p>Review of material actions by the regulator</p> <p>All actions by the CNMV are subject to review through the relevant administrative and legal appeals process.</p> <p>Pursuant to Article 16 of the LMV final decisions made by the CNMV are subject to “appeal” before the board (<i>recurso de reposicion</i>). Decisions on minor and serious disciplinary resolutions, and decisions on measures for intervening in a supervised entity or substitution of its directors have to be appealed before the MEC. All such decisions are then subject to judicial review.</p> <p>Staff has indicated that in practice, only in exceptional occasions are disciplinary sanctions appealed and that the courts have not overturned decisions made by the CNMV or the MEC.</p> |
| Assessment | Fully Implemented |
| Comments | The consultation process should be further strengthened by disclosing comments received along with a summary of their impact on the decision marking of the CNMV. |
| Principle 5. | The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality. |
| Description | <p>The conduct of staff of the CNMV is governed by a combination of legislation governing the conduct of public officials generally and specific legislation and regulations. Article 14 of the LMV makes CNMV staff subject to Law 53/1984, on Incompatibilities of the Staff at the Service of Public Authorities. CNMV staff are also bound by the provisions of the CNMV’s Internal Regulation Regime (<i>Reglamento de Régimen Interior</i>) and the CNMV’s CoC (<i>Código General de Conducta</i>).</p> <p>Article 49 of the Internal Regulation Regime provides that any other private or public activities are incompatible with their employment and those who occupy staff positions must be fully available to perform their public duties. Article 50 provides in addition that CNMV staff who, because of a public position held, have intervened decisively in issues relating with companies, institutions, firms or individuals in the securities market may not, for a period of two years following the intervention, perform private activities for the affected persons or entities - or companies in the same group - even if they no longer hold the position.</p> <p>Conflicts of interest</p> <p>The CNMV’s General CoC (Rule 10) deals with conflicts of interest. It provides that:</p> <ul style="list-style-type: none"> • Staff of the CNMV may not grant any favourable treatment to any interested person, or request or accept any gift, favour, loan, service or any other economic benefit on especially advantageous conditions from any interested person. • Staff of the CNMV must abstain from intervening in a matter and inform their immediate superior, who will take the appropriate decision if: <ul style="list-style-type: none"> - they have a personal interest in the issue in question or in another whose resolution may have an influence on the former; - they have a blood relationship up to the fourth level or relationship up to the second level with any of the interested parties, with the directors of interested firms or companies or with the advisers, legal representatives or agents which intervene in the procedure; |

- they are an intimate friend or clear enemy of any of the persons mentioned above;
- they have intervened as an expert witness in the procedure in question; and
- they have a service relationship with a natural or legal person directly interested in the issue or have provided professional services of any type to such a person over the last two years.

In order to safeguard the proper independence with which it is necessary to act with third parties, the staff of the CNMV must inform their immediate hierarchical superior of circumstances which may affect their independence. The superior may order the conflicted person to abstain from any intervention in the actions which are being carried out.

Securities trading by CNMV members and staff

Members of the Commission and Director Generals must manage any securities they hold through a blind trust. They have three months from the time of appointment to put these arrangements in place.

Article 52 of the Internal Regime Regulation deals with staff trading in securities. It applies when a staff member:

- subscribes, acquires, disposes or redeems shares or debentures admitted to trading on any organised securities market;
- acquires or redeems units in investment funds;
- acquires or disposes of products deriving from the aforementioned shares or debentures; and
- transacts in the shares of companies that have announced their decision to request admission to trading.

A staff member must give advance notice to the CNMV's General Secretariat before taking any of these actions, detailing the identity of the securities and the approximate amount of the transaction.

Staff must also confirm details of the transaction to the General Secretariat within seven days of it taking place.

New staff members must make a formal statement of their holdings of any of the securities or financial instruments described above.

Article 53 provides that CNMV staff must not dispose of any of the designated securities for at least 11 months after their subscription or acquisition. This is subject to a procedure where a staff member may request specific authorization from the General Secretariat of the CNMV for such a disposal within the eleven month period.

CNMV staff indicated that in practice very few staff have holdings in anything other than CIS (roughly only 10 staff have direct holdings in securities and conduct 4–5 trades a year).

Use of information

CNMV staff are subject to the general limitations established in Article 81 of the LMV regarding the appropriate use of inside information. The CNMV's General CoC also establishes limitations on the use of inside information (Rules 11 and 12).

Improper use of confidential information by CNMV staff may be an offence under Article 442 of the Criminal Code, which provides that a public authority or official who makes use of a secret in their possession as a result of their office or position, or of inside information, with the aim of obtaining an economic benefit for themselves or a third party, incur penalty fines of triple the amount of the benefit sought, obtained or facilitated

| | |
|---------------------|---|
| | <p>and a specific ban from public employment or office for a period of two to four years (with the upper range of penalties applying where a benefit is obtained).</p> <p>Confidentiality and secrecy</p> <p>Article 90 of the LMV requires the CNMV to maintain professional secrecy in relation to information and data it receives in carrying out its duties.</p> <p>Failure to comply with this requirement creates criminal and other liabilities provided by law.</p> <p>A person in possession of confidential information must not provide a declaration or testimony, or publish, communicate or exhibit data or confidential documents. These restrictions apply after a person has left the CNMV unless the competent body of the CNMV has granted permission. If permission is not granted, the affected person must maintain its confidentiality and is protected from any liability resulting from non-disclosure.</p> <p>Article 51 of the CNMV's Internal Regime Regulation provides that CNMV staff must maintain secrecy, even after they no longer discharge their functions, of any confidential information which they have become aware of in performing their activity. They may not make a declaration, or testimony, or publish, communicate or exhibit confidential data or documents, not even after having left the service, without express permission granted by the Board of the CNMV.</p> <p><i>Procedural fairness</i></p> <p>CVMV are bound by the rules relating to procedural fairness described under Principle 2, in particular by Articles 38 to 40 of the Internal Regime Regulation.</p> <p>Sanctions</p> <p>CNMV's technical and management staff are subject to criminal liability for offences committed in their capacity as public officials in performing the functions of the CNMV (such as improper use of inside information, breach of public duties, bribery, abuse of authority, disloyalty in the custody of documents, disclosure of secrets etc. (Constitutional Law 10/1995, of 23 November, on the Criminal Code).</p> <p>They are also subject to the disciplinary liability under labour rules for failure to comply with the conditions of their work contract, which includes failure to comply with the CNMV's Internal Regime Regulation and the General CoC. This liability may lead to their dismissal for one of the causes provided in the Workers' Statute, (Royal Legislative Decree 1/1995, of 24 March, approving the consolidated text of the Workers' Statute Act).</p> <p>Processes for dealing with violations</p> <p>Article 32.4 of the Internal Regime Regulation makes the CNMV's General Secretariat responsible for its governance, administration and internal regime. The General Secretariat is required to prepare a report for the Executive Committee. In addition, as part of its functions the Internal Control Department reviews such reports and can request additional information.</p> <p>CNVM staff indicated that it is not usual to have disciplinary sanctions on staff, but one case has taken place in recent years.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 6. | The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate. |

| | |
|-------------|--|
| Description | <p>The CNMV is not a “systemic regulator.” However, its mandate requires it to supervise securities markets and the activities of any person in such markets (Article 13 of the LMV).</p> <p>Bottom up analysis</p> <p>The supervisory programs (off site and on site) for regulated entities are the most important mechanisms to identify risks at the individual entity level, for both conduct and prudential issues.</p> <p>Top down analysis</p> <p>The CNMV also conducts analysis across the sector, in order to detect more “systemic” issues. Such analysis translates into two main reports:</p> <p>The “Securities markets and their agents: Situation and Outlook” report. This biannual report takes into account the relevant international context and focuses on the relevant risk factors affecting prices and volumes in the main trading venues and the performance of securities markets intermediaries and investment vehicles (mutual funds, SICAVs, HFs and venture capital).</p> <p>The Annual Report of the CNMV (Chapters 1 and 2): This report contains analyses of the main macro-financial developments of the preceding year and identifies the most important risks in the international and domestic context. For example, in the Annual Report for 2010, the CNMV provided some estimations of the contagion effect between some European countries in the context of the sovereign debt crisis.</p> <p>In late 2006 the CNMV established the GIEF. The GIEF is chaired by the Vice-president of the CNMV and also includes the managing directors of the two key supervisory general directorates (D.G. Securities Market Participants and D.G. Markets) and the heads of the Research Department, the International Relations Department and the President’s Office. Other qualified experts from those departments contribute regularly to the GIEF. The Research Department provides the analytical support to the GIEF.</p> <p>Currently the main role of this GIEF is to provide support to senior management in connection with the CNMV’s participation in the CESFI. It usually meets ahead of the meetings of the CESFI, although staff highlighted that even if no CESFI meeting is scheduled, the GIEF might meet if the VicePresident considers it necessary (for example, during the ban on shortselling for financial institutions)</p> <p>The main output of the GIEF is a top down analysis of the international and national macroeconomic environment and its impact on the securities market. To assess this impact the Research Department uses supervisory information available to the CNMV (for example on solvency and liquidity of securities firms or CIS). In addition to its use for the CESFI meetings, this analysis can also be used by senior management to determine whether there are important risks that need to be monitored.</p> <p>Ad-hoc issues are also analyzed by the GIEF. Usually the topics are brought to the attention of the GIEF by senior management. Examples of ad-hoc analysis include an analysis of the effects of the ban on shortselling in Europe, and Spain in particular, and the potential effects of a Greek default. Staff also highlighted that a few topics have been proposed by members of the Commission or CNMV staff, and one example was provided in this regard.</p> |
|-------------|--|

Contribution to the overall assessment of financial stability

The CNMV is a member of CESFI. CESFI was created by a non-binding inter-institutional agreement on financial stability and prevention and management of crises, signed by the Ministry of EC (Treasury and Financial Policy General Secretariat and the Directorate General Insurance and Pension Funds), the BdE and the CNMV. Members of CESFI are the State Secretary for Economic Affairs (acting as chairperson), the BE's Deputy Governor, the CNMV's Vice-president, the Director General on Insurance and Pension Funds and the Secretary-General of the Treasury and Financial Policy (in charge of the Secretariat).

CESFI met for the first time in June 2006. It meets at least twice a year and, within the framework of a financial crisis with potential systemic effects, at any time the Chairperson convenes it. The main objective of CESFI is to prevent and manage financial crises by: (i) fostering the exchange of information and views between the member institutions; (ii) strengthening instruments that preserve financial stability, prevent crises and manage them efficiently, through contingency plans, stress tests and simulations; and (iii) improving cooperation with other EU authorities in the field of financial stability and crisis management.

During the current crisis the CESFI has met frequently (every one or two months). The draft agenda for the meetings is prepared by the Secretariat, and shared with the other members. Conversations with the authorities indicate that in practice other members can make contributions to the agenda. Discussions at CESFI do not result in decisions about actions to be conducted by each agency, but have helped the member organizations to have a more comprehensive view of problems, issues and risks.

In addition, technical working groups have been launched under the umbrella of the CESFI for dealing with specific issues, such as crisis management exercises (currently only table exercises have been conducted but the goal of CESFI is to also conduct simulation exercises), and contact exercises.

European/International level

At international level, the CNMV participates actively in various forums and bodies with an explicit mandate to monitor and mitigate systemic risks.

Committee of Economic and Market Analysis (CEMA) at ESMA

The CNMV is a participant in CEMA, which has a role in identifying risks and vulnerabilities in the markets for financial services and instruments with potential systemic impact. The CNMV is represented in CEMA by the Director of the Research and Statistics Department.

European Systemic Risk Board (ESRB)

The CNMV's Vice-president is a non-voting member of the General Board of the ESRB, and the Director of the Research and Statistics Department of the CNMV is a member of the Advisory Technical Committee (ATC). Also, economists from CNMV's Research and Statistics Department participate regularly in some of ATC's working streams.

IOSCO

The CNMV is involved in the IOSCO Standing Committee on Risk and Research (established in 2011) in which it has an active role. As such, it contributes to the work

| | |
|---------------------|--|
| | <p>stream on research methodology for systemic risk by securities regulators and impact assessment. The coordinator of this group of research is the director of the CNMV Research and Statistics Department. This group is currently analyzing the main dimensions of systemic risk over a wide variety of securities markets and products (securitization and covered bond, repo, MMFs, or credit derivatives, among others), studying the counterparty, liquidity and funding risks which have appeared during the current crisis, and proposing systemic risk indicators to monitor these risks in the environment of securities markets regulators.</p> <p>Expertise</p> <p>In recent years the CNMV hired three experts for its Research Department. The addition of this staff has been critical to the ability of the CNMV to conduct analysis of the implications that the macro-economic environment has on the securities markets. More recently this Unit has faced challenges in hiring suitably qualified additional staff.</p> |
| Assessment | Fully Implemented |
| Comments | <p>The GIEF is a relatively new structure, and therefore its role is still evolving. However, it is already helping the CNMV to have a more systematic approach to identifying potential sources of systemic risk in the securities markets, and to contribute more effectively to the discussions held at CESFI. Overtime better integration of the findings from the supervisory departments, into the top down analysis carried out by the GIEF is desirable (and the membership of the Group itself should help to achieve this objective, as the directors of the front line department are already members of it). More systematic use of market intelligence—for example through regular meetings with the sector would also be beneficial.</p> |
| Principle 7. | The Regulator should have or contribute to a process to review the perimeter of regulation regularly. |
| Description | <p>Internal assessment of the perimeter of regulation</p> <p>The CNMV does not have a special process explicitly aimed at assessing whether its regulatory framework adequately addresses the risk posed by products, markets and participants to investor protection, fair and efficient transparent markets and the reduction of systemic risk.</p> <p>The supervisory programs in place for different types of regulated entities (off- site analysis and on-site inspections) do help to identify potential areas of risk and, as a by-product, contribute to determining whether additional measures at the sectoral level are needed, for example to enhance the regulations for a particular sector, or even to bring a previously unregulated activity into the perimeter of regulation.</p> <p>In this context, the identification of potential gaps follows a bottom up approach, whereby the Directors of the front-line departments identify such issues and bring them to the attention of the corresponding General Director. The General Directors in turn are responsible for determining whether such issues should be brought to the attention of the <i>Comite de Direccion</i> (management committee). This committee is composed of the Chairman, the Deputy Chairman, the General Director of the Legal, the Markets and the Entities Directorate and the Director of the Office of the Chairman. The committee meets twice a week (Mondays and Thursdays). The agenda includes the following issues:</p> <ul style="list-style-type: none"> • Information about market developments and discussion of the most relevant news (analysis of newspapers and other media communications). • Issues that require policy discussion with special focus on those that require short-term decisions, including: (i) relevant authorization files to be approved during the |

week (i.e., public offer prospectuses); (ii) Update on ongoing legislative proposals that affect the CNMV; (iii) On going relevant issues that require discussion at Management Committee level and/or discussion and decision at Executive Committee level; and (iv) Other relevant issues: special references to supervisory and sanctioning process and critical situations (e.g., judicial issues).

- Draft agenda for the next executive committee.

Decisions can be taken at the management committee level, or depending on the nature of the issue, they could be brought to the attention of the Executive Committee. These actions could involve a range of options from imposing additional requirements on regulated entities, to issuing guidance and recommendations to market participants, or proposing changes to the legislation.

Examples of the identification of emerging risks that prompted a regulatory action are the following:

- Imposition of a requirement for an independent valuation report in connection with the placement by financial institutions of their own preferential shares to retail investors through their bank networks. In this case, the CNMV considered that there was a risk that investors could not appropriately assess whether the price of the instrument was fair.
- Collaboration with the MEC for the modification of the CIS Law to allow the set-up of side-pockets in CIS, to address problems that arose as a result of the crisis when part of the CIS portfolio became illiquid or hard-to value.
- Guidance to ISPs has been issued in regard to topics such as investment advice, complex and non complex instruments, review of appropriateness and suitability.

On an ad-hoc basis the CNMV has set up working groups to review the regulatory framework for a particular area. For example, a task force has been set up to review the regulatory framework for the admission of securities to trading on RMs, and to provide recommendations.

The CNMV also has regular meetings with market infrastructure providers, and annual meetings with the big four auditing firms, to gather their views on potential risks coming from the markets and regulated entities.

Finally, on an annual basis the organization conducts a top-down exercise to identify the strategic priorities for the institution in both regulation and supervision. Such exercise is supported by background documents that departments must prepared as well as a “brainstorming” session. Priorities are defined by the board. The final outcome is an Annual Plan of Activities which is disseminated to the public. This process also contributes to the identification of gaps in the perimeter of regulation, which can prompt changes in Circulars and/or requests for changes in regulations or laws, or enhanced monitoring to assess the magnitude of risks identified.

Changes to regulations issued by the Ministry of EC or to laws

When the CNMV identifies a material gap in the regulations or securities laws, it sends a proposal to the MEC. Examples mentioned by staff were: (i) the Ley de Economía Sostenible, in which many of the reforms to the LMV were included at the request of the CNMV, and (ii) a recent reform to the CIS law, allowing for side pockets, in response to the fact that a significant proportion of assets in some CIS portfolios have become illiquid.

| | |
|---------------------|---|
| | <p>Changes in the European framework</p> <p>Participation at the European level is crucial given the key role played by EU legislation in determining the core regulation of the securities markets in Spain. The CNMV's contributions to assessing the adequacy of EU requirements and to identifying vulnerabilities, is largely channeled through the ESMA. In particular, the CNMV participates in ESMA's Committee on Financial Innovation, created in September 2011. The goal of such committee is to assist the authorities in "achieving a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities and providing advice for the Authority to present to the European Parliament, the Council and the Commission." The Committee analyzes innovations in activities and products in the retail markets, and also behavioral issues in wholesale markets with a potential impact on market integrity or systemic risk.</p> <p>In addition, the CNMV participates in all the standard committees of ESMA. In these committees, which are usually involved in reviews of the current regulation or in the issuance or the review of technical or regulatory standards, the CNMV has the opportunity to share views on market developments and new identified risks with the other competent national authorities.</p> |
| Assessment | Fully Implemented |
| Comments | The CNMV has provided examples that the organization has been concerned with addressing problems detected in the perimeter of regulation. Such cases have originated from the bottom up, based on the experience of the supervisory divisions. This is a reasonable approach, in particular because it is supported by the management committee structure, which allows for interdepartmental analysis. In addition, the process is reasonably linked to the annual definition of priorities. |
| Principle 8. | The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed. |
| Description | <p>Regulated entities</p> <p>The supervisory programs in place for the on-going supervision of securities intermediaries (described in Principle 31), CIS operators (described in Principle 24), auditors (described in Principle 19), sell side analysts (described in Principle 23) are a key mechanism to identify, monitor and when necessary take regulatory actions to address conflicts of interest either on an individual entity or for the whole sector (through circulars, or recommendations).</p> <p>In all cases the current regulatory framework requires regulated entities to put in place mechanisms to identify, monitor and mitigate conflicts of interest. The approach to mitigation is mixed: in some cases, certain activities are banned to prevent the conflict. Examples of this approach are the limitations on non-audit services for audit firms and CRAs. In others, robust controls are required. For example, in connection with the provision of investment advice by an ISP which also conducts proprietary trading, the regulatory framework requires robust information barriers. In others, disclosure to investors, rather than elimination of the conflict, is required. Examples of this approach are the disclosure of remuneration for sell-side analysts based on a firm's investment banking activities.</p> <p>Monitoring of compliance with these obligations is mainly carried out through the on-site inspections program, although, the CNMV has also conducted thematic (mainly off-site) reviews. For example, in recent years the CNMV has paid special attention to conflict of interest arisen from banks issue and placement of financial instruments to retail investors. The findings from supervision of this kind have prompted regulatory actions, for example through the imposition of additional requirements, or enhanced disclosure.</p> |

| | |
|---------------------------------------|---|
| | <p>Examples of such actions are the following:</p> <ul style="list-style-type: none"> • As described in the previous principle, the CNMV has required financial institutions placing their own issues (preferential shares) on retail investors to submit an independent valuation report. • In the case of CIS, due to the long period of time that it takes to wind up a fund of HFs, the CNMV has encouraged a detailed disclosure about the process in the CIS public periodic information. <p>Issuers</p> <p>In the case of issuers, the CNMV seeks to identify potential misalignment of incentives through the review that it does of issuers' reporting obligations. When issues of concern arise, the CNMV seeks to address them mainly through enhanced disclosure vis-à-vis investors; although in the area of securitization retention requirements have been established at the European level. For example:</p> <ul style="list-style-type: none"> • The MoE has changed the disclosure regime for directors' remuneration, from a "comply or explain" system to mandatory disclosure, as a result of a recommendation of the CNMV, which had observed that the majority of companies did not release such information. This reform will be implemented in 2012. • In particular, in connection with securitization, the CNMV has sought to improve the level and quality of the information available to investors, in order to reduce information asymmetries and identify conflicts of interest along the securitization chain. To that end, new regulations in place establish (i) retention requirements and on-going information obligations for the financial institutions that invest in securitizations, (ii) an obligation to describe in the prospectus, any conflicting interest, with detail about the persons involved and the nature of the interest, (iii) new periodic public information requirements for Spanish securitization vehicles (securitization funds), whereby the funds must publish every six months, by means of a standardized form and electronic reporting of data, their balance sheet, their profit and loss account, their cash flow statement, detailed information on the position of assets assigned to the fund and the liabilities incurred, as well as the situation of the credit enhancements incorporated in the fund, and (iv) the obligation for fund managers to send to the CNMV the audited annual accounts of their funds every year, even in the case they are private securitization funds whose securities are not listed or have not been placed by means of a public offering. |
| Assessment | Fully Implemented |
| Comments | <p>The current supervisory programs for regulated entities and issuers provide a good foundation for the identification of conflicts of interest or misalignment of incentives. Given that banks dominate selling, distribution and advice about financial products, there are inherent conflicts of interest in the system. Therefore, the CNMV should continue to monitor the source of conflict as envisaged in the 2012 Annual Plan. This is especially important in an environment where banks have been seeking capital from retail investors.</p> |
| Principles for Self-Regulation | |
| Principle 9. | Where the regulatory system makes use of SROs that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities. |
| Description | |
| Assessment | Not applicable |
| Comments | Neither the authorities nor the assessors consider that there are any SROs in the |

| | |
|--|--|
| | <p>Spanish market. In particular CNMV as the regulator has direct responsibility for the supervision of ISPs and for supervision of activity on RMs. For the main markets operated by the BME (the securities exchanges and the futures markets), the market operators have oversight functions but these are largely confined to monitoring the market to ensure it trades in an orderly fashion and a compliance function in general.</p> <p>The position is slightly different for BME's MAB market. For the part of the market that consists of small cap companies, MAB does set the listing standards and disclosure and reporting obligations of issuers, and monitors compliance with them. This is because these securities are not traded on an official secondary market, and the rules that apply under the LMV to securities trading on official secondary markets do not apply to them. MAB carries out this function under the overall supervision of the CNMV.</p> <p>The assessors do not think that this limited exception, especially in view of the size of the MAB market relative to other markets, amounts to a use of SROs that means an assessment under Principle 9 is required. See also the Secondary Markets Principles for more information relative to the supervision and regulation of markets.</p> |
| Principles for the Enforcement of Securities Regulation | |
| Principle 10. | The regulator should have comprehensive inspection, investigation and surveillance powers. |
| Description | <p>Information gathering and inspection powers</p> <p><i>General powers</i></p> <p>Article 85 of the LMV gives the CNMV extensive information gathering, supervision and inspection powers over regulated entities and (in relation to securities market activities) individuals and other entities. The Article confers power of information gathering and inspection, including powers to:</p> <ul style="list-style-type: none"> • have access to any document; • require a person to provide any information the CNMV reasonably requires, and to summon and take statements from a person; • carry out on-site inspections (including on a surprise basis); • require a person to provide telephone and data traffic records; and • seek information from auditors of ISPs and operators of official secondary markets. <p>These powers can be exercised at any time by the CNMV and no distinction is made between their use in routine supervision activities or in investigating conduct which may be liable to administrative or criminal sanctions.</p> <p>The CNMV can require information or carry out an inspection without giving prior notice, and on either a routine basis or in response to a particular inquiry.</p> <p>These powers can be exercised in relation to all regulated entities including</p> <ul style="list-style-type: none"> • operators of official secondary markets and MTFs, registration, clearing and settlement system operators, other than the BdE (Article 84.1.a and b of the LMV); • issuers (Article 84.2.a); • ISPs and their agents (Article 84.1.c and e); and • CIS operators and depositories (by virtue of Article 70 of the CIS Law, which applies Article 85 of the LMV to them). <p>They can also be exercised in relation to individuals and entities in connection with their activities on a securities market (Article 84.2.d).</p> <p>Records and information to which the CNMV has access include bank account records, including client accounts. There is no requirement for a bank to notify its client of a CNMV request for access to account details, and the CNMV can and does require the bank to keep the fact of the CNMV request confidential.</p> |

| | |
|----------------------|--|
| | <p><i>Trading activity on RMs</i></p> <p>In addition to the information gathering powers described above, the CNMV also has real time access to the trading screens of electronic markets operated by BME and has the same access to information as the operators of those markets. This includes information about the identity of the intermediaries whose orders are in the trading system. This enables the CNMV to monitor the course of trading on those markets. The CNMV also has direct access to the information on the ultimate beneficiary of each transaction through detailed transaction reports from market intermediaries made the day after each trading day.</p> <p>Record keeping requirements</p> <p>Regulated entities are subject to detailed record keeping requirements. For exchange markets and related clearing and settlement systems , records must be kept for six years (which is the time required for the keeping of business records generally under the Code of Commerce (Article 30).</p> <p>Article 32 of RESI sets out the records and registers ISPs must keep. These records generally must be kept for a minimum of 5 years. The same obligations apply to CIS operators pursuant to Article 65 CIS regulation.</p> <p>Customer identity</p> <p>Rule 14 of CNMV Circular 1/1996 requires ISPs to carry out identity checks on a client when commencing a business relationship. For natural persons, this means the presentation of an ID card, passport or residence permit. For legal persons, this requires presentation of the incorporation documents or certification of the official public registry containing its name, legal form and tax ID number, as well as powers of attorney for the persons acting on its behalf.</p> <p>Articles 3 and 4 of Law 10/2010 (the Spanish law on the Prevention of Money Laundering and Terrorism) obliges firms to carry out identity checks on natural and legal persons intending to establish business relations or participate in any transactions. The identity of both the formal holder and the beneficial holder must be checked.</p> <p>Inspections outsourced to SROs and other third parties</p> <p>The CNMV's powers can only be exercised by the CNMV itself, and no outsourcing of its function can take place.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 11. | The regulator should have comprehensive enforcement powers. |
| Description | <p>Investigative powers</p> <p>The CNMV uses the powers under Article 85 of the LMV (described under Principle 10) to carry out investigations into possible breaches of the legislation that may result in administrative or criminal sanctions. These powers are broad enough to allow the CNMV to gather documents and information that can be used as evidence in administrative sanctioning and criminal proceedings. In practice the criminal prosecution authorities rely on evidence gathered by the CNMV to make decisions on commencing proceedings and to conduct trials. CNMV staff give expert testimony in criminal cases.</p> <p>However the CNMV does not have power to seek information directly from telecommunication providers (telephone and internet). These powers can only be exercised by the prosecutorial authorities.</p> <p>The CNMV's existing powers allow it to access information identifying persons who</p> |

beneficially own (and who control entities that own) financial instruments. This information is available from data on the Companies Register, or is on the CNMV's own registers of significant shareholders, or from regulated entities. The CNMV can also use its power under Article 85.2 of the LMV to require any person, whether an individual or an entity, to provide information.

Unlike in some jurisdictions, the legislation does not require a formal decision to be made for a given matter to move from the supervision and monitoring phase to an investigation of breaches of legislation which may result in the CNMV taking action, by commencing a sanction procedure or referring a matter to the prosecuting authorities. Enforcement procedures are described in more detail under Principle 12.

Regulatory intervention measures

The CNMV has extensive power to take measures to deal with non-compliance with legislative obligations by issuers, regulated entities and others, and with potential non-compliance that may adversely affect a regulated entity's clients or the markets in which the entity is active.

Under Spanish law, the LMV and other laws administered by the CNMV are administrative and public acts. Failure to comply with them is dealt with under administrative (and in some cases) criminal proceedings. The CNMV therefore does not use civil judicial proceedings in its enforcement activities.

Issuers

Pursuant to Article 35 and 35 bis and corresponding regulations, the CNMV has power to require changes to information and documents that must be included in the public registers it is required to keep by the legislation if the information in them does not meet legislative requirements. This applies, for example, to prospectuses, audits, periodic public disclosures and information about significant shareholdings.

The CNMV can also:

refuse to register documents if it becomes aware of serious defects that might harm the interest of investors or involve discrimination between investors; (Article 26.4 LMV and corresponding regulations):

- suspend or exclude from trading securities in circumstances described in Article 33 (where required to preserve the proper operation of the market or to protect investors) and Article 34 (where the securities do not meet minimum requirements for trading, or an issuer does not comply with its obligations).

Regulated entities

Article 85 of the LMV confers intervention powers on the CNMV, including the power to:

- a) require a person to cease a practice that does not comply with the legislation;
- b) seek court orders freezing assets;
- c) place a temporary ban on professional activity;
- d) adopt any measure necessary to ensure that regulated entities and others having obligations under the legislation comply with those obligations;
- e) suspend or limit a person's market activities;
- f) suspend or prohibit trading in a financial instrument on an official secondary market or an MTF;
- g) refer a person for criminal prosecution; and
- h) authorize auditors or experts to verify or investigate a matter that is the subject of request by authorities in an EU member state.

The measures referred to in items a., c., d., e., and f. can be adopted as a preventive

measure during sanction proceedings, and can also be adopted independently of a sanction proceeding if the CNMV considers this is necessary for effective investor protection or to ensure the proper functioning of the markets, and can be maintained for as long as the problem remains.

As noted under Principle 10, the powers under Article 85 can be exercised against all regulated entities and against individuals and entities in relation to their activities on a securities market.

Suspension of trading

Article 33 of the LMV gives the CNMV power to suspend trading in a financial instrument security if special circumstances exist that may disrupt normal trading in the instrument or the measure is necessary to protect investors. Article 34 of the LMV also empowers the CNMV to exclude a security from trading when it does not meet trading and disclosure requirements. Article 85.k of the LMV gives the CNMV power to order that a financial instrument be suspended or excluded from trading, either on an official secondary market or on an MTF.

Administrative sanctions

Breaches of the legislation administered by the CNMV makes a person (a natural person or a legal entity) liable for administrative sanctions.

Changes were made to the sanctioning regime in 2007 to enable the CNMV to issue cease and desist orders, as well as to enable it to make public any sanctioning action it takes once the sanctions imposed are final, except for minor infractions. A reform of 2011 introduced new types and better definition of breaches, especially those related to conduct obligations, eliminating loopholes that made it difficult to prosecute some behaviors in the past.

The sanctioning regime is set out in Chapter II of Title VIII of the LMV and Chapter IV of Title VI of the CIS Law. Breaches of legislative requirements are classified as minor (*infracciones leves*); serious (*infracciones graves*) and very serious (*infracciones muy graves*). The conduct that gives rise to each of these categories is tightly defined in the legislation (Articles 99–101 of the LMV and Articles 80–82 of the CIS Law), with the level of breach being defined by reference to obligations or prohibitions in specified provisions of the law. The process the CNMV uses to investigate misconduct and determine or (in the case of very serious breaches) recommend sanctions is described under Principle 12.

The sanctions that can be imposed are set out in Articles 102–104 of the LMV and Articles 85–87 of the CIS Law.

The following is a summary of the sanctions that can be imposed:

For very serious breaches

For entities regulated under the LMV:

- a maximum fine of the higher of: 5 times the profit obtained as a result of the breach ; 5 percent of the capital of the entity; 5 percent of the funds (whether client or own funds) used in carrying out the infringing conduct; or € 600,000;
- suspension of the right to carry on business, or removal from membership of a RM, for up to 5 years;
- revocation of authorization;
- disqualification from office as a director or manager of the entity concerned, or of any other financial firm, for up to 5 years; and
- limitation on the type or volume of business that can be transacted.

| | |
|--|---|
| | <p>The minimum fine for breaches of the insider trading prohibition is € 60,000, and this fine in an appropriate case can be additional to other sanctions.</p> <p>Directors and managers can be fined up to € 300,500; removed from their position for up to 3 years; or prohibited from taking up a position as director or manager in another financial firm for up to 5 years.</p> <p>Analogous provisions apply under the CIS Law but the maximum fine payable under that law is € 300,000. Directors and managers of CIS operators can be fined up to € 300,000; disqualified from holding a position in any other financial institution for up to 10 years; or suspended from office.</p> <p><i>Serious breaches</i></p> <p>For entities regulated under the LMV:</p> <ul style="list-style-type: none"> • a maximum fine of the higher of: twice the profit obtained as a result of the breach; 2 percent of the capital of the entity; 2 percent of the funds (whether client or own funds) used in carrying out the infringing conduct; or € 300,000; • suspension of the right to carry on business, or removal from membership of a RM, for up to 1 year; and • disqualification from the office as a director or manager in the entity concerned, or any other financial firm, for up to 1 year. <p>Directors and managers can be fined up to € 150,250 or removed from their position for up to 1 year.</p> <p>For CIS operators sanctions are a fine of up to € 150,000; suspension of the right to carry on business for between 1 and 3 years; limitation on the type or volume of business that can be transacted; or a public reprimand. Directors and managers can be fined up to € 150,000; suspended from their position for up to 1 year; or be subjected to a public or private reprimand.</p> <p><i>Minor breaches</i></p> <p>For minor breaches under the LMV, a fine of up to € 30,000 can be imposed.</p> <p>For CIS operators, the sanctions are a fine of up to € 60,000 or a private admonition.</p> <p>Criminal investigations and sanctions</p> <p>Most breaches of the securities legislation administered by the CNMV result in administrative rather than criminal offences.</p> <p>For insider trading and market manipulation, a monetary threshold is used to distinguish between administrative and criminal violations. Insider trading cases where the gain made or loss avoided is less than € 600,000, and for market manipulation cases less than € 200,000, are administrative offences. Above those thresholds, criminal penalties apply.</p> <p>Under criminal Law, insider information is punished with imprisonment from 1 to 4 years, fine from 1 to 3 times the benefit obtained or favored and special disqualification for the exercise of the profession or activity from 2 to 5 years.</p> <p>An imprisonment penalty from 4 to 6 years, fine from 1 to 3 times the benefit obtained or favored and special disqualification for the exercise of the profession or activity from 2 to 5 years shall be imposed when at least one of the following circumstances is met:</p> |
|--|---|

| | |
|----------------------|---|
| | <ul style="list-style-type: none"> • The subjects carry out such abusive practices habitually. • The benefit obtained is notorious. • When it causes a serious damage to the general interest. <p>For market manipulation, criminal law sets out imprisonment from 6 months to two years or fine from 12 to 24 months. In addition, the penalty of disqualification for intervening in the financial market as actor, agent, mediator or informant from 1 to 2 years shall be imposed.</p> <p>When the CNMV in the course of its activities identifies conduct that may amount to a criminal offence, it is obliged under Spanish law to refer all the relevant information to the Public Prosecutor's Office and to provide any collaboration requested of it. (See Article 262 of the Criminal Justice Act and Article 408 of the Criminal Code and Article 88 of the LMV, which requires the CNMV to provide any collaboration required by the Judicial Authorities or by the Public Prosecutor's Office).</p> <p>The exercise of the sanctioning powers in the LMV is independent of any concurrent criminal proceedings. Article 96 of the LMV establishes that when there are concurrent administrative proceedings and criminal proceedings relating to the same events (or other events which cannot reasonably be separated), the administrative proceedings must be suspended until a final decision is made by the judicial authorities. When the administrative proceedings are resumed, the administrative decision must respect the finding contained in the judicial ruling.</p> <p>Private rights of action</p> <p>Private rights of action are available to shareholders and investors to seek compensation or other remedies for losses resulting from misconduct by regulated entities. Class actions are available and are used, usually through groups of affected investors forming an association to act on their behalf.</p> <p>Information sharing</p> <p>As described under Principle 13, the CNMV can obtain from other authorities information needed for it to carry out its functions. Principle 14 describes the information sharing and collaboration agreements between domestic authorities in Spain, and between the CNMV and its international counterparts.</p> |
| Assessment | Fully Implemented |
| Comments | A legal reform could be pursued to provide the CNMV with powers to request telephone and internet service providers data. |
| Principle 12. | The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program. |
| Description | <p>Inspection, surveillance and compliance monitoring</p> <p>The CNMV uses a systematic approach to the monitoring and supervision of regulated activity. Details of the processes used are set out in the relevant Principles (Principles 16, 24, 31, 34, and 36).</p> <p>The CNMV as a whole produces and publishes an Annual Plan which indicates the main areas of focus for its regulatory and supervisory activities in the coming year. Internally each regulatory department produces a plan for the year which is approved by the Executive Committee. These internal plans identify the regulated entities that will be subject to on-site inspections, and the thematic and other off-site work the department will carry out.</p> <p>The CNMV uses a risk-based approach to much of its regulatory work. Different risk analysis systems are used to identify more high risk entities for the accounting obligations of issuers, and for CIS operators and for investment firms.</p> |

New reporting obligations for investment firms and credit institutions providing investment services have been introduced (CNMV Circular 1/2010). They are designed to give the CNMV a more detailed view of firms and their clients. This should, over time, help the CNMV refine its risk analysis systems and enable them to become more focused on conduct of business risks.

Off-site supervision

For the supervision of issuers' prospectus and takeover disclosure obligations, all prospectuses are reviewed and amendment and clarification is routinely required. Issuers' periodic disclosure obligations are monitored and corrective action, including sanctions, is taken where breaches are detected. Obligations to comply with accounting standards are subject to systematic review, under a combination of a rotation and a risk-based system.

For the regulation of CIS activity and investment services, a great deal of emphasis is placed on off-site supervision and follow-up through monitoring quantitative information provided by regulated entities. Sophisticated electronic systems are used to monitor financial and investment information about investment funds and their fund managers, and the capital obligations of investment firms.

Thematic reviews

The CNMV also carries out thematic reviews of CIS operators, investment firms and credit institutions providing investment services.

Horizontal reviews of credit institutions are basically aimed to review commercialization, although other issues are analyzed as well, such as conflicts of interest. In many cases the themes chosen reflect current pressure points in the market. An example of this type of review was that conducted on distribution of preferential shares, where the CNMV used a sample of 27 firms accounting for 95 percent of the market, to review potential problems in the selling of such securities by financial institutions.

CIS operators are not usually involved in commercialization; thus in their case horizontal reviews have dealt with topics related to the operation of the fund, such as valuation of assets and related party transactions.

Finally, thematic reviews on investment firms have been focused almost solely on capital and solvency issues.

Reviews are done off-site by selecting a sample of firms and requiring them to provide documents for review by CNMV staff, such as a description of procedures and controls. The assessors saw an example of a case where detailed client files were requested and reviewed. In a few cases the thematic reviews lead to on-site inspections. It is not common that thematic reviews result also in disciplinary actions; although the CNMV provided examples of two disciplinary actions brought based on thematic reviews.

On-site inspections

It appears that less emphasis is placed on on-site inspections as a tool to monitor compliance and detect problem areas at individual firms and potentially across firms doing the same business. The following table illustrates the relatively low proportion of regulated firms that are subject to on-site inspections in a given year:

The on-site inspections that are undertaken appear to be carried out professionally, follow up actions to remedy deficiencies are routinely required and, less commonly, formal enforcement actions are commenced.

| Type of regulated entity | Number of entities (at 31-12-11) | Number of on-site inspections 2010 | Number of on-site inspections 2011 |
|---|----------------------------------|------------------------------------|------------------------------------|
| Investment firms (except advisers) | 95 | 10 | 9 |
| Credit institutions providing investment services | 189 | 5 (1 large) | 4 (1 large) |
| Advisers | 80 | | 1 |
| CIS operators | 114 | 17 (12 general and 5 thematic) | 15 (14 general and one follow up) |
| Depositories | 94 | 2 | 2 |

* In practice, only 56 firms offer the service.

Mechanisms to detect and investigate insider trading and other forms of market abuse

The CNMV has direct responsibility for supervising RMs to ensure compliance with regulatory requirements, especially the prohibitions on market abuse and insider trading. Details about its practices in carrying out this rule are contained under Principles 34 and 36. The CNMV's real time access to trading on the markets, the information it receives daily about market transactions, weekly reports from market operators and its own analysis and alert-generating systems enable it to analyze unusual market activity that may indicate market abuse, including insider trading. A special unit, the market monitoring unit (MMU) within the Market Directorate is responsible for evidence gathering and investigation in cases of suspected market abuse or insider trading. It consists of 10 people.

The CNMV at present has some capacity to deal with cross-market issues, but this is limited because different systems are used for cash markets (equities and fixed income) and for derivatives markets. A new integrated system is being designed with the intention that it be fully implemented by 2014.

Unregulated entities

The CNMV is an active participant in the ESMA and IOSCO mechanisms for monitoring and dealing with the provision of investment services by unregulated entities. In practice, if the CNMV detects unregulated activity it will, as soon as reliable evidence is available, issue a public warning and forward the information to ESMA and IOSCO. It continues the investigation and initiates a sanctioning procedure or refers the matter to the criminal prosecution authorities. Some of the larger fines imposed through the sanctioning process have been for unregulated activity of this kind, but in practice there seem to be few cases

The CNMV has the power to ask a court to freeze assets, and to directly issue cease and desist orders as a precautionary measure. In practice, these powers—which were introduced in 2011—have not yet been used.

Investor complaints

A unit within the investor department in the Legal Affairs Directorate deals with complaints from investors. 2,296 complaints were received in 2010 and 2,005 in 2011. After an initial review, many are referred to the relevant regulatory department. This may result in direct action, such as an inspection of the entity against which the complaint is made. More generally complaints are an input for the scoring mechanisms developed by the CNMV for CIS and investment firms.

The enforcement process

Administrative sanctions

Within CNMV, the investigation of conduct that may give rise to sanctions and the formal process of deciding whether and what sanction the CNMV should impose (or, for the most serious violations, recommend to the Minister of Economy) are separated. Information gathering and investigation is carried out by the relevant regulatory department. The sanctioning process is the responsibility of the litigation and enforcement department with the Directorate of Legal Affairs. This department consists of a director, three deputy directors and 8 other professional staff.

If one of CNMV's regulatory departments identifies conduct that may attract an administrative sanction, staff of that department will seek all information relating to the conduct by using the information gathering powers described under Principle 10, including the powers to compel the provision of information and to summon and take statements from any person. These statements reflect the outcome of any interview and the interviewee is asked to sign them. At the end of the investigation staff prepares a report for the Executive Committee, which should contain a proposal on whether to open or not a sanction procedure. If the Committee decides to take further action, it requests a legal report from the Legal Department on whether the facts set out in the technical report amount to a breach of the legislation and whether the conduct in question could be subject to a sanction. The litigation and legal department may ask the relevant regulatory department to obtain additional information. If the report concludes that a sanctionable violation has occurred, the Executive Committee makes a formal decision to commence a sanctioning file. The case is then given to two "instructors" whose role is to review and manage the file. At this point, they notify in writing the party who is the subject of the sanctioning process, make available to them all the information contained in the file, and advise the person of his rights. The affected party has 20 days in which to respond and the right to produce further evidence (including testimony from third parties) or to request the CNMV to do so. The instructors may seek further information from the relevant regulatory department, but they can refuse the affected party's request for information. They must give written reasons for doing so.

Once the investigation is completed, the instructors prepare a proposal for the Executive Committee, including a recommendation about the sanction that should be imposed. The affected party must be notified of the proposed sanction, and can offer further evidence or make submission on the proposed penalty.

The Executive Committee makes a decision on both the facts and the sanction to be imposed. The decision on the facts is taken on the preponderance of evidence and does not require direct proof or proof of intention. For the most serious violations (where the Minister of Economy and Competitiveness is the decision maker), the Executive Committee makes a proposal to the CNMV Board. The Board's proposal is sent to the Minister of Economy and Competitiveness.

The sanction process is largely carried out by exchanges of correspondence between the CNMV and the party affected. Once a sanctioning file is opened, the process must be completed within one year (though an instructor can extend the time by up to six months). Nonetheless, the time between the infringing conduct can be lengthy as time runs only from the time a formal decision to open a sanction file is taken. For example, potential violations of MiFID requirements were detected in 2009 but are only now going through the sanctioning process. This has the potential to undermine the general deterrent effect of the sanctions process.

Until recently the majority of the files opened corresponded to issuers' violations, with less emphasis on commencing sanction proceedings for ISPs, including credit institutions, and CIS operators. A relatively small number of insider trading cases have been subject to sanctions. This is illustrated by the following information on CNMV decisions to open sanctioning files:

| Very Serious Violations | Number of Files Opened 2010 | Number of Files Opened 2011 |
|---|------------------------------------|------------------------------------|
| Significant shareholding—failure to disclose/incorrect disclosure | 14 | 12 |
| Material event disclosure—failure to disclose/providing misleading or incorrect information/significant omissions | 2 | - |
| Breach of issuers' periodic disclosure obligations | 4 | 4 |
| Breach of takeover rules | 4 | - |
| Market manipulation | 1 | - |
| Insider dealing | 7 | 1 |
| Breach of capital ratios | - | 1 |
| Breach of investment firms general obligations | 2 | 1 |
| Breach of conduct of business rules | - | 4 |
| Breach of CIS obligations | 1 | - |
| Total files opened for very serious violations | 35 | 23 |

| Serious Violations | Number of Files Opened 2010 | Number of Files Opened 2011 |
|---|--|------------------------------------|
| Corporate governance breaches | 2 | 1 |
| Market abuse breaches | 1 | 1 |
| Insider dealing | 1 | - |
| Market manipulation | - | 1 |
| Breach of capital ratios | - | 2 |
| Breach of investment firms general obligations | 1 | - |
| Breach of conduct of business rules | - | 2 |
| Breach of CIS obligations | - | 2 |
| Failure to prepare/publish/file mandatory reports | 4 (3 for regulated entities and 1 issuer) | - |
| Total files opened for serious violations | 9 | 9 |

No minor sanction files were opened in 2011 (1 in 2010).

The Table below summarizes information on monetary sanctions imposed by the CNMV. Total fines of € 2.3 million were imposed in 2010 and € 15.4 million in 2011.

| Type of case | 2009 | | 2010 | | 2011 | |
|-----------------------------------|-------------------|---------------|-------------------|-----------------|-------------------|------------------|
| | Num. Cases | Amount | Num. Cases | Amount | Num. Cases | Amount |
| Market Abuse | 3 | 100.10 | 2 | 700.00 | 4 | 875.00 |
| Inside Information | 1 | 31.10 | 1 | 610.00 | 1 | 240.00 |
| Market Manipulation | - | - | - | - | 1 | 360.00 |
| Other market abuse related topics | 2 | 69.00 | 1 | 90.00 | 2 | 275.00 |
| Other cases | 7 | 398.00 | 21 | 1,645.50 | 15 | 14,525.00 |
| Total | 10 | 498.10 | 23 | 2,345.50 | 19 | 15,400.00 |

Since 2009 the CNMV has initiated 10 sanctioning files for breaches of conduct obligations by investment firms and credit institutions. Three arose from off-site

inspections (two on banks, and one on a CIS), two from thematic reviews (one on a CIS, and the other on credit institution), another from an investor's complaint and the remaining four were triggered by on-site inspections. In addition there are currently 8 cases in the pipeline on market manipulation.

The CNMV uses the sanctioning process in cases where breaches of requirements are clear, the breach is significant or there is persistent failure to comply with requirements. Where the breach is relatively minor or what the legislation requires is less clear CNMV may consider that remedial action is sufficient. In addition, if client losses are significant, the CNMV can seek agreement from a firm to compensate clients for losses resulting from the contravention or poor practice. In the last three years, the CNMV has secured commitments from ISPs and credit institutions to pay a total of € 34 million in compensation; and commitments from CIS operators to pay a total of € 23 million.

Where such a compensation agreement has been reached, the CNMV requires the firm to make a public announcement about the infringing practice and information about the compensation paid. This helps send a timely signal to the market about the interpretation of legislative requirements, and the necessity to compensate clients for losses resulting from breaches or poor market practices.

These compensation arrangements are not a substitute for formal sanctions, which can be imposed in the appropriate case. The CNMV takes into account an agreement to pay compensation when determining what sanction to impose or recommend the Minister impose.

Criminal actions

The responsibility for prosecuting criminal offences arising under the securities regulation mainly rests with the Special Prosecution Office Against Corruption and Organised Crime (*Fiscalía contra Corrupción y Criminalidad Organizada*), but regional prosecution offices also have specialists who deal with economic crime.

The Special Prosecution Office (FCCO) has 15 prosecutors based in Madrid and approximately 15 prosecutors throughout Spain (and other staff in specialist units). The main focus of the FCCO is on corruption and organized crime but the authorities estimate that currently approximately 10 percent of their resources are committed to securities market issues.

Criminal actions usually commence by the CNMV referring a matter to the FCCO, although the assessors were told of one case where the FCCO initiated the investigation. The number of cases the FCCO has been asked to deal with has increased markedly in recent years. There are currently 6 cases at various stages of the criminal process.

The FCCO relies on evidence gathered by the CNMV in its investigations, and uses CNMV staff as expert witnesses. If further evidence is needed, the FCCO asks the CNMV to gather it, but this rarely occurs in practice.

| Referred for criminal action | 2010 | 2011 |
|--|------|------|
| Market manipulation | 0 | 0 |
| Insider trading | 3 | 0 |
| Other market abuse | 0 | 0 |
| Other breaches of securities regulation—e.g., unregulated activities | 0 | 0 |

As is common in many jurisdictions, the criminal enforcement process for securities market offences such as market manipulation and insider trading is complex and poses challenges where, as in Spain, there are not courts that specialize in economic crime. It

| | |
|------------|---|
| | is also a lengthy process, especially because appeals against convictions are common. This means the time between the misconduct in the market place and a final conviction can be lengthy. During the last 10 years, there has been one case settled in connection with market abuse and one conviction for insider trading one year ago. |
| Assessment | Partly Implemented |
| Comments | <p>Concerns about the low coverage of on-site inspections are the key factor that determine the grade for this Principle. To a lesser extent, issues related to enforcement have also been taken into account, but the assessors acknowledged that, as described below, the CNMV appears to have moved to a more robust stance on enforcement—although results need to be shown.</p> <p><i>On-site inspections</i></p> <p>The CNMV does not appear to have an intensive program of on-site of inspections, and the coverage of the regulated firm population described above means that for some firms the time between on-site inspections may be as long as ten years. The CNMV's use of risk-based criteria shortens this cycle for firms regarded as high risk, but the assessors were told that even high risk firms may only be inspected every four years. Where on-site inspections occur, the assessors saw evidence that they are carried out in a thorough and professional way and often result in corrective action. But this also highlights that for some areas the best way of detecting problems in conduct is through the on-site inspection process.</p> <p>The CNMV contends that through robust off-site, investigation of complaints, and thematic reviews they are actually able to have better coverage. The assessors acknowledge that for conduct problems that are widespread in the market, thematic reviews are a powerful tool, provided they go beyond simple review of processes. The CNMV makes impressive use of this supervisory mechanism. In particular recent thematic reviews focused on critical areas in the market. The thematic review of selling of complex products by banks is a clear example.</p> <p>However for investment firms thematic reviews have not covered conduct obligations. For credit institutions the reviews have focused on very few topics, in spite of their dominance in all aspects of securities markets, including the distribution of financial products. This means that the conduct and business practices of these entities have many impacts across the whole market. Therefore in the opinion of the assessor thematic reviews have not offset the low coverage of the on-site programs. In addition, the relatively low rate of on-site inspections does not enable the CNMV to form a view about how well a firm's compliance procedures and internal controls are working in practice, and shortcomings are difficult to detect off-site.</p> <p>The assessors acknowledge that the situation is somewhat different for CIS operators. In Spain, CIS operators are not usually involved in the selling and distribution of CIS products to retail clients, and therefore obligations owed to clients mostly relate to the subscription and redemption process, compliance with the investment mandate, valuation and handling of assets and NAV, and periodic reporting. Failure to comply with these obligations can more easily be detected at an early stage by thorough review and analysis of periodic reports, such as that carried out by the CNMV. In addition, under the Spanish legislation, depositories have an obligation to monitor a CIS's operator's compliance with its obligations, especially with respect to the investment mandate. The CNMV provided evidence of a number of thematic reviews of CIS operators' (and depositories'). These factors mean that the need for a more intensive program of on-site inspections may be less pressing because non-compliance by CIS operators can be detected by other means. But on-site inspections remain a valuable tool for assessing the adequacy of the organizational structure, internal controls and reporting systems.</p> <p>The CNMV points out that, measured by industry coverage, over the last 5 years, on-site inspections have covered 66 percent of the Spanish CIS industry (measured by value of assets); that during the period 2009–2011, 29 inspections on investment firms were conducted (amounting to 42 percent of the retail clients of the sector and 45 percent of</p> |

the value of assets under management) ; and that during the period 2009–2011, 13 inspections on credit institutions were conducted (representing 46 percent of retail clients, and 86 percent of the amount of assets under management in the sector, and 45 percent of the assets held in custody).

These figures seem to demonstrate that the CNMV's focus is on the firms that have most clients and most assets under management, and that use is made of on-site inspections to monitor compliance by those firms. But the assessors remain concerned about the relatively low rate of coverage of firms, not just larger firms especially since compliance problems are as likely to be present in medium size and smaller firms as they are in larger ones. For all firms, the focus on compliance with conduct of business obligations, and associated compliance and internal controls systems, seems to be a relatively recent area of focus.

The assessors consider that on-site inspections are a critical tool for ensuring that the regulator has an active presence in the market place, and that poor conduct both at firm and industry level is detected and dealt with. Signals of such poor conduct do not usually manifest in regular reporting by firms, and emerge only through backward looking indicators complaints or other intelligence showing that problems have occurred.

The assessors also note that sanctioning procedures are much more likely to result from on-site inspections than from other forms of review.

Sanctioning and enforcement

The assessors review of files show that, when material misconduct is detected , CNMV staff are thorough in the investigation of it and follow a detailed process to ensure evidence is gathered in a way that supports enforcement action. Comments from market participants support this perception.

Until recently, the evidence suggests the majority of the sanctions were imposed for breaches to issuers' obligations (especially reporting obligations). However, cases in the pipeline show a trend to increased use of sanctions to deal with non-compliance by investment service providers, in addition to requiring remedial actions and compensation agreements as described above. However, the results of this new approach are not yet evident in final results. In the same vein, there seems to be a trend to increased use of sanctions in connection with market manipulation.

In the assessors' view, use of the sanctioning power is critical for maximising the deterrent effect of regulatory intervention, and signalling the regulator's willingness to pursue breaches to the market as a whole in a clear and effective way. Of course it is important to ensure that deficiencies are remedied, but strong use of available enforcement tools is also an effective way of preventing problems before they occur.

The sanctioning process described under this Principle is complex, and the same processes are used for all sanctions. Article 23 of RD 1398/1993 sets out a simplified procedure that can be used to deal with minor sanctions, but the assessors were told that in practice there is no differentiation between the processes used for serious breaches and minor breaches and this means that significant resources and time are consumed by these relatively minor matters.

The time taken to reach a decision to impose a sanction, and the often lengthy appeal process, means that there is often a very substantial time lag between the time that the offending behavior occurs and the time that any sanction imposed can be made publicly known. This undermines the deterrent effect of the process. The assessors note that this problem is common in many jurisdictions.

In the assessors' view, consideration should be given to streamlining as far as possible the sanctioning process for minor violations.

| | |
|---|--|
| | <p>There has been an increase in the number of criminal cases that are being taken for breaches of the securities laws, but this is against the background of very low use of this route over the past decade. The prosecutorial authorities appear willing to take on securities market cases, and have the resources to do so. But they depend on the referral to them of cases from the CNMV. While criminal cases could be lengthier and more challenging (due to the standard of proof required to demonstrate intention and procedural safeguards that must be met), the “credible” threat of jail remains a powerful deterrent for the most serious breaches, such as market manipulation and insider trading. Thus, the importance of successful criminal prosecution. The authorities have highlighted that one conviction has been recently secured in an insider case which initiated in a criminal court in 2010.</p> <p>In summary, the assessors note positive changes in both administrative and criminal enforcement that once consolidated should translate in an effective enforcement program.</p> |
| Principles for Cooperation in Regulation | |
| Principle 13. | The regulator should have authority to share both public and non-public information with domestic and foreign counterparts. |
| Description | <p>Domestic information sharing and co-operation</p> <p>Article 90 of the LMV allows the CNMV to share with domestic authorities any information that they need to perform their functions. For purposes of such provision, domestic authorities include:</p> <ul style="list-style-type: none"> • bank, money-laundering and insurance regulators; • Autonomous Communities with stock market supervision responsibilities; • Spanish energy sector supervisors; and • the governing companies of official secondary markets <p>These provisions do not limit the type of information that can be shared. They also do not require any external approval.</p> <p>International information sharing and cooperation</p> <p>Articles 91 to 91(4) of the LMV deal with the CNMV’s ability to cooperate with other foreign competent authorities, both European and non-European.</p> <p>Articles 91 bis and 91 tris apply to cooperation with the authorities of EU country members. In this case the LMV establishes an obligation to cooperate, and in particular to exchange information and collaborate in investigative and supervisory activities. The CNMV can use its powers to access information, even if the conduct investigated does not constitute a breach under Spanish law. Pursuant to these provisions the CNMV does not need any external approval to provide cooperation; nor is there any limit to the information that it can share.</p> <p>Under Article 91 tris, the CNMV may refuse to cooperate in an investigation, an “on site” verification or a supervisory act when:</p> <ul style="list-style-type: none"> • cooperation may be damaging to sovereignty security or public order. • legal proceedings have been brought before the Spanish authorities for the same events and against the same persons. • a final judgement (binding judicial decision) has been made on the same events and with respect to the same persons. <p>Article 91 quater deals with cooperation with non-EU countries. This provision allows the CNMV to enter into cooperation arrangements to exchange information with the competent authorities from non-EU countries, provided that (i) there is reciprocity, (ii) the foreign regulator is bound by professional secrecy obligations comparable to those in Spanish law, and (iii) the information is requested in connection with the functions</p> |

| | |
|----------------------|---|
| | <p>assigned to the foreign authority.</p> <p>For purposes of this provision competent authorities include the authorities responsible for:</p> <ul style="list-style-type: none"> • the supervision of credit institutions, other financial institutions, insurance companies and financial markets; • the resolution and liquidation of ISP; • auditing ISPs and other financial institutions, credit institutions and insurance companies; and • the supervision of entities in charge of resolution and liquidation of ISPs. <p>There are no limitations to the type of information that the CNMV can share, nor is external approval required.</p> <p>Unsolicited information</p> <p>Articles 91 bis and tris explicitly recognize that the CNMV may send information to authorities in EU countries without the existence of a prior request. Sharing of unsolicited information in connection with authorities of non-EU countries is included in the IOSCO MMoU to which the CNMV is a signatory, and the CNMV has in practice received and sent unsolicited information.</p> <p>No requirement for breach of domestic laws</p> <p>Article 91 of the LMV, which deals with information sharing and cooperation with other competent authorities of Member States of the European Union (EU), expressly recognizes that the CNMV may exercise its powers for cooperation purposes, even in cases in which the investigated conduct does not constitute a breach of Spanish law. Although a similar provision does not exist in connection with non EU countries, the general provisions relating to information sharing are broad enough to allow the CNMV to provide assistance even where conduct does not constitute a breach of Spanish law</p> <p>Bank account information</p> <p>Pursuant to Articles 91 to 91(4) information about the beneficial ownership of banking and brokerage accounts can be provided.</p> <p>Confidentiality</p> <p>As noted above, the CNMV can only share information with foreign regulators from non EU countries if the foreign regulator is subject to confidentiality obligations at least as strict as those that apply in Spain. In practice, before entering into an agreement with a foreign regulator, the CNMV verifies the other regulator's confidentiality regime. If it receives a request from a regulator with which it does not have an agreement, the CNMV requires a declaration from the other regulator that the information will not be used for purposes other than those requested (supervision and inspection of securities markets) and that it will not be provided to any other authority without the prior consent of the CNMV.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 14. | Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts. |
| Description | <p>Power to enter into information sharing agreements</p> <p>There is no explicit provision that authorizes the CNMV to enter into information sharing agreements with domestic authorities, but the authorities state that such authority is implicit in the power to cooperate confer by Article 90 of the LMV. In the case of competent authorities of EU countries, the authority to enter into cooperation</p> |

| | |
|----------------------|---|
| | <p>arrangements derives from EU Directives. Article 91 quater explained above explicitly authorizes the CNMV to enter into cooperation arrangements with competent authorities of non-EU countries.</p> <p>Information sharing mechanisms</p> <p><i>Domestic authorities</i></p> <p>The CNMV has entered into collaboration and information sharing agreements with the BdE, DGFSP and the money laundering authority (SEPBLAC).</p> <p><i>Foreign counterparts</i></p> <p>CNMV has been a signatory to the IOSCO MMoU since 2003.</p> <p>It has also entered into 18 bilateral MoUs with foreign regulators. Most are available on the CNMV website. It has also signed consultation and technical assistance agreements with most Latin-American countries.</p> <p>Confidentiality</p> <p>Confidentiality requirements that apply when CNMV supplies confidential information to foreign regulators are described under Principle 13.</p> <p>Article 91 bis prohibits the CNMV from transmitting information received from a competent authority of an EU country to other authorities without the consent of such authorities, except under exceptional situations. In this case, the CNMV must immediately inform the authority.</p> <p>Article 91 quater prohibits the CNMV from transmitting the information received from a competent authority from a non EU country to other authorities, except with the consent of the foreign authority, and for the purposes that the authority indicates.</p> <p>Practice</p> <p>The CNMV provided the assessors with examples of domestic information sharing, especially between the CNMV and the BdE. This included examples of the sharing of unsolicited information, as well the sharing of supervision plans.</p> <p>In 2011 CNMV received and acted on 35 requests from non-Spanish authorities for information relating to market abuse or activities performed by unlicensed authorities, and responded to all the requests.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 15. | The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers. |
| Description | <p>Assistance to foreign regulators—records</p> <p>As noted under Principle 10, Article 85 of the LMV provides the CNMV with the power to obtain any document and to request any information it considers necessary for the discharge of its functions. This broad power covers records and information about securities and derivatives transactions; bank and brokerage accounts; and details about clients of securities firms, including about the identity of ultimate holders of accounts.</p> <p>Articles 91 to 91 quater of the LMV enable the CNMV to share all information and documents with foreign regulators.</p> <p>The CNMV through its Department for International Relationships and a unit within the</p> |

Department of Enforcement, deal with the requests for assistance received from foreign authorities and provide the assistance requested in accordance with the “best practices” for information sharing and cooperation issued by IOSCO and ESMA.

The average time in providing a response to the requesting authority is around 30 days. However, in more complex and exceptional cases the information gathering process can be longer, and in urgent matters, it can be done more expeditiously.

Assistance to foreign regulators—compliance with laws and regulations

The CNMV can seek information and documents relating to all matters within its jurisdiction. This includes market abuse (market manipulation, insider dealing, fraudulent dealing, misrepresentation and so on), the issue of securities, market intermediaries and markets, exchanges and clearing and settlement facilities.

No requirement for independent interest

There is no requirement for the CNMV to have an independent interest in a matter about which a foreign regulator seeks assistance. The test (as described under Principles 13 and 14) is that the information requested by the foreign regulator is required for that regulator to carry out its functions.

Information on regulatory processes

CNMV can (under Articles 91 to 91 quater) provide information about regulatory processes, including the authorization process, investigations in progress and sanctions imposed.

If the information requested is held by other domestic authorities (such as regulatory or judicial authorities), the CNMV can assist by facilitating contact between the domestic authority and the foreign regulator. This is done on a voluntary basis, since the legislation does not provide for the CNMV to act formally on the foreign regulator’s behalf, other than where the formal preconditions of legal representation are met (and in practice this has not occurred).

Assistance to foreign regulators

Documents and statements

CNMV can use its evidence gathering powers under Article 85 of the LMV to require information and documents requested by a foreign regulator. The only requirement is that the information requested by the foreign regulator relates to its regulatory functions.

CNMV’s powers under Article 85 include the power to summon a person and take a statement from them. As an administrative body, CNMV does not have the power to request the taking of a person’s statement under oath, unless the natural person summoned volunteers to do so. The power to compel testimony under oath, under the Spanish Constitution, belongs exclusively to the judiciary and the courts.

Court orders

Spanish legislation does not permit the CNMV to act formally on behalf of another regulator in judicial proceedings, unless the conditions of legal representation (such as) are met, although this has never occurred in practice.

Financial conglomerates

The powers available to the CNMV under Article 85 of the LMV mean it is able to seek documents and information about financial conglomerates on a foreign regulator’s behalf, including information about:

| | |
|-------------------------------|--|
| | <p>a. group structure; b. capital requirements; c. cross investments in company groups; d. intra- group and group- wide exposures; e. relationships with shareholders; and f. management responsibility and governance.</p> <p>Information from other domestic authorities</p> <p>Using its powers under Article 85, CNMV can seek information from other domestic authorities in response to a request from a foreign authority.</p> <p>Use of information</p> <p>Articles 91 to 91 quater only require that the sharing of information is used for performing the tasks entrusted to competent authorities.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principles for Issuers | |
| Principle 16. | There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions. |
| Description | <p>Market overview</p> <p>There are four equity RMs in Spain (Madrid, Barcelona, Bilbao and Valencia) and one fixed-income RM (AIAF) which are all part of the BME Group. The official equity secondary markets have two compartments, the first market where almost all listed companies are included and a second market (<i>Segundo Mercado</i>), where only 20 companies are listed. Listing requirements are lower in the second market; however all disclosure and periodic obligations described below apply to both compartments. The CNMV is responsible for monitoring compliance by such issuers with their disclosure obligations.</p> <p>There are also two equity MTFs, both administered by the BME:</p> <ul style="list-style-type: none"> • MAB. It has over 3,000 listed entities but most of these are SICAVs and there are 18 small cap issuers. Disclosure requirements are set by the rules of the market and compliance is monitored by the market operator. • Latibex, the market for Latin American securities denominated in euros. At June 2011, there were 29 issuers whose securities trade on the market. This market only admits issuers that were previously subject to authorization requirements in a Latin American jurisdiction. The home jurisdiction's disclosure rules apply and Spanish investors receive the same information as investors receive in the issuer's home jurisdiction. Compliance with disclosure obligations is monitored by the market operator. <p>Disclosure requirements for issuers admitted to trading on an official secondary market</p> <p>The LMV and related regulatory material set out a detailed and comprehensive disclosure and reporting regime for issuers whose securities are offered to the public or admitted to trading on RMs. The regime includes requirements for:</p> <ul style="list-style-type: none"> a. a prospectus for public offerings of equity debt issues and derivatives; b. annual reports; c. half yearly reports; and d. material event disclosures. |

Public offerings of securities

Articles 25 to 30(2) of the LMV set out the framework requirements for offerings of securities for public sale and for their admission to trading on RMs. The regulatory framework in the LMV is supplemented by more detailed requirements in Royal Decree 1310/2005.

Two types of document are required:

a. Prospectus

The legislation requires an issuer to publish a prospectus approved by the CNMV before making an offering of securities for public sale.

Article 16 of the Royal Decree requires a prospectus to contain all the information about the issuer and the securities needed to enable investors to make an assessment about assets and liabilities, financial position, profits and losses, and prospects of the issuer and the rights attaching to the securities.

Detailed requirements for prospectus disclosures are set out in Regulation 809/2004 (The Prospectus Directive) of the EC, which applies of its own force.

All prospectuses required by the LMV and Royal Decree 1310/2005 must be approved by the CNMV. The function of approval is defined by Article 24 of the Royal Decree and consists of an express act of the CNMV resulting from an analysis by which the CNMV concludes that the prospectus is comprehensive, understandable and that it contains consistent information.

In addition to the prospectus, the offeror must provide the CNMV with documents which verify that the issue and the securities are in line with the legal regime applicable to them, and with annual accounts of the issuer prepared and audited in accordance with relevant legislation.

b. Summary of the prospectus

When the securities which are offered have a par value of less than € 50,000, the prospectus must contain a brief summary in nontechnical language which reflects the essential characteristics and risks associated with the issuer and the possible guarantors of the securities.

Article 22 of the Royal Decree requires a supplement to be issued if any new significant factor, inaccuracy or error which is material, relative to the information in the prospectus, and which may affect the evaluation of the securities and which arises or is observed between approval of the prospectus and finalisation of the subscription period or the start of trading.

The annual financial information contained in the prospectus cannot be older than 18 months from the prospectus date. If the issuer has published periodic interim information since the date of the last annual financial information, the periodic information must be included in the prospectus. Publication of new annual financial information during the offer period or before the securities are admitted to trading requires the publication of a supplement to the prospectus.

Annual reports

Article 35.1 of the LMV requires all issuers of securities admitted on a RM to publish an annual report which includes annual audited financial statements and a management report. The management report includes a detailed corporate governance report. Annual reports must be made public and lodged with the CNMV within four months of the close

of the financial year.

The consolidated accounts of entities that constitute a group must be prepared in accordance with IFRS. Otherwise, individual accounts are to be used under domestic accounting standards which are generally consistent with IFRS (see further under Principle 18).

Half yearly reports and quarterly management reports

Article 35 2 of the LMV requires issuers whose securities are listed on a RM to publish half-yearly financial information prepared in accordance with IFRS (IAS 34) if they prepare consolidated accounts, and with domestic standards in other cases . These reports must be published within two months of the close of the relevant period.

Article 35.3 requires issuers of shares or other equity instruments also to publish a quarterly management report containing a description of significant business operations during the quarter and of the financial situation of the issuer.

Material event disclosure

Article 82 of the LMV requires issuers of securities to immediately publish and disseminate to the market all relevant information required by the legislation. Relevant information for these purposes is information that, if known to the investor, may reasonably influence the investor's decision to buy or transfer securities or financial instruments, and therefore may materially influence the price on a secondary market.

Issuers are required to send this information to the CNMV which automatically makes it public by including it in the official register required by Article 92 of the LMV. The communication to the CNMV must be made at the same time as dissemination to any other media and as soon as the relevant fact is known, the decision is adopted or agreement or contract with third parties is entered into. The content of the communication must be accurate, clear, comprehensive and (when required by the nature of the information) quantified so that it does not mislead or cause confusion.

Issuers of securities are also required to disseminate this information on their websites. However, when the relevant information may have a negative effect on the normal performance of transactions on the issuer's securities and poses risk for investor protection, the issuer must communicate the relevant information, prior to its publication, to the CNMV, which must disseminate it immediately.

Shareholder voting decisions

The Capital Companies Act (CCA), recently amended by the Shareholders' Rights Act (*Ley 25/2011*), requires companies whose shares are admitted to trading on a RM to include full information on matters relating to shareholder voting on their website, both before and after the General Shareholders' Meeting (for example see Article 173).

Advertising

Article 28 of Royal Decree 1310/2005 requires that advertising relating to admission to trading or public offerings is clearly recognizable as such and is not inaccurate or misleading. When a prospectus is required, the advertising must declare where it can be obtained and the advertising messages must be consistent with the prospectus. It is not permitted to provide selective material to certain investors.

Other issuers

Issuers who make a public offering but are not listed in an official secondary market are not subject by law to any other requirement except the prospectus. Issuers admitted in a MTF currently MAB and Latibex are subject to the disclosure requirements pursuant to

the listing obligations.

MAB

Market rules impose prospectus-like disclosure. In addition, issuers are required to submit half yearly reports within 3 months following the end of the first half of each year and annual reports within 4 months of the end of the fiscal year. Financial statements must be prepared in accordance to IFRs, national accounting standards of the EEE or US GAAP, and annual statements must be audited. Quarterly reports do not apply to issuers admitted in MAB. Material events disclosure also applies.

The exchange has adopted measures in the past when there have been failures to comply with the disclosure requirement. For instance, the trading of Zinkia, S.A. was suspended due to this reason.

Latibex

As a general principle, issuers listed in Latibex are subject to the disclosure obligations imposed by their home regulator, but the Latibex rule book (Articles 16 and 17) do impose minimum disclosure obligations regarding key corporate actions equivalent to those that apply to issuers listed on MAB. In practice the BME conducts a due diligence process to determine whether obligations in the home country provide equivalent protection to investors than those prescribed in Spain. Only issuers from countries where the BME finds such protection to be equivalent are admitted to trading.

According to Circular 5/2010, provision 2, issuers must make available to the market every relevant information pertaining to the issuers that they have published in their home exchange. Suspensions decisions are not taken by Latibex, but by the home exchange. As soon as a Latibex issuer is suspended, the Latin-American stock exchange immediately informs Latibex about it, who suspends the trading in Spain as well.

Issuers not listed

CNMV staff indicated that in Spain the number of issuers of public offering that do not list (either in an official market or in MAB) is minimal.

Responsibility for information in regulated offer documents

Article 28 of the LMV and Chapter IV of Royal Decree 1310/2005 makes the following persons liable (both in civil and administrative terms) for the content of the prospectus and any supplement:

- the issuer or offeror;
- directors of the issuer or offeror in accordance with commercial legislation
- persons who are named in the prospectus as accepting responsibility for it; and
- persons not included in the above paragraphs who have totally or partially authorised the content of the prospectus when this is mentioned in it.

When the offeror of the securities is not the same as the issuer, the offeror is responsible for the prospectus. The guarantor is responsible with regard to the information that must be prepared in accordance with EC Regulation 809/2004.

A lead manager for an offer is liable when it does not diligently carry out the checks referred to in Royal Decree 1310/2005.

Civil Liability

Under Article 28.3, the persons responsible for prospectus content are liable to holders of securities for damages and losses resulting from misleading information or omissions of relevant information. A claim must be made within 3 years of the holder becoming aware

of the defect in the prospectus content.

Derogations

Article 82.4 of the LMV permits an issuer, at its own discretion, to delay publication and dissemination of relevant information when it believes that the information damages its legitimate interests, provided such an omission is not likely to confuse the public and that the issuer can guarantee the confidentiality of the information. The issuer must immediately inform the CNMV. So far no issuer has used this possibility to delay any relevant information. However, there have been cases in which issuers inform the CNMV in advance about some incoming project or business not yet decided or completely shaped.

Article 83(2).1.f of the LMV sets out requirements that apply to securities issuers during the preliminary or negotiation stages of any type of legal or financial operation that may materially influence the price of the affected securities or financial instruments. During this stage, if there is an abnormal development in trading volumes or prices and there are reasonable signs that this development is occurring as a consequence of a premature, partial or distorted dissemination of the operation, the issuer must immediately disseminate a significant event report which reports clearly and precisely the status of the operation in progress and which contains a summary of the information to be supplied.

Regulatory supervision—measures available to the CNMV

The CNMV has a general power (Article 85.5 of the LMV) to require, in writing or verbally, that the persons or entities linked to the securities market immediately publish the information which it considers pertinent on their activities relating to the securities market or which may have an influence on the securities market. If the required persons and entities do not do so directly, the CNMV must publish the information.

Suspension of trading

Article 33 of the LMV gives the CNMV power to suspend the trading in a financial instrument on an official Spanish secondary markets, when special circumstances exist which may distort the normal performance of transactions on that financial instrument or when carried out for the purpose of investor protection. The suspension decision must be made public immediately and the competent authorities of other Member States where that instrument is traded must be informed.

Restrictions on trading by persons with superior information

Article 85 of the LMV establishes the supervision and inspection powers of the CNMV. These powers include the power to stop all practices which are contrary to the provisions established in this Act and its implementing rules. The sanction regime establishes that failure to comply with the rules relating to inside information (Article 99.o and 99.o(2) of the LMV) is treated as a very serious breach. The sanctions applicable to very serious breaches include suspension or limitation of the type or volume of transactions or activities which the breaching party may carry out in the securities market over a period no greater than five years (Article 102b of the LMV).

With regard to annual corporate governance reports, the LMV treats the existence of relevant omissions or false or misleading data as a serious breach.

CNMV practice

Prospectus reviews

CNMV analysts review all prospectuses. The focus of these reviews is on whether the prospectus contains all required information, and whether information is presented in a consistent and easily understandable way. Particular emphasis is currently placed on

disclosure of corporate governance practices (including remuneration) and on the reliability of financial information. It is routine for the CNMV to request clarification or further information. When the analyst is satisfied the prospectus meets requirements, it is then reviewed by a more senior officer. The approval process includes sign off by the department's director, legal review by the legal affairs department and the head of the Directorate General of Markets. The formal approval decision is then made by the CNMV's President or Vice President.

This process means that it is rare for a prospectus to be refused registration, but the assessors were told of examples where this has occurred.

A recent initiative of the CNMV relates to prospectuses for preference shares and any other long-term fixed income security offered to retail investors by banks. The CNMV was concerned about the ability of retail investors to assess the value of these types of securities. It required issuers to have the value assessed by independent expert valuers and the results of this assessment to be set out in the prospectus. Later on this requirement was extended to all fixed income securities irrespective of the type of issuer.

Material event disclosures

CNMV staff review all material event disclosures after they have been made public through the CNMV website and can (and do) ask for additional information. They also monitor local and international press to identify possible instances of non-compliance with the material event disclosure obligation.

Review of issuers' compliance with periodic reporting obligations

Issuers' financial reports are sent to CNMV electronically (annual report on a voluntary basis). They are subject to two forms of review to verify compliance with accounting standards and other reporting obligations: formal review and substantive review.

In a formal review, the CNMV staff verifies whether reports have been submitted on time and whether they are complete. Substantive reviews involve a detailed review to verify compliance with accounting standards. If material non-compliance is identified, the CNMV asks the issuer for a restatement in the following year, or if the problem is more fundamental for an immediate reformulation of the financial statements. In serious cases formal sanction processes can be commenced. Where the financial reporting review reveals inadequacies in the audit, the CNMV can also refer the matter to the audit regulator, ICAC.

Two factors determine which reports are selected for substantive review:

- risk criteria—based on the probability of an error (assessed using predetermined indicators) and the market impact of a material error; and
- cycle criteria—the CNMV aims to review financial reports of equity issuers over a four year cycle. (In practice, CNMV has reviewed 78 percent of equity issuers' reports in the first two years of the current cycle).

Each year, the CNMV publishes a list of the most common problems it has identified through the accounting review process. It also announces each year the areas on which it will focus in these reviews.

In connection with the formal reviews, the CNMV has applied sanctions to issuers (and their directors individually) for late filing. In 2011, the number of persons (individual or legal) sanctioned for late filing amounted to 4 listed companies (moreover, one of them included 4 Members of the Board). In addition, in 2011, of the 75 substantive reviews of issuers reports, 81 percent resulted in a request for the issuer to clarify or explain an aspect of the report. Four issuers were asked for immediate reformulation. One issuer is subject to an administrative sanctioning proceeding

| | |
|----------------------|--|
| | <p><i>Review of Corporate Governance (CG) Reports</i></p> <p>The CNMV also reviews the CG Reports submitted by issuers. There is a team of three staff dedicated to such review. CNMV estimates that for 2011, less than 1 percent of the issuers filed these reports late. The CNMV has also imposed sanctions in connection with such late filing.</p> <p>The CNMV publishes every year a report on CG which analyzes the evolution in CG practices.</p> <p>Cross border matters</p> <p>Disclosure requirements for non-resident issuers are the same as those for issuers resident in the EU (set out in EC Regulation 809/2004). In accordance with Article 31 of Royal Decree 1310/2005, non-resident issuers may prepare a prospectus in accordance with the legislation of their country of residence providing the prospectus has been prepared in accordance with IOSCO standards and that its content is equivalent to that required in the aforementioned Regulation.</p> |
| Assessment | Fully Implemented |
| Comments | <p>For securities traded on official secondary markets (RMs), both the regulatory regime and the CNMV's supervision of compliance with it are robust; although the deadline for submission of annual reports appears long compared with international best practices. The authorities noted, however, that this deadline stems from European Directives and cannot be gold plated. The CNMV also emphasized that under the Spanish legal framework issuers must submit a semiannual report with a summary of the accounts, within two months of the end of the fiscal year. Therefore, while not audited, the market does receive information earlier than the four month deadline for the annual audited statements.</p> <p>Disclosure requirements for MAB are less stringent than those for RMs, but broadly in line with the IOSCO Principles. The BME appears to have a system in place for supervision of their compliance with disclosure obligations and oversight by the CNMV appears to be in place. The situation of Latibex is somewhat more complex, as there is not a unified set of requirements. However, the assessors note the existence of a due diligence process by the BME to determine whether disclosure requirements in the home jurisdiction where these issuers are listed are equivalent to those existing in Spain. In any case, at this moment the number of issuers in these venues is not material.</p> <p>As the CNMV's experience with preferred shares offered by banks shows, the current economic environment in Spain may lead to an increase in more complex securities products being offered to retail investors. It is important in this environment to monitor closely the emergence of these products and to ensure appropriate steps are taken to ensure that disclosure to investors is adequate and that other measures (such as the ones taken by the CNMV for preference shares and other fixed income securities) are used wherever retail investors may have difficulty assessing risks associated with these products.</p> |
| Principle 17. | Holders of securities in a company should be treated in a fair and equitable manner. |
| Description | <p>Rights and equitable treatment of shareholders</p> <p>The CCA, amended in 2011, provides the basic framework for shareholders rights applicable to any corporation. In addition, Title XIV (Articles 495 to 539) of the CCA strengthens many of the basic rights of shareholders in connection with companies listed on an RM. Law 3/2009 sets out the legal regime for changes to corporate structure, such as conversion, merger, spin-off, and global assignment of assets and liabilities. This law applies to all types of trading (confirmed) companies, including listed companies but there is a specific section (Title XIV) that only applies to companies whose shares are admitted to trading on an RM. Through this law a new regulation (applying only to capital</p> |

companies) governing intra-Community cross-border mergers was included in the Spanish legal system.

Article 93 of the CCA provides that (subject to exceptions provided for in the legislation) shareholders in any corporation must have at least the following rights:

- to share in the distribution of corporate profit and in the proceeds of its liquidation.
- preferential rights in the creation of new shares or pre-emptive subscription rights for new shares or bonds convertible into shares.
- to attend and vote at general meetings and to challenge company agreements.
- to information.

Voting

Article 514 of the CCA requires the equitable treatment for all shareholders in the same position, in regard to information, participation and the exercise of voting rights in the general meeting.

Elections of directors

The appointment of directors is the sole prerogative of the shareholders in a general meeting (Article 160 CCA).

Fundamental corporate changes

Article 160 CCA gives the general meeting of shareholders the sole power to approve fundamental changes. These include the power to:

- amend the company's articles of association;
- increase or reduce the company's capital; and
- agree to the company's transformation, merger, split, or the transfer of its assets and liabilities.

Related party transactions

There is no provision requiring shareholders approval of related party transactions, even of potentially material transactions. However disclosure of transactions with a material effect is required by the accounting standards. In addition, companies listed on an official secondary market must disclose in their Annual Report the transactions conducted with significant shareholders, managers and board members, as well as intra-group transactions that are not eliminated through the consolidation process, when such transactions are material either because of size of their relevance to understand the financial statements.

Finally pursuant to Article 229 of the CCA managers are required to inform to the board any conflict of interest that they could face vis-à-vis the company, and abstain from participating in the decisions where such conflict exists.

Notice of general meeting for issuers listed in a RM

The CCA, (Title XIV, Section II of Chapter VI), provides shareholders with access to information in advance of a general meeting of shareholders. This information must be made available through the issuer's website, and be accessible free of charge. Companies must also provide a facility through their website to enable shareholders to send suggestions for the agenda. Voting results must also be published on the website.

Notice of the convening of a general meeting must be published in The "Official Gazette of the Commercial Registry (BORME), or one of the higher readership daily newspapers in Spain and on the CNMV's website (Article 516). In addition, Article 518 requires the notice to be placed on the issuer's website and remain there until the holding of the

meeting. The notice must contain:

- the announcement convening the meeting;
- the total number of shares and voting rights at the date of call, broken down by class of shares, if any;
- documents to be presented at the general meeting and, specifically, reports from directors, auditors and independent experts;
- the full text of proposals for decision or, if there are none, a report from the competent bodies containing comments on each of the items on the agenda. As they are received, proposals from shareholders must also be included; and
- the forms to be used for proxy or remote voting, unless these are sent directly by the company to each shareholder. If for technical reasons these cannot be published on the website, the company must indicate how to obtain a hard copy form and must send it to every shareholder who requests it.

Voting at the general meeting

Companies admitted to trading in a RM must permit voting by proxy (Article 522), and may allow remote voting (Article 521).

Article 524 of the CCA allows a company providing investment services, in its capacity as a professional financial intermediary, to exercise the vote in a listed public company on behalf of its client, when authorized by the client to do so. It may vote differently on behalf of different clients.

Ownership registration and transfer of shares

Detailed rules for the registration and transfer of shares are set out in Title IV of the CCA. These provisions are supplemented by provisions in Chapter II of Title I the LMV which deal with book entry securities holdings.

Receipt of dividends:

Article 93 of the CCA provides that all shareholders have the right to share in company profits and proceeds from its liquidation, in proportion to the capital invested.

Mandatory tender offers (takeovers)

Takeovers are regulated by Chapter V of Title IV of the LMV and in its implementing legislation, Royal Decree 1066/2007. They apply to issuers admitted to trading in a RM.

The basic rule is that a person (or two or more persons acting in concert) who acquires a controlling position (defined as a position holding 30 percent or more of voting rights, or being able to appoint more than half the directors) in a listed entity must make an offer to all shareholders (Article 60 LMV). In practice, since the financial crisis the level of takeover activity is low and only 3 takeover bids were made in 2011. The legislation also allows for voluntary tender offers, which can be partial. Activity in regard to voluntary tender offers has also been low.

Royal Decree 1066/2007 requires that the offer must be addressed to all shareholders of the company (including in defined circumstances holders of non-voting shares) and to all holders of pre-emptive subscription rights and those holding bonds convertible into shares.

Article 9 of the Royal Decree requires the price or consideration offered in a mandatory bid to be fair and not less than highest price paid by the bidder (or persons acting in concert) for the same securities within the 12 months prior to the announcement of the bid. The CNMV may vary the price in specified circumstances according to the provisions established in Article 9. Those circumstances include the following: that the higher price has been set by agreement between the buyer and the seller; that the market prices of

the relevant securities have been manipulated; that the market prices, in general, or certain prices, in particular, have been affected by exceptional events; that there is an intention to turn around the company. Any decision by CNMV to permit an exception to the base requirement of the Article under the permitted circumstances must be made public.

The period for acceptance of the bid must not be less than fifteen nor more than seventy calendar days from the trading day following the publication of the first announcement of the bid following authorization by the CNMV. The acceptance period may be extended by the offeror, but must not exceed the maximum period. In the case of competing bids, the acceptance period is thirty calendar days as of the day following the publication of the first announcement of the competing bid. The presentation of a competing takeover bid interrupts the period of acceptance of the bid, or previous bids, which are automatically modified so that the acceptance periods of all bids should end on the same day. The new acceptance period, the same for all bids, must be published by the CNMV on its website.

If payment for the takeover bid consists of securities to be issued by the offeror (scrip bids), the period of acceptance is extended so that the period between the business day on which the general meeting approving the issue is held and the last day of the acceptance period, both included, is equal to fifteen calendar days.

The CNMV can extend the period of acceptance if the bidder makes an addition to the takeover prospectus (for example, where material new information requires such an addition), or modifies the bid or an extension of time is needed for the successful conclusion of the bid and the due protection of target shareholders.

The bidder must prepare an explanatory prospectus on the bid, which is subject to approval by the CNMV. The prospectus must contain all the information needed to enable the persons to whom the bid is addressed to arrive at an informed decision. The prospectus must be drafted to enable the easy analysis and understanding of its contents (Article 18 of Royal Decree 1066/2007). The Decree contains an appendix detailing the minimum information to be included in a prospectus; the offeror may add any other information to enable the recipients to arrive at an informed conclusion thereon. The CNMV may include in the prospectus notes and comments to assist in the analysis and understanding thereof.

If, following the publication of the prospectus, circumstances arise that require the addition of other data, the offeror may provide such data by means of a supplement.

Article 24 of the Royal Decree requires the governing body of the target company to publish, within ten calendar days from the start date of the acceptance period, a detailed and reasoned report on the takeover bid, which must contain, among other data, its comments in favour or against the bid being presented.

Boards must not, without the approval of a general meeting, take action to frustrate an offer (other than by soliciting rival bids). Article 60(2).

Other mandatory offers are delisting offers and the offers when a company wishes to reduce its capital by acquiring its own shares for redemption.

Mergers

A merger must be approved by shareholders meeting, and requires an extraordinary majority. In certain cases a merger would trigger the need for a mandatory tender offer.

Holding the company and its directors responsible in case of violations of law

Chapter V of Title VI of the CCA makes directors (both *de jure* and *de facto*) liable to the company, and to shareholders and company creditors, for damages caused by actions or omissions which breach the legislation or the articles of association or are carried out in

breach of the duties inherent in their office. The fact that the act resulting in damage has been authorised or ratified by the general meeting does not excuse directors from liability. All members of the governing body that reached the agreement or carried out the harmful act are held jointly liable, except for those who can prove that, having not intervened in the reaching and execution of the relevant decision, had no knowledge of it or had knowledge but took all appropriate measures to prevent the damage or, at least, expressly stated their objection.

Bankruptcy or insolvency of the company

The CCA and the Bankruptcy Act are based on the principle of equitable treatment of all shareholders in situations of insolvency and liquidation of the company. Shareholders have the right to be informed by the administrators of the status of the liquidation and, unless otherwise established in the articles of association, the liquidation share of each shareholder shall be in proportion to the share held in the share capital.

Substantial holdings of voting securities

Securities issuers must in their prospectuses identify persons who hold, either directly or indirectly, an interest in the capital of the issuer or in the voting rights thereof that must be disclosed in accordance with the legislation applicable to the issuer, along with the amount of the interest. If no such persons exist, a negative statement must be included.

Article 53 of the LMV and Royal Decree 1362/2007 which develops it requires shareholders with shares over 3 percent of the voting rights of a company admitted to trading in a RM to send the CNMV a notice within 4 days after reaching the ownership threshold. For shareholders resident in tax havens, the minimum threshold for notification is 1 percent.

Additional notifications are required when ownership reaches 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 30 percent, 35 percent, 40 percent, 45 percent, 50 percent, 60 percent, 70 percent, 75 percent, 80 percent, and 90 percent. (Article 23 of Royal Decree 1362/2007). Notifications are required for both increases above and decreases below the specified thresholds.

The CNMV keeps a public register of shareholders with significant shareholdings in listed companies, the unrestricted access to which is free of charge via the website

Notification requirements apply also to persons acting in concert and to holders of instruments giving them the right to acquire voting rights (such as holders of call options). See Article 24 of Royal Decree 1362/2007.

The CNMV keeps a public register of shareholders acting in a concerted fashion in a company admitted to trading on a RM which is publicly available free of charge.

The Annual Corporate Governance Report required by Article 61(2) of the LMV must disclose details about significant shareholdings. This report is mandatory for all companies admitted to trading on a RM. The CNMV keeps a public register of such reports.

In the case of MAB, the listing rules require issuers to include provisions in the charter of incorporation whereby shareholders are required to notify holdings when they exceed 10 percent, and then in multiples thereof.

Holdings of voting securities by directors and senior management

Directors of companies admitted to trading on a RM must report their holdings of voting rights, and any shareholding or transaction they carry out in shares or financial instruments related to shares of the company in which they hold office. Senior managers must also report any shareholdings or transactions that they carry out on shares or

| | |
|------------|---|
| | <p>financial instruments on the shares in the company wherein they hold office. The period for communication of such transactions is 5 days. (Regulated in Article 53 of the LMV, in Articles 31 and 35 of the Royal Decree 1362/2007 and in Article 9 of the Royal Decree 1333/2005). The CNMV keeps a public register of director and senior manager transactions in listed companies.</p> <p>In the case of MAB, the listing rules require issuers to include provisions in the charter of incorporation whereby directors and executives are required to notify transactions with a threshold of 1 percent.</p> <p>CNMV oversight</p> <p>The CNMV's jurisdiction is confined to the LMV and the corresponding regulations. Obligations and rights created by the CCA are enforceable only by private litigation (for example by shareholders commencing a suit against the company or its directors). In practice, shareholder suits are rare in Spain.</p> <p>A team of 5 CNMV staff members is responsible for supervising compliance with obligations concerning tender offer obligations. The process for reviewing documents and for decision making is similar to that for prospectus reviews (described under Principle 16), except that for tender offers the decision to approve the making of a bid is by the Board of the CNMV. It is usually the case that the CNMV requires clarifications and additional information through the review process.</p> <p>There is also a dedicated team of three staff for the review of notifications of significant shareholdings, as well as notifications of transactions by insiders, as the CNMV receives an average of 4.000 notifications per year. CNMV staff indicated that late submission of notifications is a problem, although it is decreasing over time. In 2011 the 16 percent of notifications received did not meet the regulatory deadline (17.5 percent in 2009, 16.6 percent in 2010). The CNMV has opened files against both significant shareholders and directors for failure to notify or delays. For example, in 2011 there have been 7 files opened against significant shareholders and 2 against board members. In 2010, 5 files against significant shareholders and 6 against board members were opened.</p> <p>Cross border</p> <p>Shareholder rights granted by the CCA are only applicable to companies incorporated under Spanish law.</p> <p>Issuers who do not reside within the EU must include in their prospectuses a statement on whether or not the issuer complies with the system of corporate governance of its country of origin and general information about the system that applies. If the issuer does not comply, the issuer must include a statement expressing the non-compliance and an explanation for it. To be listed on a Spanish market, issuers whose home jurisdiction is outside the EU must be bound by duties of periodic disclosure of public information equivalent to those applying in Spain. Article 21 of Royal Decree 1362/2007 sets out the tests for such equivalence.</p> <p>Issuers from other EU jurisdictions are considered to be subject to an equivalent regime.</p> |
| Assessment | Fully Implemented |
| Comments | <p>As in other countries in Europe the assessors note that some minority protections apply only to the official markets. Some protection of minority shareholders is provided in MAB if a takeover bid for the company is made, but the rules are not in line with the provision in the LMV. The Listing agreement also requires issuers listed on MAB to include a provision in their articles of association requiring notification of substantial holdings and insider holdings, although the thresholds are different than those established for RMs. If the MAB market grows to any significant size, these differences should be addressed and investors in these shares should have the same protections as those available to shareholders in companies listed on an official secondary market. As for Latibex, the authorities should continue to ensure that the due diligence process conduct by the BME</p> |

| | |
|----------------------|--|
| | in fact result in equivalent protections. |
| Principle 18. | Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality. |
| Description | <p>Audited financial statements</p> <p><i>Public offers of securities</i></p> <p>Audited financial statements must be lodged with the CNMV before an issuer can make a public offer of securities or have its securities admitted to trading on an official secondary market (Article 26.1.b of the LMV and Article 12 of Royal Decree 1310/2005). Both individual and consolidated annual financial statements must be provided. The financial statements must include at least the last three years in the case of participatory securities (such as shares and equivalent securities) and the last two years in other cases (for example, bonds or derivative securities). The prospectus must include these statements (EC Regulation 809/2004).</p> <p><i>Annual report and financial reports</i></p> <p>The requirements for an annual report including audited financial statements are set out in Article 35 of the LMV. Financial statements must include balance sheet, a statement of results, cash flow statement, the notes and the management report as well as changes in ownership.</p> <p>Use of unaudited financial statements</p> <p>Half yearly financial reports are not required to be audited but must be prepared in accordance with applicable accounting standards.</p> <p>Accounting standards</p> <p>For issuers whose securities are traded on an official secondary market, financial statements must be prepared in accordance with IFRS for consolidated statements and domestic Spanish standards for individual financial statements.</p> <p>Domestic Spanish standards are almost fully assimilated to IFRS, with differences only in two standards:</p> <ul style="list-style-type: none"> • Spanish standards allow capitalization of research expenses. • Spanish standards do not provide the options available under IFRS, in connection with the valuation of certain assets (mainly real state and intangible assets). <p>Oversight, interpretation and independence</p> <p>ICAC is the body responsible for setting Spanish accounting standards and providing interpretation and guidance on their use. It is a government entity, attached to the Ministry of EC. A more detailed description of ICAC's role and governance structure is provided in Principle 19.</p> <p>Any proposal to change the accounting standards must be subject to consultation with the Consultative Committee on Accounting Standards of ICAC, where the CNMV, the BdE, the DGSF participate along with representatives from the professional bodies, issuers and investors. The final decision belongs to the Accounting Council of ICAC, which is composed of the President of ICAC and representatives from the CNMV, the BdE and the DGSP.</p> <p>Review of compliance with accounting standards</p> <p>Then CNMV has responsibility for monitoring issuers' compliance with their financial</p> |

| | |
|--|---|
| | reporting obligations, including compliance with accounting standards. The legal framework provides it with the power to require additional information, corrective notes or, in the most serious cases restatements. The system set up by the CNMV has been discussed in detail in Principle 16. |
| Assessment | Fully Implemented |
| Comments | |
| Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers | |
| Principle 19. Auditors should be subject to adequate levels of oversight. | |
| Description | <p>Background</p> <p>The ICAC is a governmental body attached to the Minister of Economy, which has functions related to accounting and auditing. In particular it is in charge of:</p> <ul style="list-style-type: none"> • Approving the accounting standards, as well as any interpretation in connection with them (See Principle 18). • Approving (“homologating”) auditing standards (see Principle 21). • Administering the registration system for auditors. • Overseeing the quality of auditors. <p>ICAC’s governance structure includes:</p> <ol style="list-style-type: none"> a) A president, proposed by the MEC and appointed by the Government. The President is in charge of “homologating” the auditing standards via resolution and imposing disciplinary measures on individual auditors and audit firms. b) The Accounting Board: is a decision-making body in charge of approving the accounting standards. It is composed of the President of ICAC and one representative from the CNMV, the BdE, and the DGSP. c) The Consultative Committee of Accounting: is in charge of providing advice to the Accounting Board on accounting standards and their interpretation. It is composed of accounting experts. The <i>Ley de Auditoria de Cuentas</i> (LAC) requires that certain entities and organizations have representatives on it including the Ministry of Justice (MoJ), the MEC through the ICAC, the DGSP, the CNMV, the BdE, the associations of issuers and the associations of investors. d) The Consultative Committee on Auditing, in charge of providing advice to the President on issues related to auditing standards and auditors’ oversight. It is composed of the President, and a maximum of 13 members, including one representative from the CNMV, DGSP and the <i>Intervencion General del Estado</i>, one from the <i>Tribunal de Cuentas</i>, four from the professional bodies, one from BdE, one government lawyer; one academic; one investment analyst and one expert on accounting and auditing. <p>Article 28 authorizes ICAC to request from audit firms and auditors any information that it needs to carry out its mandate.</p> <p>ICAC is funded by a levy on audit firms. The level of such levy is updated every year in the budget law.</p> <p>Auditors’ qualifications</p> <p>Pursuant to the LAC auditors must register with the ICAC to be able to carry out audits. Requirements to be an auditor include:</p> <ul style="list-style-type: none"> • A corresponding university degree • Approval of an exam administered by the ICAC |

- Practical training of three years
- 120 hours of continuous education, in programs approved by the ICAC (including at least 30 hours a year on auditing)

There are currently 19,657 individual auditors and 1,369 audit firms authorized to carry audits in Spain. Out of such number roughly 214 auditors and audit firms perform audits for PIE firms, which include issuers listed in an RM, financial institutions (credit institutions, ISPs, insurance companies), CIS with a minimum of 150 units or shareholders, pension funds (with a minimum of 500 unit holders) and companies above a certain size. The big four firms audit roughly 90 percent of listed issuers (47 percent of IBEX, that is 35 or 50 percent of blue chips are audited by Deloitte).

Quality control

The LAC establishes a system of quality control for all auditors, not only PIEs firms. Prior to 2010 such system of quality control was carried out by examinations conducted by the professional bodies (three in Spain) under the oversight of the ICAC. In 2010 the system was changed to a model where the ICAC is directly in charge of conducting the examinations of auditors that audit PIE firms, while it relies on external reviewers (from the professional bodies) for the examinations of non PIE firms. PIEs include among others issuers admitted to listing in a RM, and financial institutions (investment firms, credit institutions, CIS and insurance companies). A quality control review involves a “field” review which entails review of the internal controls and procedures of the audit firm, and a “file review” which entails the review of particular engagements to determine whether procedures were followed for such engagement.

A program of investigations complements the quality control system, whereby the ICAC conducts ad-hoc investigations on auditors or audit firms, as a result of a “complaint or “referral” by a financial regulator (the ICAC refers to these investigations as “technical” control). In ICAC’s experience more than half of the investigations start out based on information obtained from whistleblowers. Referrals by the financial regulators (mainly the CNMV, but also the DGSP and the BDE) are the second most important source for these investigations.

The Technical Directorate of ICAC is in charge of both the quality control examinations and the technical investigations. To this end, it prepares an annual plan, which is submitted for consultation to the Consultative Committee on Auditing, and is finally approved by the President of ICAC. The Directorate is composed of 19 staff, including 12 inspectors. ICAC foresees adding 30 additional inspectors to carry out its new responsibilities vis-à-vis PIE firms. A three-year recruitment plan has already been approved and the process to hire 10 people is underway. The ability of ICAC to hire such personnel, however, is dependent on an increase of the fees through the annual budget.

Under the current legal and regulatory framework PIE firms must be subject to quality control reviews on a three year cycle, and non PIE firms on a six year cycle. However the objective of ICAC is to conduct reviews of the big four firms every year. Over time its goal is to add a risk-based component to the rotation system.

In 2011, ICAC finalized the review of two of the big four firms, which included a field review and the file review of one important engagement, and 30 reviews on other PIE firms.

In addition, in connection with all auditors (not only PIE firms) ICAC conducted 82 investigations related to audit works and 53 investigations related to auditors’

| | |
|----------------------|--|
| | <p>independence.</p> <p>Enforcement</p> <p>Pursuant to Article 30 of the LAC, the ICAC has the power to impose sanctions on auditors. Sanctions are divided into minor, medium and serious. All infractions can carry money penalties. In addition medium and serious infractions can carry suspensions.</p> <p>Sanctions can be imposed as a result of deficiencies found during a review process, but also as a result of the investigations carried out by ICAC.</p> <p>During 2011 ICAC imposed 42 money penalties to auditors and audit firms, out of which six were PIE firms. It has also imposed money penalties in previous year, including penalties assessed on each of the big four firms. Such penalties have been imposed in connection with investigations.</p> <p>Mechanisms of collaboration CNMV-ICAC</p> <p>There are mechanisms to foster collaboration between ICAC and the CNMV, starting with the participation of the CNMV in the Accounting Board as well as the consultative committees. As indicated before, the CNMV has also been a source of referrals of potential cases of breaches of obligations by auditors of PIE firms. Both ICAC and the CNMV confirmed that the CNMV has been active in referring cases to ICAC.</p> |
| Assessment | Broadly Implemented |
| Comments | As explained in the description, ICAC is in the process of implementing a new approach for the quality control review of PIE firms. The discussions held with ICAC as well as market participants lead the assessors to conclude that such new approach should strengthen the quality control review of audit firms that provide audit services to listed issuers—however enhancing resources of ICAC will be key to achieving such objective. The grading reflects the fact that these arrangements are still at an early stage of implementation. |
| Principle 20. | Auditors should be independent of the issuing entity that they audit. |
| Description | <p>Framework for independence</p> <p>The LAC establishes principles aimed to ensure auditors' independence, as well as specific prohibitions (incompatibilities). Article 12 of the LAC establishes as general principles that an auditor must:</p> <ul style="list-style-type: none"> • Be independent • Not take part in the decision- making process • Adopt measures to identify threats (self-review, advocacy, self interest, family or trust or intimidation) that may compromise its independence • Apply safeguards to mitigate, or if required, to eliminate any threat to independence <p>Where appropriate abstain from performing the audit</p> <p>Article 13 contains specific prohibitions for an audit firm to take an engagement, in cases where:</p> <ul style="list-style-type: none"> • The lead partner has had a position as director or management • A financial interest, direct or indirect in the audited firm, when such interest is material • Marriage or blood relationship with the management team of the audited company • Services of (i) Preparation of the financial statements or other accounting documents for the audited company, (ii) valuation, (iii) internal audit; and (iv) legal advice, |

| | |
|--|---|
| | <p>development and implementation of IT related to financial information</p> <ul style="list-style-type: none"> • Performance of non audit services when they constitute a significant proportion of the remuneration of the audit firm for the last three years <p>The duty of independence is strengthened in two ways:</p> <p>Time period: auditors' independence is not only compromised when the causes of incompatibility occur during the period of the engagement, but also when they are present from the beginning of the first year prior to the period to be audited</p> <ul style="list-style-type: none"> • By "subject": auditors' independence is compromised when the causes of incompatibility occur in (i) entities linked to the audited firm, as long as the incompatibility exists during the period to be audited (Article 15) or when (ii) the causes of incompatibility are present in close relatives of the lead auditor, in persons directly related to the auditor or audit firm (network) or entities that belong to the auditors' network (for non audit work) (Articles 16–18) <p>Article 19 establishes a requirement of rotation of the lead engagement partner for PIE firms, after seven years, and two years must pass before the partner can audit the same audited company again.</p> <p>Mechanisms to ensure compliance</p> <p><i>Auditors' internal controls</i></p> <p>As indicated above auditors are required to establish mechanisms designed to identify potential threats to independence. In addition, the ICAC highlighted that audit firms will be required to implement NIIC-1 by 2012. Conversations with market participants indicate that the big four firms have already implemented quality control mechanisms in line with NIIC-1.</p> <p><i>Issuers' Oversight</i> With the reforms to the LAC introduced in 2010 the responsibilities of the audit committees of issuers admitted to trading in a RM vis-à-vis both internal controls for financial reporting and monitoring of selection and independence of auditors' have been strengthened. Concerning the latter, Article 26 requires audit firms to prepare and publish on their websites a "transparency" report, which should include the following information: description of quality control systems; summary of PIE firms to which the firm provided services; information on procedures to ensure independence and internal reviews carried out to ensure that such obligation has been met; information on continuous training policy; information on total remuneration with a breakdown of audit and non audit services; information on remuneration of partners. In turn the audit committee of the issuer must submit a report/opinion to the board in connection with such transparency report. In addition, the governance of such committees was also strengthened by requiring at least one independent member expert in accounting and/or auditing.</p> <p><i>ICAC</i></p> <p>The quality control review programs, along with the investigations carried out by ICAC are a critical component of the system to ensure auditor's independence. As indicated above, for example during 2011 ICAC carried out 53 investigations in connection with independence (including both PIE and non PIE). Article 21 requires auditors to inform the ICAC on an annual basis as to the remuneration received from each audited company, with a breakdown of audit and non audit services.</p> |
|--|---|

| | |
|----------------------|--|
| Assessment | Fully Implemented |
| Comments | The competent Spanish authorities should consider extending the requirements for the audit committees to issuers admitted to trading in MAB. |
| Principle 21. | Audit standards should be of a high and internationally acceptable quality. |
| Description | <p>Quality of the standards</p> <p>Pursuant to Article 6 of the LAC, auditors must conduct audits in accordance with the Spanish auditing standards.</p> <p>Such Standards are developed by the three professional bodies. Any proposal must be subject to a public consultation process, as well as to consultation with the Consultative Committee on Auditing. Through the consultative committees the financial regulators are able to provide feedback on such reforms. Conversations with ICAC and the CNMV lead the assessors to conclude that the process is fluid. The standards must be approved (“homologated”) by the President of ICAC via resolution, and then they must be published in the Official Bulletin of ICAC.</p> <p>According to experts there are no major differences between Spanish Standards and the ISA, as the professional bodies in coordination with ICAC took the opportunity during transposition of the EU Directive on Audit to review the standards and adapt them to ISA.</p> <p>Mechanisms in place to ensure compliance</p> <p>Internal controls by auditors and ICAC’s reviews are the main mechanisms to ensure compliance by auditors’ with auditing standards. Referrals of the CNVM are a complementary mechanism.</p> <p>See Principle 19 for full discussion on the oversight regime.</p> <p>In addition ICAC issues guidance in connection with the auditing standards, which also enhances compliance by auditors.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 22. | CRAs should be subject to adequate levels of oversight. The regulatory system should ensure that CRAs whose ratings are used for regulatory purposes are subject to registration and ongoing supervision. |
| Description | <p>Background</p> <p>Since 7 September 2010, CRAs in Europe are required to comply with the Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies (CRA 1) as amended by Regulation (EU) No 513/2011 (CRA2), in their consolidated version, “the EU CRA Regulation”, that entered into force on June 1, 2011.</p> <p>The EU CRA Regulation, which is of direct application, covers the IOSCO Principles set out below as well as additional requirements. There is no direct reference to IOSCO CoC in the EU CRA Regulation, but it does incorporate the underlying principles of the CoC as well as going beyond by specific requirements.</p> <p>As of July 1, 2011 the ESMA has taken over responsibility for direct supervision of all registered CRAs issuing credit ratings in Europe. ESMA is also the sole directly competent regulator to receive and assess any new CRA’s application for registration in the Union. The largest 3 global CRAs, Standard & Poor’s, Moody’s Investor Service and Fitch Ratings, as well as DBRS, have been registered in the EU and as such, are under ESMA’s ongoing supervision since October 31, 2011.</p> |

Use of ratings for regulatory purposes

As per the EU CRA Regulation (of direct application) ratings that are used for regulatory purposes may only be used if issued by CRAs established in the Union and registered in accordance with this Regulation. In Spain ratings are used for regulatory purposes in connection with the capital framework as well as the framework for CIS and pension funds (the latter two in connection with eligible assets).

The Regulation provides room for the use of ratings from CRAs that are not located in the EU, in two forms: (i) by a process of endorsement, whereby a CRA registered in the EU can under certain conditions endorse the ratings of a “sister” CRA located in a third country; and (ii) by a process of certification of the CRA from a third country, provided that the CRA is subject to registration and oversight in its home country that is equivalent to that of the EU, there are cooperation arrangements in place and the CRA is not *systemic for the EU market*.

Registration requirements

The EU regulation provides ESMA with the authority to obtain all information it deems necessary from a CRA seeking registration in order to determine whether the requirements for registration have been fulfilled. As part of any application for registration, the applicant is expected to provide detailed information and evidence as to how it demonstrates compliance with the applicable requirements of the EU CRA Regulation. The content and format is provided for in the annexes of EU CRA Regulation. CESR published Guidance in connection with the registration process, which distinguishes seven areas of requirements: (i) General Organization and Governance; (ii) Internal Controls; (iii) Business Activities and Resources; (iv) Conflicts of Interest; (v) Rating Process and Methodology; (vi) Disclosures; and (vii) Endorsement. All documents related to these seven areas have to be provided in the form of policies and procedures.

Quality and integrity of ratings

The EU Regulation requires that CRAs put in place written procedures and methodologies providing for a fair and thorough analysis of all information relevant to credit analysis. In particular, CRAs are required to use rating methodologies that are “rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing.” CRAs are also required to put in place procedures for permanent monitoring as well as regular updates of credit ratings as new information becomes available.

The EU Regulation also requires that a CRA establish a review function responsible for periodically reviewing its methodologies, models and key rating assumptions, such as mathematical or correlation assumptions, and any significant changes or modifications thereto as well as the appropriateness of those methodologies, models and key rating assumptions where they are used or intended to be used for the assessment of new financial instruments.

Record keeping

The EU CRA Regulation introduces several requirements concerning internal record keeping. There is a general requirement to maintain internal records of credit rating activities and to retain them for six years or the duration of the rated instrument.

Sufficiency of resources

The EU CRA Regulation introduces a requirement for CRAs to have sufficient resources in order to carry out high-quality credit assessment. Annex 2 of the Regulation describes

the information to be provided in the application for registration. The list of covered areas includes “financial resources to perform credit rating activities,” “staffing of credit rating agency and its expertise” as well as “documents and detailed information related to the expected outsourcing arrangements including information on entities assuming outsourcing functions.”

Addressing conflicts of interests

EU Regulation requires CRAs to take all necessary steps to ensure that the issuing of a credit rating is not affected by any existing or potential conflict of interest or business relationship involving the CRA issuing the credit rating, its managers, rating analysts, employees, any other natural person whose services are placed at the disposal or under the control of the CRA, or any person directly or indirectly linked to it by control. To ensure compliance with such principle CRA must comply with the requirements set out in Sections A and B of Annex I.

Organizational requirements (Annex I Section A)

CRAs must have an administrative or supervisory board. Its senior management must ensure that conflicts of interest are properly identified, managed and disclosed. In addition to their overall responsibilities as members of the board, independent members of the administrative or supervisory board have the specific task of monitoring the effectiveness of measures and procedures instituted to ensure that any conflicts of interest are identified, eliminated or managed and disclosed. The compliance officer must ensure that any conflicts of interest relating to the persons placed at the disposal of the compliance function are properly identified and eliminated. The compliance officer must report regularly on the carrying out of his or her duties to senior management and the independent members of the administrative or supervisory board.

Operational requirements (Annex I Section B)

CRAs are subject to a general obligation to identify, eliminate or manage and disclose, clearly and prominently, any actual or potential conflicts of interest that may influence the analyses and judgments of its rating analysts, employees, or any other natural person whose services are placed at the disposal or under the control of the CRA and who are directly involved in issuing a credit rating or approving a credit rating. More specific obligations include:

Prohibitions

The EU regulation prohibits CRAs (i) from issuing ratings when the CRA directly or indirectly owns financial instruments of the rated entity or related parties or has any direct or indirect ownership interest; or a control relationship or certain other specific types of relationships that may cause conflicts of interest, as well as (ii) from providing consultancy or advisory services to the rated entity or a related third party regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or related third party. A CRA may provide ancillary services.

Specific rules concerning analysts

Certain rules on analysts, include the prohibition to participate in fee negotiations, prohibition on trading securities, analysts rotations, or non “business contingent” remuneration. In relation to Article 7, Annex 1 Section C introduces several rules for rating analysts and other persons directly involved in credit rating activities (including securities and derivatives trading by such analysts and persons and their compensation arrangements). These rules address among others:

Specific disclosures

- Disclosure of rated entities and related parties from which a CRA receives more than five percent of annual revenue
- Disclosure of (i) the largest 20 clients of the CRA by revenue generated from them; (ii) a list of those clients of the CRA whose contribution to the growth rate in the generation of revenue in the previous financial year exceeded the growth rate in the total revenues of the CRA in that year by a factor of more than 1.5 times. Any such client shall be included on the list only where, in that year, it accounted for more than 0,25 percent of the worldwide total revenues of the CRA at global level, and (iii) list of all ratings including the proportion of unsolicited ratings.

Transparency and timeliness

The EU CRA Regulation introduces a general requirement to ensure timeliness on the release and distribution of credit ratings (where newly issued or for subsequent changes). A CRA shall disclose any credit rating, as well as any decision to discontinue a credit rating, on a non-selective basis and in a timely manner. In the event of a decision to discontinue a credit rating, the information disclosed shall include full reasons for the decision.

Information on ratings

The EU CRA Regulation introduces several requirements related to the publication of CRAs' procedures, methodologies, models and key rating assumptions. When methodologies, models or key rating assumptions used in credit rating activities are changed, the CRA must immediately disclose the likely scope of credit ratings to be affected.

When announcing a credit rating, a CRA shall explain in its press releases or reports the key elements underlying the credit rating.

Historical defaults

The EU CRA Regulation introduces several requirements related to the publication of information about historical default rates of the CRAs credit rating. These requirements comprise a general obligation to disclose information on its historical performance to a central repository for CRAs (CEREP) managed by ESMA and an obligation of periodic disclosure (every six months) data about the historical default rates of its rating categories, distinguishing between the main geographical areas of the issuers and whether the default rates of these categories have changed over time.

Confidentiality

The EU CRA Regulation contains requirements designed to ensure CRAs protect non-public information.. There is a general obligation not to use or share confidential information for any other purpose except the conduct of credit rating activities, and as a result the obligation to take measures to achieve such objective.

Enforcement powers

The EU CRA Regulation provides ESMA with a set of enforcement powers in cases where a regulated CRA fails to meet registration requirements after its initial registration including (i) the imposition of a fine as well a periodic penalty payment, in order to compel CRAs to be cooperative; and (ii) for certain violations it can (a) withdraw the registration; (b) temporarily prohibit the CRA from issuing credit ratings with effect throughout the Union; (c) suspend the use, for regulatory purposes, of the credit ratings; (d) require the

| | |
|------------|--|
| | <p>CRA to bring the infringement to an end; (e) and issue public notices.</p> <p>Registration process and ongoing supervision</p> <p>As of January 2011, there were 16 CRAs registered groups involving 28 legal entities and one certified entity, all of them registered under the transitional provisions that granted the local authorities jurisdiction over the registration process. Colleges of supervisors were set out to review the application of the global CRAs. The CNMV participated in the colleges as the global CRAs have a presence in Spain (Moody's and Fitch through subsidiaries and Standard and Poor's as a branch from the U.K. registered entity).</p> <p>The registration process was divided in two stages. In the first one, the college reviewed that documents were complete, while in the second the colleges reviewed that requirements were met from a substantive point of view.</p> <p>The process was long (roughly one year). At the end of their review colleges shared their findings and views, which helped to achieve a consistent application of registration requirements. In practice such review led to changes in organizational structure for some CRAs. Examples were given of cases where the CRA had to make legal changes to isolate the rating activity into one legal entity, or to incorporate independent members on the board. In addition, changes to procedures were requested (roughly 50 percent of procedures were redrafted).</p> <p><i>Supervision</i></p> <p>As indicated in the introduction supervision is now under ESMA. ESMA created a specialized unit, which is currently composed of 12 staff, but the program approved would allow it to increase to up to 20 staff. The Division will have the policy, supervision and risk identification functions.</p> <p>The Unit is in the process of solidifying its supervisory approach. The inspections program will be fed by risk signals, including the findings (i) from previous inspections, (ii) complaints, and (iii) signals/concerns submitted by local authorities.</p> <p>In connection with smaller/local CRAs, ESMA foresees the possibility to delegate specific tasks in connection with the on-site inspection to the local authorities (for example review of documents).</p> <p>Since October 2011 the ESMA unit has already conducted on- site inspections on the three global firms to get a better understanding of the rating process, as well as to identify potential issues that require further attention (risk signals). Three ratings from each of the following categories (sovereign, banking and covered bonds) were selected for review. The inspections lasted roughly four weeks and employed a team of two-three persons. Individual reports were sent to each CRA and a report on general findings was released to the public in March of this year. ESMA has not determine yet whether any of the findings constitute also a breach of the laws that requires further enforcement action.</p> |
| Assessment | Broadly implemented |
| Comments | <p>Conversations with market participants lead the assessors to conclude that the registration process by the colleges was thorough and there was an effort to achieve a consistent implementation of the requirements across the different CRAs. The supervisory approach is at an early stage, but it appears to be shaping up well. In this regard, the assessors note that an initial inspection on the three global CRAs has taken place and a general report on findings from such inspections was recently released. Effective allocation of the resources approved will be key to ensure robust supervision of CRAs.</p> |

| | |
|----------------------|--|
| Principle 23. | Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them. |
| Description | <p>Sell side analysts</p> <p>Providing analysis or research is an auxiliary activity that can be carried on by ISPs. A separate authorization is not needed, but in the program of activities that the entity must submit as part of the authorization, it must indicate if it intends to provide it. The current legal framework also allows the existence of “independent” analysts but the CNMV indicated that in practice research and analysis is carried out by the big financial groups.</p> <p>Framework</p> <p>Pursuant to Article 70 of the LMV ISPs must establish appropriate administrative and organizational measures to prevent possible conflicts of interest which may be detrimental to clients.</p> <p>In addition, Article 83 of the LMV requires that all entities or groups of entities providing investment services and other entities acting or providing investment advice services in the securities markets carry out proprietary trading, portfolio management and analysis in separate units, in order to prevent the flow of proprietary information. Such provision is complemented by Article 47 of Royal Decree 217/2008 which requires organizational measures and a written policy on conflicts of interest from entities which prepare and disseminate investment reports.</p> <p>Article 83 of the LMV requires all entities and groups of entities which carry out, publish or disseminate reports or recommendations on companies issuing securities or listed financial instruments to behave in a loyal and impartial manner, making a clear mention in their reports, publications or recommendations of any relevant relationship, including commercial relationships, and of any stable shareholding that the entity or group holds or plans to hold in the company subject to analysis, as well as the fact that the document does not constitute an offer of sale or subscription of securities.</p> <p>Finally pursuant to Article 12.1 of the Royal Decree 1333/2005 any person making a recommendation is required to disclose all circumstances which may reasonably endanger the objectivity of the recommendation, in particular, all relevant financial interests in one or more financial instruments which are subject to the recommendation, or the relevant conflicts of interest with the issuer to which said recommendation refers. In the case of legal persons, such obligation extends to any legal or natural person working for it, by way of a contract of employment or any other way, who is responsible for making the recommendation.</p> <p>Pursuant to Articles 12 and 13 of the Royal Decree when the relevant person is a legal person, the information to be disclosed must include, at least, the following items:</p> <ul style="list-style-type: none"> • Interests or conflicts of interest of the legal person, or related legal persons, to which the person in charge of making the recommendation should have access (knowledge) or should reasonably be expected to have access. • Interests or conflicts of interest of the legal person or related legal persons, which are known by the persons who, albeit not having taken part in the preparation of the recommendation, should have or could reasonably be expected to have access to the recommendation prior to its disclosure to the clients or the public. • If the research has been contracted to another natural or legal person, information on (i) whether the remuneration for such persons is related to investment banking |

operations carried out by the investment services company or credit institution or any related legal person, and (ii) whether such natural persons would receive or acquire shares from the issuers prior to the public offering thereof, and the price and date of purchase of the shares.”

Pursuant to Articles 45.3 and 47.1 of Royal Decree 217/2008 when research is disseminated to clients, disclosure of conflicts of interest must be provided in a durable medium, with the obligation to include sufficient data, according to the nature of the client, to enable the latter to take an informed decision in regard to the investment or other services affected by the conflict of interest.

Pursuant to Article 47.2 a) of Royal Decree 217/2008 when a research report is released analysts and the ISPs involved are not allowed to trade either for their own account or for any other person regarding the securities evaluated.

Ongoing supervision

The CNMV has not conducted thematic reviews on this area. However compliance with these obligations is monitored in two ways:

- Through the Market Department: in the case of important public offerings, the staff looks at research as part of the information to review in connection with the offering
- Through on-site inspections of ISPs and credit institutions: in such inspections staff reviews the procedures in place to address conflict of interest, in particular that appropriate information barriers are in place, as well as that trading restrictions are observed.

Other types of information providers

In Spain the valuation of real state can only be done by valuation companies (sociedades tasadoras) subject to the regulation and supervision of BdE. In 2008 the CNMV issued recommendations for real estate companies admitted to trading in an RM and real estate valuation experts in connection with the valuation reports.

Recommendations for the valuation companies

Companies must implement

- Internal procedures to ensure the independence of the company vis-à-vis the personnel in charge of the valuation of the real state and to detect any possible conflict of interest. In particular it recommended the issuance of an internal CoC, information barriers between the valuation department and other departments of the company; mechanisms to mitigate concentration of income in the same client or group of clients and a compliance officer.
- Mechanisms to identify, prior to accepting an engagement, whether the company has the means and expertise to carry out the services.
- Mechanisms to review the quality of valuations.
- Establish clear policies in regard to liability.
- Establish mechanisms to ensure that remuneration of the valuation expert is independent from the value of the real state.
- Minimum expertise for valuation experts.
- Application of international standards for valuation.
- Carry out follow-up of report made for internal use.

| | |
|---|--|
| | <p><i>Recommendations for the companies admitted to trading</i></p> <p>Companies must implement:</p> <ul style="list-style-type: none"> • Internal mechanisms for the selection of valuation experts that require to check (i) independence, (ii) absence of conflict of interest; (iii) reasonability of the methodology and assumptions. • Verification that the report has been done in accordance with the international standards. • Internal review of valuations. • Avoid excessive concentration in valuation services from one company. • Provide appropriate disclosure, in particular NIC 40 in relation to real estate investments. • More involvement of audit committees in the selection of real state valuation experts and in the identification of potential sources of conflict of interest. |
| Assessment | Fully Implemented |
| Comments | Under the current framework the remuneration of analysts can be linked to investment services operations; although in such case appropriate disclosure should be made. The CNMV believes that although these remuneration arrangements are permitted, in practice they have not presented a major problem. The CNMV might wish to take this topic for a thematic review to verify the extent of the practice and any problems associated with it. |
| Principles for Collective Investment Schemes | |
| Principle 24. | The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme. |
| Description | <p>Background</p> <p>The main legislation governing collective investment schemes (CIS) is:</p> <ul style="list-style-type: none"> • Law 35/2003, of November 4, on CIS Act, as amended by Act 31/2011; and • the Regulation implementing the Act, which was approved by Royal Decree 1309/2005 (the CIS Regulation). <p>CIS can take the form of an investment fund (<i>fondo de inversión</i>) or an investment company (<i>sociedad de inversión</i>). (See further under Principle 25.). In practice, most investment companies delegate the management function to an authorized fund management company.</p> <p>Regulatory framework— authorization</p> <p>Authorization is required for both the marketing and operation of a CIS. Formal authorization is made by the Minister of Economics and Finance on a proposal by the CNMV (Article 41.1 of the CIS Act).</p> <p><i>Marketing a CIS</i></p> <p>Article 40.3 permits CIS to be marketed by CIS operators (either directly or through agents). Marketing can also be undertaken by firms authorized to provide investment services, which in this context means investment firms and credit institutions (Article 63 of the LMV).</p> <p><i>Operating a CIS</i></p> <p>Article 40.6 of the CIS Act requires that only CIS operators can establish and manage a CIS. Investment companies that directly perform management and other functions are subject to the same requirements as a CIS operator.</p> |

CIS operators—whether managing an investment fund or an investment company—must be authorized under Title IV of the CIS Act.

Eligibility criteria

Title IV of the CIS Act sets out the regime for authorization of CIS operators.

Fit and proper test

Article 41.2 requires that, to obtain authorization, a CIS operator must provide evidence of the integrity and professional competence of its directors and managers. To do so they complete a CNMV questionnaire. Information about significant shareholders must also be provided (defined as those who hold, directly or indirectly, more than 10 percent of the shares or (even if they do not hold this level of shares) exercise a significant influence on the management company, Article 45).

Financial capacity

To be authorized, a CIS operator must have the minimum required share capital and after authorization must maintain additional equity capital commensurate with the value of the assets under management. (Article 43.1.e of the CIS Act and 70 of the CIS Regulation).

Article 70 of the CIS Regulation establishes the minimum share capital as € 300,000, and provides for additional capital related to assets under management:

- a. 0.5 percent the cash value of the CIS assets under management up to € 60;
- b. 0.33 percent of the amount in excess of € 60 million up to € 600;
- c. 0.2 percent of the amount in excess of € 600 million up to € 3 billion;
- d. 0.1 percent of the amount in excess of € 3 billion up to € 6 billion; and
- e. 0.05 percent of the amount in excess of € 6 billion.

Internal management structure and procedures

The documentation required to support an application for authorization must include a report describing in detail the company's organizational structure, a list of the activities to be performed, and a list of the technical and human resources at its disposal (Article 41.2 of the CIS Act).

Documentation in support of an application must also demonstrate how the applicant will comply with requirements for:

- a. internal control and risk management. Article 43.1.j of the CIS Act sets out requirements for internal controls. Article 75 of the CIS Regulation and CNMV Circular 6/2009 (internal control of CIS operator) add detailed requirements, including requiring the CIS operator's board of directors to identify the main risks and implementing necessary internal control systems to mitigate them. CNMV Circular 6/2009 also requires CIS operators to have a dedicated risk management unit that functions independently and ensures proper management of all risks, including by ensuring compliance with the risk limits approved by the CIS operator's board or investment committee.
- b. compliance function: Rule 3 of Circular 6/2009 requires a CIS operator have a compliance unit that operates independently. Rule 5 of the Circular details the roles to be performed by this unit. In general, this unit must establish, implement and maintain appropriate procedures to detect and correct any breach of the CIS operator's obligations.

Depositories

All CISs must have a depository (custodian) that must be authorized under Title V of the CIS Act. The depository of a CIS holds assets and oversees compliance by the CIS operator with investment objectives (Articles 57 and 60). Credit institutions, dealers and broker dealers may be depositories provided that they are members of the clearing, settlement and record-keeping systems in the markets where they operate, either directly or through another market member. In the latter case, the member must use separate accounts for each CIS. Article 5.2 of Order EHA/596/2008 provides that a depository may provide custody services either directly or through a market member. The depository must establish oversight mechanisms to ensure that assets are disposed only with its authorization.

Record keeping requirements

The CIS operator is responsible for keeping and maintaining records and documents relating to the shares, and in general to all transactions in the securities market (Article 40.11 of the CIS Act).

Specifically, Article 73 of the CIS Regulation and Rule 3.4.d of CNMV Circular (internal control of CIS operators) require operators to have internal control policies and procedures to ensure that each transaction can be fully reconstructed.

Rule 3.4.a of Circular 6/2009 states that the CIS operator must adopt administrative and accounting procedures and policies that are appropriate to ensure the proper registration of applications for subscription and redemption of units, and keep a record of unit-holders or shareholders.

Rule 10 of Circular 6/2009 obliges CIS operator to have internal manuals detailing internal control policies and procedures as set out in the regulations.

Conflicts of interest

The general obligation of CIS operators to act in the interest of holders of interests is set out in Article 46 of the CIS Act. This is supplemented by other provisions dealing with specific areas of potential conflict:

Related party transactions

Article 67 of the CIS Act and Article 99 of the CIS Regulation set out the rules governing related-party transactions. A related-party transaction is defined as any business, transaction, or provision of services involving a CIS and any company in the business group of the CIS operator, of the depository or any member of its board of directors, or other CIS managed by the same CIS operator. Overall the Act imposes obligations to have an internal procedure to ensure that related-party transactions are performed solely in the interests of the CIS and at prices or on terms that are equal to or better than those available in the market. Compliance with these requirements must be confirmed by a unit that is independent of line management. "Material" transactions are subject to a pre-approval process by this unit, while the remaining are subject to ex-post review. The CNMV places particular attention to reviewing the independence of this unit, in particular that it is not involved in the operational side of the business.

The documentation required by the CNMV at the authorization stage includes the procedure for oversight of related-party transactions.

Related-party transactions are subject to special rules of disclosure in the prospectus and periodic reports sent to unit-holders.

Related depositaries

Depositaries can be related party entities of the CIS operator. Where the depositary of a CIS belongs to the same group as the operator (or investment company), the CIS operator (or investment company) must have a specific internal procedure to prevent conflicts of interest, called rules of separation between operator and depositary (Article 68). Additional safeguards are in place as described in Principle 25.

Conduct of business rules

Article 98 of the CIS Regulation provides that CIS operators, depositors and marketers must have written and binding internal rules of conduct to regulate the performance of their boards of directors, employees and representatives. These internal rules of conduct must reflect the principles set out in the conduct rules that apply to investment services firms under the LMV and related regulations.

Specifically, CIS operators must establish internal control procedures that can demonstrate that investment decisions for a specific CIS or client were adopted prior to the transmission of the order to the executing broker. There must be pre-established criteria and objectives for the distribution or allocation of transactions affecting multiple CIS clients, to ensure fairness and non-discrimination between them.

Best execution

CIS must enter into transactions at market prices and conditions, except where transactions are performed under conditions that are more favorable for the CIS (Article 66 of the CIS Act).

Rule 3.4.e of CNMV Circular 6/2009 requires a CIS operator to have policies and procedures for selecting the financial intermediaries involved in the transactions entered into on behalf of the CIS, taking into account price, costs, speed and likelihood of execution and settlement, volume, nature of the transaction and any other factor that is relevant for their execution. These arrangements must be regularly reviewed by the risk management unit (Rule 4.b.viii) of CNMV Circular 6/2009).

Churning

The general obligation that a CIS operator act in the interests of the investors in the CIS (Article 46.2 of the CIS Act), and the related party controls described above are designed, among other things to prevent churning.

In its supervisory work, the CNMV analyses the purchase and sale of assets in the portfolios of the CIS to detect churning. Also, if the CIS is to trade actively, this must be stated expressly in the CIS prospectus. The semi-annual report that must be delivered to investors prior to subscription, together with the prospectus, includes an index of rotation of the fund's portfolio in the preceding six-month period.

Underwriting

The related party transaction rules in Article 67 of the CIS Act refer specifically to securities or instruments issued by or guaranteed by a related party of the CIS operator.

Investment due diligence

Rule 4.1. of CNMV Circular 6/2009 requires that the risk control unit perform appropriate pre- and post-investment checks to verify that investments conform to a fund's investment policy, and to assess their risks and their contribution to the overall risk profile of the CIS.

Fees and expenses

Article 17 of the CIS Act and Article 22 of the CIS Regulation regulate the information that must be disclosed in the CIS prospectus. The required information includes disclosures of all the institution's costs and expenses.

Article 5 of the CIS Regulation prescribes maximum fee percentages for management, depository, and subscription and redemption fees payable by the fund. Any other expenses to be paid from fund assets must be for services actually rendered to the fund that are essential for the proper conduct of its business. (Article 5.11 of the CIS Regulation).

This Article 5 also provides that, if the operator is permitted to agree to rebate fees to investors, this must be stated in the fund prospectus together with the criteria governing such repayments.

Soft commissions are permitted provided that they are disclosed in the prospectus and requirements relating to payment for the services of investment analysts (Article 5.12 of the CIS Regulation) are met.

Fees are payable for research services by intermediaries only if the services contribute to enhancing investment decisions and there are mechanisms in place to prevent, detect and correct any conflicts of interest in the selection of the broker (Rule 3.4.e) of CNMV Circular 6/2009).

A CIS operator's compliance with its obligations in relation to fees and commissions by a CIS operator is one of the functions of the compliance unit required by Rule 5 of CNMV Circular 6/2009.

Delegation

Article 68 of the CIS Regulation regulates the delegation of functions by a CIS operator. Its provisions include:

- a. the CIS operator retains full liability for compliance with the obligations imposed on it by law as a CIS operator;
- b. delegation must not result in the operator becoming a mere shell;
- c. entities to which CIS operators delegate functions must be subject to the same related-party transaction rules as the CIS operators themselves;
- d. when delegating, CIS operators must take measures to ensure that they can terminate the delegation contract when necessary, without detriment to continuity and quality of service;
- e. the CIS prospectus must specifically disclose the existence of the delegations and their scope;
- f. CIS operators must notify the CNMV of any delegation of the internal audit, compliance and risk management functions before it comes into force. The delegation of asset management is subject to authorization by the CNMV; and
- g. delegation contracts must include a commitment by the delegate to facilitate and enable any monitoring that the CNMV considers necessary to perform in the delegate's offices. Additionally, the CIS Operator must make available to the CNMV, upon request, any information required to monitor compliance with applicable requirements of the delegated activities.

In addition:

- a. Rules 7 and 8 of CNMV Circular 6/2009 impose specific requirements regarding the delegation of the functions of regulatory compliance, risk management and internal audit.
- b. Rule 9 of CNMV Circular 6/2009 requires CIS operators to have the necessary human and technical resources and experience to effectively monitor the risks associated

with the delegation and to ensure the continuity and quality of the delegated functions. Oversight of the activities performed by the delegate must be performed by an independent committee created within the CIS operator's board of directors or by a general manager or similarly senior employee.

International cooperation

Article 15 of the CIS Act regulates the marketing in Spain of CIS authorized in other states. In the case of CIS subject to Directive 65/2009/EC (those that have an EU passport), a system is established for notification between the home and host supervisory authorities provided that both are Member States of the EU. Under Article 41 of the CIS Act, the authorization of a CIS operator that is a subsidiary of, or belongs to the same group as, or is under the control of the same people as another institution that is authorized in another Member State of the EU must first be cross-checked with the relevant supervisory authority.

Article 10 of the CIS Act establishes the possibility that a CIS authorized in Spain may be managed by a CIS operator authorized in another Member State of the EU.

Article 71(3) of the CIS Act establishes a regime for cross-border cooperation between competent authorities within the EU.

Article 68.7 of the CIS Regulation provides that, in the event that a CIS operator delegates the management of assets of one or more CIS to a foreign entity, there must be a bilateral cooperation agreement between the CNMV and the authority with equivalent functions in the State in which such entity has its legal base.

Finally, Article 58 of the CIS Act requires that CIS depositories have their legal base or, failing that, a branch in Spain.

Supervision and ongoing monitoring

Responsibility and powers of regulator

Article 41 of the CIS Act makes the Minister of Economy and Competitiveness responsible for authorizing CIS operators, based on a proposal by the CNMV. Article 10 of the CIS Act makes the CNMV the competent body for authorizing and registering individual CIS funds.

Article 70 of the CIS Act makes the CNMV responsible for inspecting CIS operators and overseeing compliance with their obligations. By Article 69, the supervision and inspection regime applies to CIS, Spanish CIS operators, CIS depositories, and person to whom these functions have been delegated, and generally to any other natural and legal persons that may be covered by the provisions of the Act and its regulations.

Articles 72–76 give the CNMV power to intervene in a CIS operator or temporarily replace its administrative or management bodies, by sending a reasoned report to the Minister of Economy and Competitiveness. This can only occur when a CIS or CIS operator is in an exceptionally serious situation that gravely endangers its solvency or affects the stability of the financial system or the public interest, and when the true status of the entities cannot be deduced from their accounts.

Article 92 of the CIS Act allocates responsibilities for investigating and taking disciplinary action as follows:

- a. the CNMV is responsible for commencing investigations and initiating disciplinary proceedings;
- b. the CNMV is responsible for imposing sanctions for serious and minor violations; and
- c. the Minister of Economy and Competitiveness is responsible for imposing sanctions for very serious violations, based on a proposal by the CNMV, except for the

| | |
|--|--|
| | <p>revocation of the licence, which can only be determined by the Cabinet.</p> <p>Articles 80–82 classify offences into the three categories defined in Articles 80–82.</p> <p><i>Authorization</i></p> <p>Applications for the authorization of a CIS operator are lodged electronically. Basically the entity must complete a manual developed by the CNMV—which is currently under review, and attached relevant documents.</p> <p>The review of requests for authorization of CIS operators is conducted by a unit, within the Entities Department, composed of 6 persons. The review of a number of selected files indicates that the analysis by the CNMV is thorough. Particular attention is given to the CVs of managers and board of directors to ensure that they have the necessary expertise. In one of the files reviewed (in connection with an ISP) the CNMV expressed serious concerns for the lack of expertise of key personnel, and this resulted in the withdrawal of the application. The CNMV also pays special attention to meeting capital requirements. Furthermore, at the moment of authorization the CIS operator is required to comply not only with the minimum capital but also with own resources in connection with the estimate of assets under management stipulated in its plan of operations. In practice, the CNMV encourages entities to triple the minimum capital required by law. In one of the files reviewed, the CNMV expressed concerns that the ISP that was requesting the authorization to constitute a CIS operator had losses in the two previous periods. Thus, it requested that the capital situation of such company was addressed before providing the authorization for the constitution of the CIS operator. The CNMV links its review of resources to the program of operations provided by the entity. Issues such as whether appropriate physical segregation of activities exists are reviewed by requiring the presentation of the drawings of the building where the entity will provide services. Certain aspects such as IT, internal controls and risk management are assessed in regard to the extent to which they seem reasonable and the entity must provide a sworn statement that it will implement all controls and procedures and obtain all resources stipulated in the plan of operations. No onsite visits are carried out in connection with the authorization, nor are “nursery” visits scheduled within a short time after the authorization has been granted. However the lack of an on-site inspection is one of the factors included in the risk scoring system explained below.</p> <p>Based on its analysis, the CNMV submits a proposal to the Minister of Economy and Competitiveness. Staff indicated that the Minister of Economy and Competitiveness has not deviated from the CNMV’s recommendations.</p> <p>It has been the practice that when the CNMV has serious objections, the affected party withdraws the application. As a result there are not many cases of formal rejections (the last one took place in 2008).</p> <p>Applications for new funds are also lodged electronically. CNMV staff examine the application, which includes supporting information including the fund constitution and the proposed prospectus. In reviewing the prospectus, particular attention is paid to the completeness and comprehensibility of the disclosure, and currently there is detailed focus on the key investor information (KII). The CNMV also reviews that the fund is correctly classified (vis-à-vis a typology of funds). Almost in all cases the Department requests clarifications and additional information. For “simple” funds the review process takes roughly a week.</p> <p>The formal decision to approve a new fund and its entry into the CNMV register is made by the CNMV President or Vice President.</p> <p><i>Ongoing monitoring</i></p> <p>Ongoing supervision of CIS activity is carried out by the CIS supervision department within the Directorate General of Entities. This department prepares an annual</p> |
|--|--|

supervision plan which is approved by the CNMV's Executive Committee.

Two layers of supervision are used, each under the responsibility of different teams:

Off-site supervision (distance supervision)

Section III of CNMV Circular 3/2008 (accounting standards, annual accounts and confidential information of CIS) contains forms for the confidential reports for each fund that must be filed with the CNMV. There are three types:

- a. Monthly: Portfolio of financial investments and cash (M04), Portfolio of derivatives (M05), Assets of each CIS/class of shares and daily net asset value (NAV) (MB2), and six other statements that offer additional information, among other aspects: fees paid by the CIS, volume of assets held by individual investors and by different types of qualified investors, and the investment diversification coefficients.
- b. Quarterly: a statement of asset allocation (T01) and a statement of changes in assets (T02).
- c. Annually: balance sheet (P01), income statement (P02) and a statement of allocation of income for the year (A01).

Two other CNMV Circulars establish confidential reporting requirements relating to CIS operators and depositories:

- a. CNMV Circular 7/2008 requires semi-annual reports to the CNMV comprising the balance sheet, income statement, proprietary investments of the CIS operator and information on individual CIS under management and other assets under management,
- b. CNMV Circular 3/2009 requires depositories to submit semi-annual reports to the CNMV for each CIS that has deposited assets with them. These statements refer to: valuation of assets (D01), reconciliation of securities and balances (D02), incidents in the NAV (D03), coefficients and legal limits (D04), and a report containing supplementary information (D05).

Off-site supervisors review the detailed material provided by CIS operators in monthly, quarterly and semi-annual reports. Content requirements for these reports are set out in CNMV Circular 4/2008. Monthly reports provide information on the position of each fund of all fund managers. They are received in an electronic format enabling analysis of data across fund managers and are used to monitor, for example, compliance with funds' investment policies and mandates, and to identify unusual patterns of trading within a fund. Quarterly and semi-annual reports provide more detailed information and are able to be analyzed in the same fashion. Additional IT tools developed by the CNMV allow it to for example, compare the NAV of different funds based on a given benchmark to detect deviations. This regular flow of readily analyzable information provides CNMV staff with the tools to monitor the investment activities of all funds and CIS operators on a continuous basis. If problems are found, then the CNMV send letters requesting explanations.

CNMV also routinely seeks information from firms about compliance issues. In 2011, 563 requests for information of this kind were sent to CIS operators.

In addition, semi-annual reports of the CIS operators financial position are reviewed and a report is produced for the CNMV's Executive Committee.

On-site inspections

Supervisors in the on-site team make extensive use of a computerized risk scoring system, to classify CIS operators as low, medium or high risk. Inputs used in building the risk profile are:

- a. corporate profile (for example, stand-alone independent firms will be treated as high

- risk because of concerns about the level of resources available for adequate compliance);
- b. business profile (including both quantitative factors such as market share; and qualitative factors such as other lines of business, such as portfolio management);
 - c. financial situation of the operator (solvency margin, losses etc);
 - d. errors or mistakes identified through the off-site supervision process; and
 - e. risks identified from previous on-site inspections (also taking into account the amount of time since the last inspections).

These factors have different weightings within the system, and higher weightings are given to the last two inputs. Using this methodology, around 15 percent of CIS operators are classified high risk.

In 2011, CNMV carried out 17 on-site inspections (15 inspections to CIS operators, of which 14 were general and one a follow up inspection, and 2 inspections to depositories). The CNMV aims to carry out on-site inspections of high risk firms on a 3–4 year cycle; and other firms over a 7 year period. The CNMV highlighted that due to the high level of concentration of the CIS industry (4 CIS concentrate approximately 50 percent of the activity) in a 3–4 year span it is able to inspect a high percentage of the market. For example over the last three years it conducted 13 inspections on CIS, which included 3 of the 4 largest CIS. These CIS accounted for 46 percent of the sector retail clients, 86 percent of assets under management and 45 percent of the safekept total assets.

Generally on-site inspections are full scope reviews and cover all aspects of a firm's compliance with their obligations. For this purpose the inspectors select and review a representative sample of funds under management by the CIS. For example in two cases reviewed the sample amounted to 45 percent of AUM, while in the other to 80 percent of AUM by the CIS operator. Inspections of large CIS take approximately 4 weeks and involve 2 inspectors, while inspections of smaller CIS operators take approximately two weeks and might be conducted by one inspector. CNMV staff informed assessors that the goal of the Directorate is to move to more "risk-based" inspections, whereby only selected aspects based on risk criteria would be subject to review.

Inspections reports are subject to review by the Deputy Director and the Director. Once approved the inspection report is sent to the board of the CIS operator. The board in turn is required to convene a meeting to discuss it and propose a plan of action to correct deficiencies identified by the CNMV. This plan is reviewed by the relevant staff which must prepare a proposal on (i) whether to accept the plan as is or request additional actions and (ii) whether an administrative proceeding is warranted. Such proposal must be reviewed by the Director and it is then submitted to the Executive Committee. Staff indicated that while not often, the Executive Committee has in some cases departed from the proposal of the Directorate. For example, in one of the cases reviewed the Executive Committee did not consider that the actions proposed were sufficient. If material deficiencies are found in the course of an inspection, such deficiencies are dealt with immediately, without waiting for the completion of the report. In such cases the Director sends a letter to the manager of the CIS operator requesting immediate action.

Thematic work

The CNMV also carries out some thematic work. This is usually done off-site by asking for and reviewing information and documents. In most thematic reviews, the CNMV reviews the whole of the sector. A focus for 2012 will be the related party transactions of CIS management companies.

Sanctions for non-compliance

The sanction regime for CIS is set out in Chapter IV of the CIS Act. Breaches of legislative requirements are classified as minor (*infracciones leves*); serious (*infracciones graves*) and very serious (*infracciones muy graves*). The conduct that gives rise to each of these categories is tightly defined in the legislation (Arts 80–82), with the level of

| | |
|----------------------|--|
| | <p>breach being defined by reference to obligations or prohibitions in specified provisions of the law. The process the CNMV uses to investigate misconduct and determine or (in the case of very serious breaches) recommend sanctions is described under Principle 11.</p> <p>CNMV's primary focus appears to be on ensuring that identified compliance deficiencies are remedied, with less emphasis on pursuing sanctions. In 2010, it sent 2,196 deficiency letters to CIS operators, 1,954 as the result of off-site supervision and 242 as a result of on-site inspections. In 2011, 1,698 deficiency letters were sent to CIS operators.</p> <p>In a few cases the CNMV has also entered into remedial agreements with CIS operators, which are disclosed to the public (see Principle 12).</p> <p>In the period 2008-2011, a total of 15 sanctions were imposed:</p> <ol style="list-style-type: none"> One for violation of the rules on trading in own shares by an open-end SICAV. Two for violations of the rules on CIS operator equity. Two for mortgaging assets comprising the CIS operator's equity. Nine for failure to present auditors' report and annual financial statements. One for violation of the rules on expenses that can be charged to a CIS. <p>The 17 on-site inspections carried out in 2011 resulted in 3 proposals for sanctions.</p> |
| Assessment | Broadly Implemented |
| Comments | <p>Assessment of this Principle is affected by the issues discussed in the comments under Principle 12.</p> <p>The assessors recognize that off-site monitoring and thematic reviews can play a larger role in connection with CIS operators, especially when the regulator receives so much granular information on the CIS as the CNMV does. They also acknowledge that through its-risk based approach the CNMV is covering high-risk operators under a shorter cycle; however believe that overall more use should be made of on-site inspections—including as part of the authorization process—as they are valuable for systematically reviewing the functioning of business practices, and organizational issues, including compliance systems and internal controls. Assessment of these requirements early on, is essential to validate reporting systems on which much of the off-site supervision relies. The addition in on-site inspections could be done for example through spot checks on specific areas of concern and does not imply that all on-site inspections need to be full scope inspections.</p> <p>Principle 24 also requires the regulator, where appropriate, to carry out investigations of breaches. This envisages the possibility that breaches will result in the use of enforcement remedies (such as sanctions). As noted under Principle 12, the CNMV seems to be moving towards a more active use of sanctions as a regulatory tool.</p> |
| Principle 25. | The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets. |
| Description | <p>Legal form and investors' rights</p> <p>Under the CIS Act, CIS vehicles may adopt either investment fund or investment company form.</p> <p>Investment funds: Article 3 of the CIS Act defines investment funds as separate estates without legal personality whose management and representation is undertaken by a managing company, with the participation of a depository. Article 5.3 of the CIS Act sets out the rights of fund participants.</p> <p>Investment companies: Article 9 of the CIS Act defines investment companies as CIS that adopt the form of a corporation.</p> <p>The CIS Act distinguishes between two types of CIS:</p> <ol style="list-style-type: none"> Financial: financial CIS can take the form of either a mutual fund or an open-end SICAV. Financial CIS invest in financial assets and instruments. |

- b. Non-financial: the CIS Act distinguishes between real estate and non-classified CIS. To date, the only type of regulated non-financial CIS is real estate CIS.

Disclosure to investors

The prospectus for a CIS must include the relevant constitutional documents, management regulations (in the case of a mutual fund) and articles of association (in the case of a SICAV).

The CIS operator must all provide investors with annual and half-yearly reports (Article 18 of the CIS Act).

Responsibility for monitoring compliance with form and structure requirements

Title II of the CIS Act makes the CNMV the competent body to authorise the creation of a new CIS. Article 70 of the Act makes the CNMV responsible for supervision of funds' compliance with all legislative requirements on an ongoing basis.

Changes to investor rights

Generally, all material changes to a mutual fund's regulation must be authorised by the CNMV and then disclosed immediately to investors by the CIS operator (Article 12 of the CIS Act). Some changes (changes of domicile; change of name; addition to the regulations of mutual funds or the articles of association of investment companies required by operation of law; and capital increases out of the reserves of investment companies) do not require CNMV authorization but must be entered into the CNMV's public register.

Investors must be notified at least one month before a change comes into effect if the change relates to:

- a. modification of the management regulation or prospectus affecting the fund's investment policy;
- b. the earnings distribution policy;
- c. the replacement of the operator or depository by an entity belonging to a different group;
- d. delegation of portfolio management to another entity;
- e. change of control of the operator;
- f. merger, change of form or splitting of the fund;
- g. establishment or increase of fees; and
- h. other cases determined by regulation.

In all these cases, if there is any back-end fee or associated expense or discount, the investors is entitled to withdraw without charge.

Separation of assets/safekeeping

Securities, cash and other assets of a CIS must be held by a depository registered with the CNMV (Article 57 of the CIS Act). Each CIS must have only one depository and no entity may simultaneously be the operator and depository of the same institution (Article 58.2).

Article 68 of the CIS Act provides that no entity may be a depository of a CIS managed by a company belonging to the same group or of investment companies in the same group, except where the CIS or CIS operator has a specific procedure to avoid conflicts of interest. An independent unit of the CIS operator must verify compliance with the requirement, and prepare a report to the board.

CNMV staff indicated that in practice in many cases CIS are under the custody of entities belonging to the same group as custody is concentrated in a few banks. Specific

| | |
|----------------------|--|
| | <p>procedures developed to address potential conflict of interest include the establishment of information barriers, disclosure of related party transactions and procedures to check that transactions are carried out at market price. In addition, the external auditors of the CIS are required to prepare an annual basis a specific report on the adequacy of segregation. Circular 5/2009 of the CNMV provides guidance in regard to the content of such report. In particular it requires external auditors to do sampling. In addition, as part of the on-site inspections of depository institutions, the CNMV conducts conciliations of the positions reported by the depository versus the positions in Iberclear.</p> <p>Order EHA/596/2008 details in Article 5 the depository's obligation with respect to the custody of securities and cash of a CIS. This allows custody to be provided directly or via a third entity that is a member of the clearing, settlement and recordkeeping systems in the markets in which the CIS is to trade, although the depository maintains liability at all times for the proper performance of custodial duties.</p> <p>The CIS Regulation (Article 92.2) states that where securities are deposited outside Spain, assurance must be given that the CIS holds full and free ownership and control and is free to dispose of the assets at any time.</p> <p>For investment funds, the operator exercises ownership functions but does not own the assets of the fund, which remains with the investors. Article 6 of the CIS Act establishes that the assets of CIS funds are not liable for the debts of investors, the CIS operator or depositories.</p> <p>Article 60 of the CIS Act establishes that the depository must safeguard the securities belonging to the CIS, and monitor compliance with investment policies as set forth in Principle 26, and will be liable even if it does not discharge those duties directly. In this regard, in connection with outsourcing part of the custody of assets, the CNMV highlighted that the depository would be liable for damages to investors caused by the conduct of the entity to which it outsources custody, but that it could raise a due diligence defence if it were sued.</p> <p>Article 92 of the CIS Act requires the CIS operator and the depository to establish adequate mechanisms and procedures to guarantee that the assets of the CIS are not disposed of without the CIS's consent and authorization.</p> <p>Winding up</p> <p>The dissolution and liquidation of a CIS is regulated in Article 24 of the CIS Act and in Article 33 of the CIS Regulation. In the case of CIS that are companies, the dissolution and liquidation must comply with the general rules for corporations notwithstanding the specific rules for CIS. We should include the rules for funds (I assume is administrative dissolution, xxx).</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 26. | Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme. |
| Description | <p>Disclosure to investors</p> <p>Article 17 of the CIS Act requires a CIS operator, for each fund (or investment company) it manages, to publish for distribution among shareholders, investors and the general public:</p> <ol style="list-style-type: none"> a. a prospectus; b. a KII document; and c. annual, half-yearly and quarterly reports. |

Article 19 requires public disclosure of significant events as detailed below.

The CNMV maintains a register of prospectuses, periodic reports, annual reports and CIS audits that is available to the public. A register of significant event disclosures is also publicly available.

Article 17.6 of the CIS Act requires the CNMV to draft standardized formats for all disclosure documents a CIS operator must make public.

Prospectus and KII disclosure

Prospectus content is regulated by Article 17 of the CIS Act. The basic requirement (Article 17.2) is that it meets the same standard as a prospectus for the issue of securities under Article 27 of the LMV.

Article 22 of the CIS Regulation lists all aspects that must be included in the complete prospectus of a CIS. They include:

- the date of issue of the prospectus;
- the management regulations (in the case of a mutual fund) or articles of association (in the case of a SICAV);
- the identity of the CIS operator and the persons who take responsibility for the content of the prospectus;
- information about the methodology for valuing assets (where this is different from that required by the legislation, this is included in the management regulations or articles of association);
- procedures for subscriptions and redemptions and the NAV applied;
- the name and group of the depository, and the name of any sub-custodians;
- the investment policy;
- information on the risks inherent in the investments;
- the existence of delegations (including information about firms providing consulting services); and
- all costs and fees, including the maximum fees permitted by law and the fees applied for each item.

CNMV Circular 3/2006, of 26 October establishes the forms of prospectus for CIS.

CIS operators must send the prospectuses electronically to the CNMV, and as soon as they are entered in the CNMV registers, they may be accessed on its website.

Article 17 of the CIS Act establishes that the KII, which must obligatorily be delivered to the investor prior to the subscription of units, must be concise, use non-technical language and a common format that permits comparisons and facilitates easy analysis and understanding by the average investor so that he/she is in a position to comprehend the essential characteristics and the nature and risks of the investment product being offered and to make a well-founded decision without having to consult other documents.

Periodic and immediate reports

Article 18 of the CIS Act requires annual and half-yearly reports to be sent to investors unless they expressly ask not to receive them. Half-yearly reports must include the total expense ratio, which is the sum of all the operating costs in the period divided by the fund's assets.

Quarterly reports must be sent to investors who ask to receive them. Detailed requirements for the content and format of these reports are set out in CNMV Circular 4/2008 (as amended by Circular 6/2010 and Circular 4/2011).

Article 28 of the CIS Act sets out the events or circumstances which require a CIS operator to make immediate disclosure to the market (by lodging a report with the

| | |
|------------|---|
| | <p>CNMV). These include reduction of more than 20 percent of the assets of a fund, replacement of a manager or depository, incurring debts to third parties that amount to more than 5 percent of the fund's assets or any decisions which require an updating of any essential part of the prospectus.</p> <p>Regulator's powers</p> <p>A CIS may not begin operating until it has been entered into the CNMV's administrative register and its prospectus has been registered (Article 10.6 of the CIS Act).</p> <p>The CNMV verifies that the prospectus complies with the established requirements, entering it into the corresponding official register if it does comply, and demanding compliance if it does not. As a result, the CNMV may deny registration of a CIS that it considers being in breach of the requirements.</p> <p>Advertising</p> <p>All advertising that includes an invitation to subscribe units or shares of a CIS must state that there is a prospectus and a KII as well as the places and form in which the general public may obtain or access them. The advertising may not contradict or downplay the importance of the information in the prospectus and in the KII (Article 18.3 of the CIS Act).</p> <p>Article 94 of the Securities Market Act (hereafter LMV) allows the CNMV to intervene to ensure the termination or rectification of inappropriate advertising.</p> <p>Accounting</p> <p>CNMV Circular 3/2008 (accounting rules, financial statements, and confidential information of CIS) contains the requirements for accounting to be used for CIS. It incorporates the fair value standards in the Spanish Commercial Code, the LMV and the General Accounting Plan, which are in turn based on international standards.</p> <p>The regulation under Law 12/2010, which deals with requirements for audit generally, treats CIS with more than 150 unit-holders as institutions of public interest. Accordingly, audits of those entities are subject to the stricter requirements than those that apply to issuers and other public interest institutions, in particular rotation requirements of the lead engagement partner as described in Principle 20.</p> <p>Regulatory supervision</p> <p>As indicated under Principle 24, in Spain the depositories carry out an oversight role on compliance of CIS with investment policies. In practices two companies have developed IT software that allows for automated monitoring of investment objectives by CIS. Depositories have acquired such softwares. CNMV indicated that depositories do inform the CNMV when the CIS are in breach of their investment policies, immediately upon detection of a breach, In addition, as stated in Principle 24 they are also required to submit an annual report to the CNMV.</p> <p>In addition, the CNMV also verifies that CIS are following the investment policies set out in their prospectuses. To do so, it uses the information about investment portfolios CIS must send to the CNMV every month. Additionally, an analysis is performed of the daily NAV of the CIS and the performance of a representative benchmark index, on the basis of the investment policy and approach established in the prospectus. See more detail of CNMV supervision activities under Principle 24.</p> |
| Assessment | Fully Implemented |
| Comments | |

| | |
|----------------------|--|
| Principle 27. | Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme. |
| Description | <p>CNMV Circular 3/2008 (accounting rules, financial statements and statements of confidential information by CIS) and Circular 6/2008 (NAV determination and operating aspects of CIS) establish the regime for asset valuation for CIS.</p> <p>Circular 3/2008 describes the specific valuation criteria that should be used for each asset in which a CIS invests (fixed-income securities, equities, CIS and derivative financial instruments, and real estate).</p> <p>Asset valuation</p> <p>For the purpose of establishing the value of an interest in a CIS, the NAV of a fund is established by subtracting accounts payable from the fund's total assets.</p> <p><i>Principles for asset valuation</i></p> <p>CNMV Circular 3/2008 sets out in detail the accounting rules that the CIS must comply with for asset value calculation. The Circular includes the accounting framework established in Spain's new General Accounting Plan, approved by Royal Decree 1514/2007. The Plan's objective is convergence with the international rules on financial information issued by the EU.</p> <p>Article 7 of Circular 3/2008 establishes the basic accounting principles which must be applied by CIS. They include the principle of uniformity, which requires the application to transactions of standardised criteria maintained over time.</p> <p><i>Timing</i></p> <p>Article 48 of the CIS Regulation requires the NAV of a fund to be calculated daily, except where otherwise provided in the management regulation and where required for the investments envisaged for the CIS, in which case the NAV will be calculated at least once per fortnight.</p> <p><i>Where market prices are not available</i></p> <p>Rule 12.3.2 of CNMV Circular 3/2008, establishes that, if there is no market for a specific fixed-income security, the generally-accepted valuation techniques will be applied, using observable market data where possible, especially with regard to current interest rates and issuer credit risk.</p> <p>Derivative financial instruments for which there is no sufficiently liquid market or which are not traded in organised markets are to be valued using appropriate and accepted valuation techniques or models.</p> <p>CNMV Circular 4/1997 establishes the criteria for valuing unlisted securities in which a CIS invests.</p> <p>Article 48.7 of the CIS Regulation allows for valuation at the last known market price for securities that are suspended from trading provided that they do not account for more than 5 percent of the fund's assets. If they account for more than 5 percent, they will not be valued, and subscriptions and redemptions are performed using a NAV that reflects only the portion of the portfolio susceptible of valuation at the time, with an obligation to settle the differences that arise when valuation is resumed.</p> <p><i>Independent audit</i></p> <p>Article 21 of the CIS Act states that CIS must be audited. The LAC approved by Legislative Royal Decree 1/2011 establishes that the audit report must include a technical opinion stating clearly and accurately whether the financial statements provide</p> |

a true and fair view of the assets, financial situation and earnings.

To express such an opinion, an auditor must check whether the institution's assets are valued at market prices, or, if market prices are not representative, that appropriate valuation criteria are used.

Pricing and redemption of interests

Article 22.1.ñ of the CIS Regulation requires disclosure in the prospectus about the method for redeeming units and the NAV to be applied for redemptions. The prospectus must indicate the daily deadline for accepting subscription and redemption orders and the frequency with which the NAV will be published and the place and manner in which it may be consulted.

The items that must be included in the NAV calculation are set out Circular 6/2008. CNMV Circular 3/2008 details the accounting rules the CIS must use for asset value calculation.

The CIS operator is responsible for valuations (Article 40 of the CIS Act). Rule 3.4.b of CNMV Circular 6/2009 (internal controls) requires CIS operators to adopt procedures to oversee the accuracy of NAV calculations. The depositary is responsible for supervising the criteria, formulas and procedures used by the CVIS operator to calculate the NAV of units (Article 60.1.e).

CNMV performs an analysis of the daily yields of mutual funds with a view to detecting atypical yields. The majority of atypical yields are the result of errors in NAV calculations. When significant errors are detected, the CNMV requires that internal control systems be strengthened. In the event of especially serious or repeated errors, the sufficiency and validity of the existing valuation mechanisms and internal control systems are analysed, and managers are urged to establish mechanisms to oversee NAV calculation prior to the execution of subscriptions and redemptions.

Disclosure

Article 4.8 of the CIS Regulation requires CIS operators to provide information on the NAV of its units, on the assets and on the number of investors. Information must be made available free of charge in a way that guarantees reliable, quick and non-discriminatory access. For these purposes, appropriate methods of distribution are securities market bulletins, the CIS operator's website, and any other methods approved by the CNMV.

Pricing errors

Article 46 of the CIS Act makes the CIS operator responsible for all losses incurred by investors as a result of non-compliance with legal obligations.

Rule 3 of Circular 6/2009 requires CIS operators to have mechanisms to identify, evaluate and resolve, immediately or as quickly as possible, any incidents, errors or breaches of the applicable regulation that impact the NAV of the managed CIS. For these purposes, CIS operators must establish tolerance limits for identifying these incidents and for the purposes of indemnifying or informing investors. Those limits must be set out in internal manuals.

Suspension/deferral of valuations and redemptions

Article 48.7 of the CIS Regulation regulates the procedures to be followed when the trading has been halted in listed securities that account for 5 percent or more of a mutual fund's assets. In those cases, the subscription and redemption of units will be in cash for the part of the unit price that does not correspond to the suspended securities, and the remainder using the trading price on the first day when trading resumes.

| | |
|----------------------|---|
| | <p>When the securities affected by the suspension of trading exceed 80 percent of the fund's assets, the CIS operator may suspend redemptions and subscriptions until the causes that led to suspension are rectified.</p> <p>Article 45bis of the CIS Regulation establishes that, when exceptional circumstances affect financial instruments in which the CIS invests, and those instruments account for more than 5 percent of the CIS's assets, the CIS operator (with the knowledge of the depository may split the original CIS and transfer the affected assets to a new CIS comprising only those assets. The investors in the original CIS will receive units or shares of the new or special-purpose CIS compartment (a "side pocket") in proportion to their stake in the original CIS. These specially-created CIS cannot issue new units; and their objective is to sell the assets with all diligence as the extraordinary situation affecting them disappears, and to distribute the funds so raised to the investors.</p> <p>This provision was introduced recently to help resolve problems with real estate funds which had become illiquid as a result of adverse movements in real estate values. The introduction of these measures appears to have been successful.</p> <p>Article 48.8 of the CIS Regulation recognises the possibility that the CNMV may, in exceptional circumstances, allow units to be reimbursed in the form of securities.</p> <p><i>Reporting to regulator and regulator's powers of intervention</i></p> <p>A suspension or deferral of redemptions rights, or the splitting of an existing fund under Article 45(2) of the CIS Regulation, would be a significant matter requiring the CIS operator to make immediate disclosure to the CNMV under Article 28 of the CIS Regulations.</p> <p>Article 72 of the CIS Act gives the CNMV powers to intervene a CIS operator, to temporarily substitute its administrator, or directors, and to substitute altogether the CIS operator that manages a specific CIS in exceptionally serious situation that endangers the solvency or the assets of its investors. These measures could be taken during a sanctioning proceeding, but also independently of the existence of such procedure. The CNMV must justify its actions in a reasoned report to the Minister of Economy and Competitiveness.</p> <p><i>Regulatory authority to monitor compliance</i></p> <p>Using the reports it receives from CIS operators (and, where necessary, its broad powers of inspection under Article 70 of the CIS Act), the CNMV reviews information about each registered CIS, including their asset value and daily NAV, the month-end valuation of all assets in which the CIS invests, and all securities purchases and sales in the month. Using that data, the CNMV performs a systematic analysis of the yields on the CIS NAVs, which allows it to detect errors in accounting and NAV calculation and weaknesses in the operators' internal control procedures. See under Principle 24 for more detail about CNMV's supervision activities.</p> |
| Assessment | Fully Implemented |
| Comments | <p>The need for a report to the MEC in cases that the CNMV uses its intervention powers have been justified in the Spanish framework on the basis of the fact that authorization of CIS operators is a responsibility of the MEC. However, as indicated in Principle 2 the assessors consider that all these functions should be vested in the CNMV.</p> <p>The use of side pockets by real state funds should be kept under scrutiny.</p> |
| Principle 28. | Regulation should ensure that HFs and/or HFs managers/advisers are subject to appropriate oversight. |
| Description | <p>Definition of HF</p> <p>The Law 35/2003 and secondary legislation (Royal Decree 1309/2005) provides a</p> |

framework for CIS in Spain. Such law introduced a special category of CIS, the *instituciones de inversion colectiva de inversion libre* (“alternative investment schemes”) which would include what is internationally known as HFs. The law does not define them; rather simply exempt those funds from some of the prudential requirements applicable to financial funds (such as diversification rules, leverage rules, etc). To apply to this regime, a CIS needs to have a minimum investment of 50,000 EUR and can only be marketed to professional investors. Professional investors include financial institutions, government and international organizations, individual persons when they meet certain networth thresholds, institutional investors, and clients who request to be treated as professional investors provided that they have the relevant knowledge and experience to understand the risks they undertake. The law 35/2003 also introduced the funds of HFs, which can be marketed to retail investors. The latter funds are subject to a regime similar to that of conventional CIS. CNMV 1/2006 provides more detail in regard to the regime applicable to HF and FoHFs.

Authorization requirements for HF operators

Pursuant to Rule 2 of Circular CNMV 1/2006 the authorization and registration of operators of HFs and of funds of hedge funds (FoHF) is subject to the general rules applicable to other CIS operators as set out in Article 41 of the CIS Act.

Ongoing requirements for CIS operators contained in Circular 6 are also applicable to HF operators. This means that they must implement adequate internal controls. HF operators in particular are required to have risk control systems that measure current and potential exposure to risks, especially for operations that involve leveraging or unlisted securities, or illiquid or derivative instruments whose valuation is complex. They are also required to periodically perform stress tests and simulacra of specific crisis situations.

They are required to manage appropriately conflicts of interest. In this regard the general rules on related party transactions described in Principle 24 also apply to them.

HFs, like other CIS, must have a depository which supervises the management activity performed by the operator, while also being responsible for the deposit or custody of securities, cash and any assets of the mutual fund. Article 3 of Order EHA/596/2008, of March 5, regulating certain aspects of the legal regime of CIS depositories, establishes certain special features applicable to the vigilance and supervision function of a HF's depository. Article 7 of such Order establishes special features of the securities custody and administration function that must be performed by a HF depository. In particular, the HF manager is obliged to notify the depository of all the contracts that it has signed on behalf of the HFs with a prime broker; these contracts must include certain clauses in order that the depository can carry out its functions.

In accordance with Rule 6 of Circular 1/2006, HF operators must monitor the fund's assets assigned as collateral and over which a right of disposition has been exercised.

Pursuant to Rule 4 of Circular 1/2006 operators of HF and FoHF are required to have additional own funds to cover possible operating risks, of at least 4 percent of gross fee revenues from managing these CIS.

Disclosure to investors

According to Article 43 of the CIS Regulation, before subscribing to the HF, investors must sign a consent form certifying in writing that they understand the risks inherent to the investment. Investors who wish to subscribe to a fund that invests primarily in HFs must also sign this document prior to subscription (Article 44 of the CIS Regulation).

| | |
|---|---|
| | <p>HF are subject to the same rules on disclosure to investors as established in the general regulations for CIS, with some special features with respect to the content of the prospectuses (rule 13 of Circular 1/2006) and the periodic information to be sent to investors (Rule 14 of Circular 1/2006).</p> <p>Authorization process</p> <p>Firms that want to manage HFs must go through the same process of authorization as any other manager of a CIS. Accordingly they are required to submit a set of information, including the program of operations which has to detail the type of funds that they intend to manage.</p> <p>There are currently 23 firms authorized to manage HFs, 18 to manage FoHF and 7 authorized to manage both. HF operators are usually boutique firms.</p> <p>The funds themselves have to also go through an authorization process, similar to that of any other CIS. The only differences in this case are that (i) the context of the prospectus is more limited, and (ii) so is the periodic information that will need to be provided to investors.</p> <p>There were 35 HFs, with AUM of 719 million EUR., and 28 FoHF with 650 in AUM.</p> <p>Ongoing supervision</p> <p><i>Off site monitoring</i></p> <p>Rule 18 of Circular 1/2006 establishes the obligation of operators to provide the CNMV with a monthly statement of confidential information about each of the HFs they manage, including information on individual positions of the CIS's investment portfolio. They also have to provide a statement of statistical and operating information which includes information on the volume of subscriptions and redemptions in the period, types of investors, indebtedness, percentage of assets received on loan, the institutions' value at risk (VaR) and CVaR (conditional VAR), percentage of liquid assets, the value of assets provided as collateral to a prime broker on which the right of disposition has been exercised, fees and expenses paid by the fund and the NAV on the last day of the month.</p> <p>The CNMV has the same powers over HF operators that it has over all other CIS operators. As such it can request information from them, and share such information with other regulators, in the same terms described in Principle 13, including confidential reports.</p> <p><i>Onsite inspections</i></p> <p>In principle HF operators can be subject to on-site inspections. In practice, however, CIS operators who only manage HFs are not inspected by the CNMV.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principles for Market Intermediaries | |
| Principle 29. | Regulation should provide for minimum entry standards for market intermediaries. |
| Description | <p>Regulatory framework and industry background</p> <p>Entities that provide professional investment services (ISPs) require authorization under the LMV. Chapter I of Title V sets out the services that require authorization, with a distinction made between investment services and auxiliary services. A firm requires an</p> |

authorization to provide investment services; no separate authorization is required to provide auxiliary services. Some auxiliary services are reserved for authorized ISPs (custody for example) but some (such as general financial advice) are not.

Article 63 of the LMV provides that:

Investment services are:

- receipt and transmission of orders from clients;
- execution of these orders on behalf of clients;
- proprietary trading;
- portfolio management for individual clients on a discretionary basis;
- placement of financial instruments;
- underwriting an issue or placement of financial instruments;
- investment advisory services; and
- management of MTF.

Auxiliary services are:

- the custody and administration of securities instruments;
- the granting of credit for securities trading;
- corporate advisory services;
- auxiliary services for underwriting or placement;
- the preparation of investment reports and financial analysis reports;
- currency exchange services relating to investment services; and
- other investment or auxiliary services on underlyings of derivatives linked to investment or auxiliary services.

Proposals are being developed to make custody and administration an investment service rather than an auxiliary service.

Article 64 of the LMV creates four categories of ISPs (in line with MiFID):

- broker dealers (*Las sociedades de valores*);
- brokers (*Las agencias de valores*);
- portfolio management firms (*Las sociedades gestoras de carteras*); or
- financial advice firms (*Las empresas de asesoramiento financiero*).

Broker-dealers are permitted to operate professionally both on third party account and on their own account and may perform all investment services and auxiliary services. Brokers may not carry on proprietary trading, or underwriting or the auxiliary service of granting credit. Portfolio management companies can only provide investment services for managing portfolios and advisory services, and certain auxiliary services. Financial advisory firms are limited to the service of providing investment advice and the auxiliary services of corporate analysis and advice. Both legal persons and natural persons can be authorized as financial advisory firms.

CIS management companies can (under Article 40 of the CIS Law) carry out discretionary portfolio management for individual clients and investment advisory services. The authorization regime for these firms is analogous to that applying to investment service providers under the LMV regime.

Credit institutions can perform all the above activities directly, without the need for a subsidiary, if their articles of association include such activity and the authorization granted by the BdE enable them to do so (Article 65 LMV). The MEC is responsible for the authorization of credit institutions, based on a proposal of the BdE. However the law requires a mandatory report from the CNMV when the request for authorization includes investment or auxiliary services.

Activities that do not require authorization are set out in Article 62.3, and reflect the exclusions provided in the MiFID regime (Article 1.2 of Directive 2004/39/EC).

| Firms Registered with the CNMV as at November 10, 2011 | |
|---|--------------|
| Spanish investment firms | 181 |
| Broker-dealers | 50 |
| Brokers | 45 |
| Portfolio management companies | 6 |
| Financial advisory firms | 80 |
| European investment firms | 2,371 |
| Investment firm branch | 38 |
| Investment firm under free provision of services regime (passport into the Spanish market) | 2,333 |
| Credit institutions registered with the CNMV and authorized to provide investment services | 177 |
| Agents | 7,193 |

Source: CNMV.

Agents referred to in this table are natural or legal persons to whom an investment firm has granted powers of representation to promote and market investment services. They are tied agents (represent only one investment service provider) and in practice about 50 percent of the total number represent one large insurance company/investment service provider.

In addition, at November 2011, 177 credit institutions were registered with the CNMV and therefore able to provide investment services.

In practice, the investment services business is dominated by banking and other credit institutions. The assessors were told that less than 50 percent of registered firms are independent of banks and insurance companies. A large portion of the distribution of financial products is done directly through banks.

Investment service providers who are authorized to provide financial advice are mostly independent firms, though many have remuneration-based distribution contracts with product providers and other investment service providers. The 80 firms in this category currently have only a total of about 3,000 advice clients.

Authorization requirements for ISPs

Authorization requirements are set out in the LMV and the corresponding regulations. They include capital requirements, integrity requirements for directors and senior managers and suitability requirements for major shareholders, competence requirements for board members and senior management and appropriate internal controls and resources.

Capital requirements

Article 15 of the RESI (Article 22 in the case of financial advisory firms) sets out minimum initial share capital for investment firms. The requirements are described under Principle 30.

Integrity

Article 67.2.f of LMV requires all directors and senior managers in an applicant entity (and the parent entity, if any) to have recognized business or professional standing. This is assessed by requiring directors and senior managers to complete and submit a questionnaire relating to their business and professional standing, along with their CVs.

The CNMV also requests information from the registries of the BdE, and the CNMV itself. A person will not meet the integrity standard required if, in Spain or abroad, they have a criminal record for fraudulent offences, they have been banned from holding public office or from administration or management positions in financial entities, or they are an undischarged bankrupt.

The agents of an investment firm must also meet the business and professional standing standards that apply to directors and senior managers: Article 65(2)2 of the LMV.

A general suitability test also applies to significant shareholders (Article 67.1.b). Article 69.1 defines a significant participation in an investment services firm as one that, directly or indirectly, reaches 10 percent of the capital or the voting rights of the firm.

Competence

Article 67.2.g requires that the majority (and at least three) of the board members and all senior managers have suitable knowledge and experience with regard to the securities market. This is assessed by using the questionnaire described above.

Aside from board members and senior management, the current regulatory regime does not require individuals carrying out specific functions for the ISPs to be registered with the CNMV, nor to pass examinations. However, the board of an applicant is responsible for ensuring that its staff have the necessary knowledge and expertise.

Internal controls

Article 67.2.h of the LMV required that, for an investment firm to obtain authorization, it must:

- Have the procedures, measures and resources necessary to meet the organization requirements set out in points 1 and 2 of Article 70(3) of the LMV. These require investment service providers to establish and apply appropriate policies and procedures for:
 - organizational structure
 - compliance systems
 - information systems
 - compliance registers
 - protection of client funds and assets
 - risk control and internal audit
 - continuity of service
 - managing risk from outsourcing

Article 70(3) also requires firms to have remuneration policies and practices which are compatible with, and promote, appropriate and effective risk management, and limit variable remuneration if it is incompatible with the firm's ability to maintain a sound capital base. These requirements (and others, such as those relating to the qualifications and expertise of staff) must be proportionate to the nature, scale and complexity of their business activity and the nature and range of services provided.

Have an internal CoC and appropriate control and security mechanisms for information systems and internal control procedures, including a regime for personal transactions of the company's directors, senior management, staff and legal representatives. In the authorization stage, a review is made of the firms' internal procedures.

Authority of the regulator

Authorization

Authorization may be refused only for reasons set out in Article 67 LMV. They include:

- a. failure to meet the standards required to obtain and hold an authorization;
- b. unsuitability of shareholders;
- c. lack of transparency in group structure; and
- d. other factors that may impede effective supervision.

Authorization process

Pursuant to the LMV the formal authorization is granted by the Minister of Economy and Competitiveness based on a recommendation from the CNMV. So in practice applicants complete a manual developed by the CNMV to assist the application process and lodge it in electronic format. Such manual must be accompanied by supporting documents, including the charter of association, questionnaires and CVs of relevant persons, a business plan, the internal CoC, and a description of controls, policies and procedures.

The CNMV's entity authorization and registration department (which has 14 staff members dedicated to the authorization of ISPs) carries out a detailed assessment in accordance with internal operational procedures. Clarification of information is routinely requested, and CNMV staff hold direct discussions with applicants. As stated in Principle 24 at this stage the CNMV places significant emphasis on integrity, experience, and financial resources. Examples were given of one case where the CNMV objected to the proposed senior management for an ISP due to lack of recent direct experience and another where it required additional resources to set up an ISP. Human and IT resources and internal controls are reviewed at a high level, and the applicant must provide a sworn statement that it will implement controls and resources as described. The CNMV does not conduct on-site visits as part of the authorization process, nor are "nursery" visits scheduled within a short period of time after the authorization has been granted. However the lack of inspections is one of the risk factors in the risk scoring framework of the CNMV.

Once the analysis is complete, the CNMV prepares a recommendation for the MEC. Staff from both the CNMV and the MEC indicated that the MEC has not deviated from such recommendations.

Once an authorization is granted, the applicant's corporate entity must be registered in the Companies Registry, and included in the CNMV's registry of authorized entities. Authorization is specific, and can be limited to particular activities within the main MiFID categories of types of ISPs.

In 2011 CNMV dealt with around 30 applications for authorization as an investment adviser, and 2 applications for other types of authorization. The statistics do not show many cases of refusal, as applicants prefer to withdraw the request when there have been objections from the CNMV. Assessors have reviewed one of such files.

For new credit institutions who also want to provide investment services, the BdE is in charge of analyzing the application and provides a recommendation to the MEC. However the law requires the MEC to seek the opinion of the CNMV in connection with the program of operation. In practice, there are few of such applications in the current environment.

Revocation of authorization

Article 73 of the LMV sets out the circumstances where an investment firm's authorization may be revoked. These include a failure to comply with any of the requirements for obtaining authorization.

By Article 74 of the LMV, the CNMV is responsible for initiating and investigating revocation proceedings. The final determination is made by the Minister of Economy and Competitiveness, following a proposal from the CNMV, or in the case of financial advisers directly by the CNMV.

Under Article 69 of the LMV, changes in shareholder control of investment firms are subject to prior verification carried out by the CNMV with regard to the suitability of the new shareholders relating to their standing, resources and exposure to risk.

Banning of individuals

If a director, senior manager or an agent fails to maintain good business and professional standing (as required by Article 67.2.f and Article 65(2)2 of the LMV), they may be banned from holding management positions or belonging to the board of directors of the authorized firm, or acting as an agent. If such a case is detected, the CNMV may seek his/her removal. Such a ban only applies to administration or management positions or agents, but not to employees of the firm.

Ongoing requirements

Prior regulatory approval is required for:

- material amendments to the articles of association of investment firms (non-material amendments require only notification); and
- any change in the investment services and supplementary activities initially authorized.

The process used for assessing such changes is that used for the initial authorization of a new firm (Article 68 of the LMV).

The transformation, merger, split or segregation of a line of business, as well as other modifications of the company carried out by an investment firm or which lead to the creation of an investment firm, will require prior authorization from the MEC, following a proposal from the CNMV, except in the case of financial advisory firms, which require prior authorization from CNMV. Article 72 of the LMV.

A natural or legal person who intends to acquire, directly or indirectly, a significant holding in an investment firm must give advance notice to the CNMV. The CNMV has a maximum of 60 business days from the date on which it was informed, to object to the acquisition (Article 69 of the LMV).

The CNMV deals with these functions by using an internal written procedure.

Public disclosure of authorized firms

Article 92 of the LMV requires the CNMV to maintain a number of official registers and make them available to the public. They include registers setting out the investment firms that operate in Spain, their directors, senior management and similar positions, and the agents or legal representatives who regularly act on their behalf. The registers include the investment services which the investment firms are authorized to perform. They currently also include information on significant shareholders. Investment firm registries containing this information are available to the public in the offices of the CNMV and on its website. The CNMV also maintains a register of credit institutions authorized to provide financial services.

Investment advisers

Firms or individuals authorized as advisers are not permitted to deal on behalf of clients, to hold client funds or assets, or to provide custody services. These advisers are subject to record keeping obligations, conflict of interest requirements and client disclosure obligations in the same way as other authorized ISPs.

Entities that provide advice to clients as well as dealing and/or custody services to clients (such as portfolio management firms or CIS managers) are subject to the same capital and operational requirements as other authorized firms. These requirements are

| | |
|----------------------|---|
| | described under Principle 31. |
| Assessment | Fully Implemented |
| Comments | <p>The adequacy of proposed compliance and internal control arrangements is often difficult to assess at the authorization point before the ISPs have started to operate. As noted under Principle 24, “nursery visits” are a valuable tool in validating regulatory judgments about systems and processes reviewed as part of the authorization process, and can provide valuable information for the CNMV’s risk scoring system.</p> <p>However, the number of new market entrants (other than advisers) is small, and only 6 new authorizations have been granted in the last two years. Also, in practice, the CNMV at the authorization stage makes an assessment of risk based on the types of products or services an applicant plans to offer. Of the 6 authorizations granted in 2010–2011, 5 were for smaller scale, low risk, activities; one involved higher risk activities (derivatives) and the CNMV carried out an on-site inspection soon after authorization. This indicates nursery visits are used in targeted way based on risk criteria.</p> <p>New authorizations for entities and individuals providing advisory services are more common, but the industry and scale of activities remains small.</p> <p>Additionally, auditors are required to report annually on the adequacy of investment services firms’ internal control procedures. This should help the CNMV identify problems in newly authorized firms.</p> <p>These factors lead the assessors to conclude that the authorization process for investment firms is sufficiently robust.</p> <p>Finally the assessors note that under the current framework all directors are subject to an integrity requirement. The authorities should explore extending also the competence requirement to all directors.</p> |
| Principle 30. | There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake. |
| Description | <p>Capital requirement</p> <p>All ISPs are subject to initial and ongoing minimum capital requirements. Subsidiaries of banks and other credit institutions are subject to the CNMV’s capital regime on a solo basis, as well as being subject to the group-wide regime that applies to their parent bank supervised by the BdE, though securities activities are not required to be conducted in a separate subsidiary from the credit institution.</p> <p><i>Initial capital requirements</i></p> <p>Initial capital requirements are:</p> <ul style="list-style-type: none"> • Broker dealers: € 2 million • Brokers: <ul style="list-style-type: none"> ○ where they intend to become members of secondary markets or affiliate with the securities clearing and settlement systems, or if their program of activities includes the custody of financial instruments and they may hold instrumental and transitory credit accounts: € 500,000 ○ Other brokers: € 300,000 ○ When they are only authorized for receiving and transmitting orders without holding funds or financial instruments of their clients, € 120,000 or a professional civil liability insurance or equivalent guarantee which allows them to meet their liability for negligence in exercising their professional activity throughout the EU with a minimum coverage of € 2.5 million per claim for damages and a total of € 3.5 million annually for all claims, or any combination of initial capital and insurance with an equivalent level of coverage • Portfolio management companies: € 100,000 |

- Financial advisory firms
 - which are corporations: € 50,000 or a professional civil liability insurance which covers the entire EU, bond or other comparable guarantee to meet liability arising from professional negligence in exercising their professional activity throughout the EU, with a minimum coverage of € 1.0 million per claim for damages, and a total of € 1.5 million annually for all claims, or a combination of initial capital and insurance with an equivalent level of coverage.
 - which are natural persons, must comply with the insurance requirement

For these purposes, “capital” is defined in the same way as in the European capital adequacy directives (Directives 2006/48/EC and 2006/49/EC)—see Article 3 of CNMV Circular 12/2008.

Ongoing capital requirements

Ongoing capital requirements after the firm begins operating are based on Basel II principles and reflect the transposition of European Directives 2006/48 and 2006/49 into national legislation.

Article 7 of CNMV Circular 12/2008 requires investment firms **<CHECK: also financial advisors? Not financial advisors >** at all times to hold own resources (capital) equal to or greater than the highest of the following items:

- the sum of requirements for:
 - risks linked to the trading book, counterparty credit risk and settlement risk
 - requirements for exchange rate and commodity risk
 - 8 percent of credit risk weighted positions
 - requirements for operational risk
- Requirements depending on the level of activity: 25 percent of fixed expenses
- Two thirds of the minimum capital
- 0.5 percent of the value of assets held in managed portfolios

Circular 12/2008 sets out in detail the methods for calculating each of the components of this requirement.

In specific cases, and subject to CNMV approval, some firms may be released from complying with some of the requirements described above, provided that the reduction in capital is associated with limitations on the activity and as a result there is a lower level of risk.

Articles 78 and 94 of Royal Decree 216/2008. To date, there have been no cases.

Liquidity requirements

Investment firms, that are not solely investment advisors, also have liquidity requirements. They must maintain minimum investment volumes in specified categories of low-risk liquid assets in order to safeguard their liquidity, as established in Article 70.1.b of the Securities Market Act (hereafter LMV).

The legislation requires that clients' funds, which make up the main liability of many investment service providers, are fully held in liquid, low risk assets, which largely limits the possibility of investment firms placing their clients' funds and, in short, their solvency at risk (Circular 7/2008, rule number 60).

Orderly winding down

Pursuant to Article 21 of European Directive 2006/49 (transposed into Spanish legislation in Article 94 of Royal Decree 216/2008) investment firms, not including financial advisors that do not hold funds must maintain capital of above 25 percent of the structural (fixed) costs of the preceding financial year (or the forecast for the current year if there are

significant variations). This is designed to enable the firm to remain in operation for one quarter without revenue so as to be able to carry out an orderly liquidation if necessary.

Reporting

Article 70 of the LMV requires firms at all times to meet the capital requirements and inform the CNMV about the results of their calculation of capital requirements and details of the items that make up the calculation.

Article 147 of Circular 12/2008 requires investment service providers to have effective and proportional procedures to identify, manage and report on the risks to which they are subject. Article 155 of Circular 12/2008 sets out a schedule and content requirements for monthly, quarterly and six monthly reports to be given to the CNMV on compliance with capital requirements. It empowers the CNMV to require more frequent reports, or additional content, either generally or in a particular case.

Independent audit

Article 86 of the LMV requires an annual audit of the individual and consolidated accounts of an ISP. These accounts must be approved by a general meeting of shareholders, within four months of the balance date. Pursuant to Rule 6 of Circular 7/2008, the CNMV makes the annual, individual and consolidated accounts available to the public.

Monitoring by regulator

The capital requirements of investment firms and their consolidated groups are reviewed regularly. The basis of CNMV review is the monthly, quarterly and (for consolidated groups) six monthly reports that ISPs must lodge with the CNMV (Rule 58 of CNMV Circular 7/2008 and Article 155 of Circular 12/2008).

Compliance with the capital ratio is reviewed monthly based on the information sent in the required form (RP10) and accounting statements. A more exhaustive review is conducted every quarter, on the basis of both RP10 and additional information about the breakdown of the calculation of each one of the risks to which a firm is subject. The Supervision Department prepares a formal report every two months for ISPs and every six months for consolidated groups. See further under Principle 31.

Regulator's powers of intervention

When the minimum capital requirements provided in Article 87(2).3 of the LMV are not met, the CNMV is empowered to:

- a. require a firm to hold capital over minimum requirements
- b. require that procedures, mechanisms and strategies are strengthened
- c. require the application of specific policies for (1) adding to provisions, (2) paying dividends, (3) other type of treatment for assets subject to weighting for the purposes of capital requirements, (4) reduction of the risk inherent to its activities, products and systems
- d. restrict or limit the operations of the firm
- e. require that dividend payments be limited

In addition Article 113 of Royal Decree 216/2008 requires an investment firm (when the capital of the firm or its consolidated group falls below the minimum required) to immediately notify the CNMV and present a program for rectification. This program must at least identify the reasons for non-compliance, and contain a plan to return to compliance, including by limiting activities which involve high risk and raising additional capital, along with timelines.

In practice, if material deficiencies come to light (such as failure to comply with capital

| | |
|----------------------|--|
| | <p>requirements, or changes in profitability that may indicate a problem), CNMV requires the firm to take immediate measures. If the firm does not comply with such a request, CNMV then requires the firm to produce a plan for returning to compliance which must contain the reasons why non-compliance has occurred, measures to be adopted and deadlines for rectification.</p> <p>Non-compliances with risk concentrations are also reviewed. Such non-compliance has declined recently because of the CNMV's stance of deducting the excess of the position over the 25 percent limit from firms' capital. Although this measure has affected the general level of capital in some firms, there have only been specific one-off cases of non-compliance.</p> <p>In 2010, the following requirements for corrective action were sent:</p> <ul style="list-style-type: none"> - 1 requirement for a failure to comply with the liquidity ratio. - 15 requirements relating to the limits to major risks. - 3 requirements relating to the asset position. <p>Risks from outside the regulated entity</p> <p>The calculation of capital requirements takes into account both on and off-balance sheet items in order accounts (as established, <i>inter alia</i>, in Article 19 of Royal Decree 216/2008).</p> <p>Article 86.4 of the LMV establishes the obligation for investment firms to consolidate their accounting statements with other financial institutions which make up one single decision unit, and Article 86.6 establishes that other instrumental companies (even unregulated companies) will form part of the group when their activity is an extension of the business of the investment firm or when they include the provision of auxiliary services to the investment firm. Consequently, the calculation of the capital requirements often includes an affiliate not subject to authorization and registration when it is part of the group of an investment firm.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 31. | Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters. |
| Description | <p>Management and supervision</p> <p><i>Organizational requirements</i></p> <p>Requirements for the integrity and competence of directors and managers are described under Principle 29. Failure to maintain these standards is grounds for revoking an authorization (Articles 67.2 and 73 LMV).</p> <p>Article 70(3) deals with requirements for internal organization. Investment firms must among other things have:</p> <ul style="list-style-type: none"> • a structure appropriate to the nature, scale and complexity of their activities • adequate procedures and measures to ensure compliance with their obligations • well-defined lines of responsibility • information systems that ensure staff are aware of their obligations • measures designed to avoid conflicts of interest • adequate business continuity measures • appropriate administrative accounting procedures • measures necessary to manage operational risk when investment services or |

| | |
|--|---|
| | <p>functions essential for providing those services are outsourced to a third party</p> <p>Article 37 of the RESI creates detailed requirements for outsourcing of functions, including:</p> <ul style="list-style-type: none"> • that the investment firm's responsibility for complying with its obligations must not be reduced • the authorized firm must adopt measures to ensure that the delegated third-party has the competence, capacity and any authorization required by the law to carry out the delegated activity • the investment firm and the third party must prepare, apply and maintain an emergency plan for data recovery in the event of catastrophes, regularly verifying the IT security mechanisms <p>Rule 6 of CNMV Circular 1/1998 (internal systems for control, monitoring and ongoing evaluation of risks) requires that when third parties carry out activities which involve risks, the authorized firm must ensure the professionalism, capacity and experience of the third party and apply the authorized firm's procedures and controls to the subcontracted services.</p> <p><i>Internal controls/compliance function</i></p> <p>Article 70(3).1.b of the LMV requires investment firms to have an independent compliance unit Article 70(3).2.a requires an authorized firm to have an internal audit function and systems and policies for identifying and managing risks. In addition, Circular 1/1998 requires ISPs to have an internal control function. Detailed requirements for the compliance, risk management and internal audit functions are set out in Articles 28, 29, and 30 of the RESI.</p> <p>Articles 67.2 and 73 of the LMV require an investment firm to have an internal CoC and appropriate information control and security measures and internal control procedures, including a regime for personal transactions of the company's directors, senior management, staff and legal representatives.</p> <p>CNMV Circular 1/1998 establishes minimum requirements for risk control, monitoring and ongoing assessment of broker-dealers, brokers and portfolio management companies.</p> <p>Senior management responsibility</p> <p>Article 31 of the RESI requires that senior management must ensure that the investment firm meets its obligations under the legislation and that, in particular, it must evaluate and review, at least annually, the effectiveness of the policies, measures and procedures established to meet the obligations imposed by law on the firm, and measures taken to rectify any deficiencies.</p> <p>Senior management must also periodically receive written reports on compliance, risk management and internal audit activities which indicate whether appropriate measures have been adopted to rectify any deficiencies.</p> <p>Circular 12/2008 (solvency of investment firms) provides more detail on board responsibility for internal control mechanisms:</p> <ul style="list-style-type: none"> • Article 146 requires an authorized firm to have a clear organizational structure, with well-defined, transparent and coherent lines of responsibility. It requires directors to delegate functions within the organization and the criteria for preventing conflicts of interest • Article 147 requires directors to approve the internal control strategies and procedures on which they must receive periodic reports |
|--|---|

Evaluation of internal controls and risk management

As indicated above, the internal audit function, as well as the internal control unit and compliance unit must prepare annual reports for senior management.

In addition, Rule 15 of the CNMV Circular 1/1198 requires the internal control function to prepare a report on the compliance of the ISP with the internal control requirements set forth by the CNMV, main incidences detected and measures adopted. Such report must be approved by the board or the audit committee of the ISP, and sent to the CNMV.

Organizational requirements

Internal systems

Article 27 of the RESI (implementing Article 70(3) of the LMV) requires investment firms to maintain a register of their activity and internal organization, and to ensure that the persons responsible carry out their functions in a fair, honest and professional manner. Article 33 of the RESI, as well as Articles 7 and 8 of EU Regulation 1287/2006, require investment service providers to have a register of orders and transactions which verifies diligence and fair treatment of clients.

Article 146 of CNMV Circular 12/2008 (capital and solvency) requires investment firms to have a register of all transactions in financial instruments and investment services so as to verify that firms have complied with all obligations relating to their clients. The same Article requires the compliance function to ensure there are procedures and controls to ensure staff compliance, and to supervise any measures taken to rectify deficiencies.

Segregation of functions

Rule 6 of CNMV Circular 1/1998 on internal systems for risk control, monitoring and evaluation contains an express requirement for investment firms to have an organizational structure which ensures segregation between functions that involve higher operational risk.

Conflicts of interest

Under Article 70(4) of the LMV, firms must have arrangements and adopt measures to detect possible conflicts of interest between the firm and its clients, or between the firm's clients. Detailed requirements for such arrangements are set out in Articles 44 ff. of the RESI.

If the organizational measures adopted to manage conflicts of interest are not sufficient to ensure, with reasonable certainty, the prevention of risks that harm client interests, an investment firm must give the client prior notice about the nature and source of the conflict before acting on its own account. The firm is not precluded from acting provided proper disclosure is made.

Direct electronic access (DEA) systems

There are no specific provisions in the LMV or related regulations on DEA; but general obligations on internal controls and risk management would apply. In addition, CNMV staff highlight that guidelines from ESMA, published in December 2011, will be in place soon. This issue was initially left to the market operator (BME). In March 2012, the CNMV notified ESMA its intention to comply with the mentioned guidelines.

In this regard, DEA systems ("sponsored systems") are not prohibited under BME market rules. They are not expressly dealt with in the rules and are regulated through the requirements applying to the BME member. Under market rules, members are subject to limitation on order volume, regardless of their source. BME reviews and authorizes

members' trading systems, and this "homologation" process includes review of the filters members must have in place to ensure compliance with volume limits. BME market systems have triggers that identify when volume limits are reached and orders will not enter the trading system until a confirmation is received from the member.

In its on-site supervision of secondary markets, CNMV's secondary markets department has paid special attention to the platforms' organizational requirements and pre-trade controls. In this regard, CNMV has required information on the specific measures in place and has checked whether the arrangements were enough and have worked properly, in particular:

- Records of decisions on actions to deal with expected and unexpected problems, such as: system properties, testing methodologies, etc.
- Requirements for members' pre and post trade controls, and their implementation, such as: arrangements that members have in place (Order price and quantity, unauthorized access, etc).
- Measures to constrain or halt trading implemented by the platform, such as: volatility measures and automatic rejections of orders which are outside a certain set of volume and price threshold.
- Arrangements in place to prevent capacity limits from being breached.
- Measures in place to prevent access of a particular member.
- Business Continuity plans, including: procedures and arrangements for various circumstances, such as physical emergencies.

Protection of clients

General obligation

Article 79 of the LMV requires investment firms to act with diligence and transparency in the interests of their clients, treating client interests as if they were their own. This general duty is supplemented by Article 59 of the RESI which requires intermediaries to clearly disclose receipt of incentives by third parties (if allowed) to the client.

Client funds and assets

Article 70(3).f of the LMV requires investment firms to adopt appropriate measures to protect the financial instruments and funds they hold for clients and to prevent their improper use. Clients' financial instruments cannot be used on the firm's account, except when the clients provide their express agreement. Detailed requirements are set out in Title II, Chapter I Section 5 of RESI.

Firms must also maintain effective separation between their own securities and financial instruments and those of each client. A firm's internal registers must make it possible to know at any time all clients securities positions and transactions in progress.

Article 70(3) also provides that, once the winding up of a securities depository firm commences, the CNMV can immediately require client assets to be transferred to another authorized firm, even if they are deposited with third parties. For this purpose, both the competent judge and the bankruptcy bodies are required to facilitate access to the accounting and IT registers needed to carry out the transfer. The existence of bankruptcy proceedings does not prevent the client holding the securities from receiving the cash resulting from their sale.

Investor complaints

Law 44/2002 established a requirement for financial institutions to address and resolve client complaints about their interests and legally recognised rights. For this purpose, credit institutions, investment firms and insurance companies must have a customer service department and must keep a log of customer complaints. They may also designate a client ombudsman to resolve complaints. Such departments must prepare a report for the board on an annual basis.

Investment firms must inform the CNMV of the name and contacts of the firm's head of the customer service department. This information is available to the public on the CNMV's website.

Client information*Contract of engagement*

Article 79(2) of the LMV sets out the requirements for investment firms for information to be provided to clients. All information addressed to clients, including advertising, must be impartial, clear and not misleading, and advertising must be clearly identified as such.

Clients, including potential clients, must be provided with understandable and appropriate information on the firm and the services it provides; on financial instruments and investment strategies; on order execution venues and on the associated fees and expenses so the client can understand the nature and risks of the investment service and of the specific type of financial instrument being offered and can make fully informed investment decisions. Information relating to financial instruments and the investment strategies must include appropriate guidelines and advice on the risks associated with said instruments and strategies.

Articles 62, 63 and 64 of the RESI set out the pre-contractual information that must be provided to clients, including contractual conditions and a general description of the nature and risks of financial instruments including an explanation of the characteristics of the type of financial instrument in question and the risks inherent to the instrument in a sufficiently detailed manner, so that the client may take well-founded investment decisions.

Article 79(3) of the LMV requires investment firms to create a register containing the agreements the firm enters into with its clients. Agreements must set out the rights and obligations of the parties and the other conditions under which the firm will provide services. A written record of contracts executed with retail clients must be kept. For investment advisory services to clients, a written or verifiable record of the personalised recommendation is sufficient.

Reports to clients

Article 79(2).4 of the LMV requires authorized firms to provide clients with appropriate reports about services provided. This general requirement is elaborated in the RESI:

- a. Article 68 requires the authorized firm to provide a client with detailed information about executed orders not relating to portfolio management services;
- b. Article 69 specifies the information that must be provided about portfolio management services (periodic statements on a durable medium of the portfolio management activities carried out on the client's behalf. For retail clients these periodic statements must be provided half yearly unless the client requests that they be sent quarterly, or has a leveraged portfolio, in which case the statements must be sent on a monthly basis); and
- c. Article 70 requires investment firms that hold client financial instruments or funds to send them an annual statement detailing client holdings on a durable medium.

Information about fees

Article 66 requires the investment firms to advise clients and potential clients about all costs associated with a transaction in a financial instrument or the provision of a service, including all related fees, commissions, costs, expenses and taxes. If the exact price is not given, the clients must be informed of the basis for calculating the total price in a way that enables them to verify the calculation. The client must also be informed about the possibility of other potential costs as a consequence of transactions linked to the financial instrument or service and which are not paid through the investment firm. Fees charged must be separately itemised.

The reports required by Articles 68 and 69 of the RESI must include information about the costs of the transactions and services performed on the client's behalf. Fees charged must be separately itemised.

Article 69.1.c of the RESI provides that retail clients must be given information about the total amount of the fees and expenses accrued over the period of the report, separately showing the full amount of the management fees and total expenses associated with execution.

Know your client and suitability rules*Know-your-client rules*

Rule 14 of Circular 1/1996 requires investment firms to carry out an identity check on a client when commencing a business relationship. For natural persons, this means the presentation of an ID card, passport or residence permit. For legal persons, this requires presentation of the incorporation documents or certification of the official public registry containing its name, legal form and tax ID number, as well as the powers of attorney for the persons acting on its behalf.

Articles 3 and 4 of Law 10/2010 (money-laundering and terrorist financing), obliges firms to carry out identity checks on natural and legal persons intending to establish business relations or participate in any transactions. The identity of both the formal holder and the beneficial holder must be checked.

Suitability rules

Article 79(2) of the LMV requires that investment firms at all times have the necessary information about their clients. When providing investment advisory or portfolio management services, the firm must ensure that the services or financial instruments offered are suitable to them (*'test de idoneidad'*). To ascertain that investment firms must obtain information about:

- a. the client's (and where appropriate potential client's) knowledge and experience in the area of investment relevant to the specific type of product or service involved.
- b. the client's financial situation and investment goals, so that the firm may recommend investment services and financial instruments which are most appropriate for the client.

When the firm does not obtain this information, it must not recommend investment services or financial instruments to the client or potential client.

The requirement to obtain information on the client's knowledge and experience does not apply to professional clients (as defined in Article 78).

For services other than those mentioned above, the investment firm must still assess whether the services or financial instruments are "appropriate" to the client (*"test de conveniencia"*). In such cases, they must request from clients (including potential clients) information about their knowledge and experience in the investment area relevant to the

specific type of product or service. When, based on this information, the firm considers that the investment product or service is not appropriate for the client, it must inform the client. When the client does not provide the information requested or the information provided is insufficient, the firm must warn the client that the lack of information prevents it from determining whether the investment product or service is suitable.

A firm providing execution-only services does not have to follow the procedure described above provided that :

- a. The client order is for shares admitted to trading on a RM or on an equivalent market of a third country; money market instruments; debentures or other types of securitised debt, except when they include an implicit derivative; UCITS harmonised in the EU and other non-complex financial instruments.
- b. the firm clearly informs the client that it is not obliged to evaluate suitability of the instrument offered or the service provided and that, therefore, the client does not enjoy the protection of the suitability rules.
- c. the firm has appropriate measures to prevent possible conflicts of interests that may harm its clients' interests.

Books and records

By Article 32 of the RESI, investment firms must keep the data included in all the required registers for at least five years. The CNMV in exceptional circumstances can require that all or some of the registers indicated in the previous paragraph are kept for as long as necessary depending on the nature of the instrument or transaction.

Registers must be kept on a medium which allow the information to be easily accessible for the CNMV, and the following conditions must be met at all times:

- a. The CNMV may easily access the registers and may reconstruct each one of the essential stages of processing each transaction
- b. It must be possible to distinguish any correction or modification made to the content of the registers prior to each stage, without it ever being possible to manipulate or alter the registers in any way

Regulatory oversight

Ongoing supervision of authorized intermediaries is carried out by the investment firms and credit institutions supervision department within the Directorate of Securities Market Participants (Entities). The department consists of three teams: one responsible for off-site supervision of both investments firms and credit institutions, one for on-site inspections of credit institutions and one for on-site inspections of investment firms. A total of 36 people are in the department, with equal numbers devoted to credit institutions and investment firms.

The department prepares an annual supervision plan which is approved by the CNMV's Executive Committee.

Off-site supervision

Investment firms (other than purely advisory firms) must provide monthly reports to the CNMV on capital and solvency. They also provide more detailed quarterly reports (full accounts), again with the main focus of the report being on compliance with capital, solvency and liquidity rules. Off-site supervision staff review these reports on a monthly basis. A report is produced on a bimonthly basis for the director of the department, highlighting trends and identifying firms where problems may be emerging (outliers). An annual report is produced for the Executive Committee. It is common for CNMV staff to seek additional information when they have reviewed a firm's periodic report. CNMV staff indicated that an average of 6 follow-up requests are made each month, in addition to

| | |
|--|--|
| | <p>phone calls.</p> <p><u>On-site inspections</u></p> <p><i>Risk analysis system for ISPs (other than financial advisors)</i></p> <p>The CNMV uses a systematic process for analyzing risk and classifying firms according to the level of risk they present. Four categories of risk are used: high; medium-high; medium-low; and low. The inputs into this process are detailed information about each firm including:</p> <ul style="list-style-type: none"> • information held on the CNMV's register; • information from the offsite monitoring; in addition to the financial reports discussed above, Circular 1/2010, recently implemented, requires both authorized firms and credit institutions to provide detailed information annually about the firm and its clients. For example: information about market share for each sector in which the firm is active, about the firm's clients (including client funds held), its branches and agents, the volume of transactions, and financial information (such as profit, leverage, capital and solvency and profitability. Where relevant, this includes information at the group level. This information has only been received for one year. The CNMV is in the process of reviewing how to improve the quality of the information received); • information from CNMV's supervisory activities (on-site inspections); and • information from public complaints or from the CNMV's sanctions area. <p>There are several factors imbedded in the risk scoring (ownership structure, activities authorized, size, financial indicators, liquidity and solvency ratios, asset concentration, diversification of own account, etc). There is no pre-established weighting for them. A CNMV staff member reviews this information (for example, for the 100 brokers and broker-dealers, 5 staff members each review 20 firms), and determines the level of risk of the firm. This assessment must be validated by the deputy director. After such assessment, the time of the last inspection and the results of the last inspections are input in the final evaluation of risk.</p> <p>A different method is used for assessing the risk of banks active in the securities markets but still based on information from Circular 1/2010). The key factors for assessment of these institutions are the number of clients and the volume of business.</p> <p><i>On-site inspections</i></p> <p>The frequency with which CNMV conducts on-site inspections depends on the risk category, and the availability of resources. There are no fixed cycles for any category of ISP.</p> <p>In the case of investment firms, the CNMV aims to do an on-site inspection of high risk firms every four years; for medium-high and medium-low firms every 6–7 years, and for low risk firms the cycle can be as long as ten years. The CNMV highlighted that currently only 12 firms are categorized as high risk, 18 are low risk and the remaining firms are medium risk.</p> <p>On site-inspection of investment firms are full scope inspections and cover both solvency and conduct issues. Robust sampling techniques are used to select and review files, including client files. The CNMV carried out 10 on-site inspections of investment firms in 2010 and 9 on site inspections in 2011.</p> <p>Banks dominate the financial services industry, including the selling and distribution of financial products.</p> <p>The CNMV aims to review 4 banks a year, 1 of the four large banks which together</p> |
|--|--|

| | |
|------------|---|
| | <p>account for around 50 percent of the market, and 3 smaller ones. The focus of these reviews is on the conduct of business obligations of the bank. The CNMV conducted 5 on-site inspections on banks in 2010 and 4 on site inspections in 2011.</p> <p>Finally as indicated earlier, the sector of financial advisers is still small, though this is the category where more new authorizations are taken place. In the last two years the CNMV have only conducted one on-site inspection in an advisor.</p> <p>As in the case of CIS operators, the relevant staff prepares a report with the findings of the inspection. Such report must be approved by the Deputy Director and the Director the Department. Once approved it is sent to the board of the ISP. The board must convene a meeting to discuss the report and propose actions to correct any deficiency identified. Action plans are reviewed by the Director and a proposal on whether to accept it (and close the inspection), request additional actions or even open an administrative proceeding, is prepared. The final decision is reported to the board. While not frequent, CNMV staff indicated that there have been cases where the Executive Committee requested additional actions beyond what was proposed by the Directorate.</p> <p><u>Thematic reviews</u></p> <p>The CNMV also carries out thematic reviews, mainly in connection with credit institutions (as they concentrate commercialization activities). Themes are chosen on the basis of information gained through on-site inspections (where identified problems may be more widespread in the industry) and public complaints, and sometimes as a result of issues identified in the CNMV's prospectus reviews for particular products. Reviews are carried out off-site by requiring a significant sample of regulated firms to provide information about the theme under review. An example is the work carried out by CNMV in 2011 that focused on selling practices relating to issues of preference shares by financial institutions. Problems with the selling practices of a firm were identified in an on-site inspection. CNMV made a public statement about these practices, but when they persisted conducted a review of 27 firms that accounted for 95 percent of the total market. The CNMV proposes to issue a final report on this work in the near future.</p> <p>Enforcement</p> <p>The CNMV also has used general recommendations on "bad practices" as a way to influence behaviour. As indicated under Principle 12, current cases in the pipeline indicate that the CNMV is using more sanctions in connection with breaches to conduct obligations by investment firms and credit institutions.</p> |
| Assessment | Partly Implemented |
| Comments | <p>The main concern that prompts the partly implemented grade is the low coverage of the on-site inspection program for all types of ISPs, but, in particular in connection with banks as they concentrate commercialization activities. Overall the assessors believe that more use should be made of on-site inspections also for the reasons stated in Principle 24. This could be done through spot checks on issues of particular concern and therefore this conclusion does not imply that full scale inspections would need to be conducted in all cases. A more detailed explanation of these issues is included in Principle 12.</p> <p>The new reporting requirements for investment firms and credit institutions might assist the CNMV to refine its risk analysis in relation to conduct issues when the quality of the data is improved and this information is integrated into the existing risk-analysis systems. This might help to better target the firms for on-site inspections.</p> <p>Finally the assessors note that in Spain the role of financial advisers is still very limited. However it is important that the CNMV start to integrate this sector more fully into its supervisory program, as there are risk to investors that arise from the engagement of financial advisers (even if they do not hold custody of assets nor have discretionary management of portfolios). Furthermore quality of investment advice is a current challenge in most countries.</p> |

| | |
|----------------------|--|
| | |
| Principle 32. | There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk. |
| Description | <p>Plans for dealing with failure of regulated firm</p> <p>The CNMV has a manual to dealing with “crisis” situation in investment firms, including interventions of investment firms, and substitutions of CIS operators. The manual details the procedures to be followed in each case (intervention or substitution) and includes also templates of the different type of resolutions that the CNMV might need to issue in connection with such situations.</p> <p>In addition, Title VI of the LMV establishes an investment guarantee fund (<i>Fondo de Garantía de Inversiones</i>, FOGAIN) designed to provide compensation to investors of up to € 100,000 when they cannot obtain reimbursement of their money, securities or financial instruments from an investment firm. This fund is most likely to be called upon if a firm fails.</p> <p>Membership of FOGAIN is mandatory for all ISPs, with the exception of financial advisory firms (who are not permitted to hold clients’ cash or securities) and those who only manage an MTF(Article 3 of Royal Decree 948/2001). At the end of 2011, it had 45 brokers, 50 dealers, 6 portfolio management companies, 47 UCITS management companies, and 0 foreign investment companies . Client cash balances and financial instruments held by credit institutions are covered by the deposit guarantee arrangements applying to those institutions. HFs are not covered.</p> <p>FOGAIN is pre-funded and at December 31, 2011 the amount held in the fund was € 55 million.</p> <p>Only a small number of events have led to claims on the fund during its existence, the most recent significant one being in March 2010 when a major broker dealer failed and compensation of approximately € 1 million was paid.</p> <p>The CNMV may initiate the transfer of clients' cash and financial instruments.</p> <p>Early warning systems</p> <p>As indicated in Principle 31, the CNMV receives monthly information from ISPs on their capital and solvency (with a month lag). ISPs are not required not notify to the CNMV if their solvency levels fall below a certain “early” warning threshold. The CNMV uses an estimate of five months of losses as an internal threshold to trigger regulatory action. Thus, in cases where the firm hits such level, the CNMV places it under intense monitoring and conversations take place with the management and if necessary, the board.</p> <p>Regulator’s powers to intervene</p> <p>The legislative regime for ISPs gives the CNMV extensive powers of intervention in authorized firms. These powers include:</p> <p>the power to take control of a firm or temporarily replace its management body (Article 107 of LMV, in reference with Article 31 of Law 26/1988). A reasoned explanation for the exercise of this power must be given to MEC. A firm in this position is subject, by virtue of Article 107 of the LNV, to the measures available for intervention and substitution under the legislation applying to credit institutions. The power can only be exercised if:</p> <ul style="list-style-type: none"> ○ the firm is in a situation of exceptional seriousness which endangers the effectiveness of its capital or its stability, liquidity or solvency, |

| | |
|---|---|
| | <ul style="list-style-type: none"> ○ there are well-founded indications that the a situation of exceptional seriousness may exist and the true situation of the firm cannot be deduced from its accounting, or ○ the firm itself requests the intervention. <p>the power to suspend the authorization of the firm totally or partially (by limiting activities or the scope of the authorization (Article 76 of the LMV). This power can only be exercised where the measures taken are required to ensure the firm's solvency or to protect investors.</p> <ul style="list-style-type: none"> • the power to revoke a firm's authorization (Article 74 of the LMV). This decision ordinarily must be made by the Minister, but can be made by the CNMV if the firm expressly relinquishes its authorization or if it ceases to belong to the investment guarantee fund. Revocation of authorization has immediate effect and the firm must not enter into new transactions. The MEC may decide, at the request of the CNMV, that the revocation also results in the forced dissolution of the firm. In that case, the CNMV (and the management companies of the official secondary market, if market members are involved) can take measures to protect investors and the proper functioning of the market by: <ul style="list-style-type: none"> ○ transferring client cash and client positions to another firm; ○ requiring a specific guarantee from the administrators appointed by the company; and ○ appointing administrators or intervening in winding up. <p>Communication and cooperation with other authorities</p> <p>The CNMV keeps regular contact with the BdE in connection with the supervision of credit institutions that provide investment services.</p> |
| Assessment | Fully Implemented |
| Comments | <p>The assessors note that the firms that dominate the industry are credit institutions, especially banks. What is most at risk if an investment firm fails are the funds and assets of clients (rather than severe market disruption) and there are adequate mechanisms available to protect them, including the guarantee fund, FOGAIN. Furthermore, the assessors note that in the last five years there has only been one case of a failure of an investment firm. The experience from that case shows that tools available to the CNMV can be effective.</p> <p>Finally the assessors note that the early warning system used by the CNMV is not typical, as many regulators use as a trigger a threshold based on capital requirements; however it appears that this tool has served the CNMV well. The CNMV might wish to explore the pros and cons of its current tool versus a more traditional early warning tool.</p> |
| Principles for the Secondary Markets | |
| Principle 33. | The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight. |
| Description | <p>Background – Spain's secondary markets</p> <p><i>BME group markets</i></p> <p>Trading in securities in Spain is dominated by exchanges and trading systems operated by the BME group. BME brings together the Spanish equity, private fixed-income and derivatives markets and their clearing and settlement systems. The BME Group trading venues and infrastructure entities are:</p> <ol style="list-style-type: none"> a. 4 stock exchanges (Barcelona, Bilbao, Madrid and Valencia), each an official secondary market (also refer in this report as RMs); b. 2 futures markets each regulated as an official secondary market; <ul style="list-style-type: none"> - MEFF <i>Productos Derivados</i> (equities and index products) and - MEFF <i>Renta Fija</i> (public debt products) c. a market for the trading of corporate debt, AIAF <i>Mercado de Renta Fija</i>, regulated as |

- an official secondary market;
- d. 3 MTFs:
- MAB, a market for secondary trading of round 3,000 SICAVs and a small number of small cap companies;
 - Latibex, a market for the trading of Latin American shares denominated in euros; and
 - *Sistema Electrónico de Negociación de Activos Financieros (SENAF)*, a market for the electronic multilateral trading of public debt.
- e. Iberclear, a central securities depository for the equities and fixed interest markets;
- f. MEFFCLEAR, a CCP for repo transactions on Spanish public debt securities, managed by MEFF Renta Fija.

The *Sociedad de Bolsas*, owned by the four Spanish stock markets, is responsible for technical management of the Spanish Stock Market Interconnection System (*Sistema de Interconexión Bursátil Español*, SIBE). The SIBE provides a single electronic platform and trading system for the approximately 172 issuers whose equities are listed on at least two of the stock exchanges. Shares in a company listed on one stock exchange market can only be traded on that market and trading does not take place through the SIBE system. Only a small number of companies are in this category.

The MAB and Latibex markets use the SIBE systems but are currently small by comparison with the main BME markets. 34 Latin American stocks are traded on Latibex, and 18 small cap stocks on MAB (MAB also trades interests in approximately 3,000 SICAVs). Only two of the stocks listed on MAB trade on a continuous basis. For other stocks, two auctions are held each day, with the SIBE's pre-opening algorithm being used to find an equilibrium price. Both the MAB and Latibex markets use market makers to provide liquidity.

There are two other official secondary markets outside the BME Group:

MFAO

The only RM on commodities derivatives at present is the olive oil futures market, MFAO. Trading volumes are very small.

Mercado de Deuda Pública en Anotaciones

This market is the RM for public debt instruments managed by the Bank of Spain who is in charge of its supervision and oversight.

MTFs

Spain has no MTFs other than the three BME Group MTFs mentioned above.

Authorization of secondary markets

Article 31bis of the LMV requires official secondary markets to obtain authorization from the MEC, on the recommendation of the CNMV, before they commence operations. The MEC's role is set out Article 45 of the LMV (authorization of stock exchanges of nationwide scope) and Article 59.1 (authorization of official secondary markets for futures and options of nationwide scope).

For markets that only operate in one autonomous region, authorization is the responsibility of the relevant autonomous region (Article 45), and the CNMV has no authority of these markets.

MTFs do not require authorization as an official secondary market, but are subject to prior verification and supervision by the CNMV (Article 119 of the LMV). In this regard, as part of the authorization of the MTF operator the CNMV would verify all rules pertaining to the functioning of such MTF.

Clearing and settlement systems

Article 44 bis of the LMV establishes the regulatory framework for the *Sociedad de Sistemas* which is the central securities depository for the securities markets (both equity and debt). Iberclear is the commercial name of the *Sociedad de Sistemas* that operates this clearing and settlement system.

Currently, the clearing and settlement of Spanish derivatives markets is done through their central counterparty mechanisms (MEFF, MEFF RF, and MFAO). Article 59.2 of the LMV requires these markets to act as the counterparty to all contracts (or to ensure another organization does so). Article 44 ter of the LMV allows the regulated derivative markets to perform clearing activities. Pursuant to this provision MEFFCLEAR acts as a CCP for repo transactions on Spanish public debt.

Authorization criteria

Official secondary markets

Article 31 bis of the LMV sets out the criteria for authorization as an official market. The criteria require an official market (among other things) to have:

- a. a management company responsible for trading and market services, for providing the resources to implement those services, and for managing and organising market activities in general;
- b. a board of directors and a managing director who must meet integrity standards and have relevant competencies and experience in securities markets. CNMV must be notified of the appointment of directors and the managing director, and can object to the appointment;
- c. sound administrative and accounting organization, and appropriate human and technical resources; and
- d. the minimum share capital and the minimum capital adequacy required by the legislation, appropriate to the nature and scope of the transactions to be made through the market and the type and level of risk involved.

Market rules must include rules for tradeable financial instruments, members, margin systems, trading, record keeping, clearing and settlement of transactions (where applicable), market supervision and discipline, and governance measures such as rules relating to conflicts of interest and risk management (Article 31 bis g) of the LMV).

A market's articles of association, operating regulations, the circulars and operating instructions must all be approved as part of the authorization process.

At the authorization stage, an applicant's plan must include detail about the organizational structure of the market and the resources and mechanisms to be used to carry out proposed functions. Markets must also send their contingency plans to the CNMV, which assesses their technical adequacy.

MTFs

MTFs can be operated by a financial services firm holding an authorization under Article 66 of the LMV; the management company of an official market; or a special purpose entity wholly owned by one or more such management companies (Articles 118 and 119 of the LMV).

The management company of an MTF is responsible for internal organization and operation and must have the resources necessary to operate the market (Article 120.1). It must have a general regulation (*reglamento general*) that sets up all aspects related to the functioning of such market included rules on the financial instruments that can be traded on it; information available on the securities that will be traded, types of

transactions, types of members, and conditions for access; rules relating to the supervision of the market including supervision of market abuse provisions, a regime for disciplining participants who breach market rules, and an obligation to notify CNMV of possible breaches of the LMV or related legislation. This general regulation is subject to prior approval by the CNMV and must be published (Article 120 LMV).

Ongoing conditions

Changes to the management company's articles of association or to market regulations require the prior approval of the CNMV (Article 31(2).3); Article 51.5 for futures markets). The same applies to MTFs pursuant to Article 120.1.

Supervision

Management companies of both RMs and MTFs must have a supervision department which, during each trading session, ensures that trading is conducted in an orderly manner in compliance with market rules and any other applicable legislation, especially in respect of market abuse (Articles 12.3 of Royal Decree 726/1989 for Stock Exchanges and Article 18.3 of Royal Decree 1282/2010 for regulated derivatives markets; for MTFs, Article 120.3.iv and 122 of LMV).

Management companies are also obliged to notify CNMV of any events or incidents which might involve a breach of mandatory rules (rules the legislation requires the management company to adopt), and to provide the CNMV with any assistance it requires to perform its duties of supervision, inspection and sanction. A similar obligation applies to MTFs pursuant to Articles 120 and 122 of the LMV.

Securities and market participants

Market products

The decision to admit securities to trading on an official secondary market is made by the market management company after the CNMV verifies that the security meets the requisites and procedures established in the LMV.

For derivatives markets, CNMV authorizes the general terms and conditions of contracts to be listed on the market (Article 11 of Royal Decree 1282/2010). For commodities contracts, a report from the authorities and institutions related to the underlying assets is required (Article 5 of order ECO/3225/2002).

For the corporate bonds market (AIAF), Article 8 of the AIAF regulation sets out the securities that can be admitted to trading, and the CNMV must review and approve admission before trading can commence.

For regional markets, the relevant regional authority approves the listing of stocks to trade on the market (Article 32 LMV).

In the case of MTFs, the CNMV is not involved in the process of verifying that a specific issuer/security meets the relevant requirements. Rather, in this case verification is made solely by the BME. For Latibex, securities must meet the listing standards of their home jurisdiction, and issuers must also comply with the reporting obligations that apply to them in these markets. Disclosures must be made available to Spanish investors by the MTF management company. For MAB, market rules establish minimum criteria for listing (including a prospectus like document and an activity statement or business plan for future operations).

Members

Article 37 of the LMV states that membership of a RM is open to all investment firms and credit institutions which apply for it, providing they meet the access conditions stipulated

| | |
|----------------------|---|
| | <p>by each market. These conditions must be transparent, non-discriminatory and based on objective criteria. Application for membership may only be refused due to a failure to comply with the conditions specified in the market rules. To become a member, an applicant must make an application to the market's management company, accompanied by certification from the CNMV or the Bank of Spain (depending on the type of entity) certifying that the applicant is registered on the relevant public register.</p> <p>For the MTFs, Article 120.2.i.c of the LMV applies the membership rules in Article 37 to MTFs. The board is responsible for determining which entities will be admitted to membership, in accordance with the provisions of their regulations, which must respect the principle of objective access criteria.</p> <p>Fairness of order execution procedures</p> <p>Before recommending authorization of an official secondary market, CNMV verifies that the rules contain detailed criteria for order execution and that these rules are fair to market participants and users.</p> <p>The electronic trading platform used by the BME equity markets, SIBE, is an order driven system using a price-time algorithm. The SIBE platform is continuous for liquid stocks, and for illiquid stock two auctions per day, using the pre-opening procedures that apply to the continuous market. The MEFF markets use a similar algorithm.</p> <p>Market participants have obligations under the conduct rules established by Title VII of the LMV, particularly Article 79(6) which deals with the management and execution of orders. Market participants must take all reasonable measures to ensure the best outcome for their clients. Articles 80 and 81 of the Royal Decree 217/2008 regulate the general principles applicable to the management of the client orders and the aggregation and distribution of the client orders.</p> <p>In addition market abuse provisions are applicable to the trading on MTFs (Chapter II of Title VII in connection with Article 121 of the LMV).</p> <p>Operational information</p> <p>The management companies of RMs are responsible for ensuring that all members have access to trading information under equitable conditions. The right to this information must be included in the market rules approved by the CNMV.</p> <p>A market operator's record keeping obligations, and investment firms' obligations to keep records about own account and client orders and transactions (Article 70 ter.1.e of the LMV) mean that there are records that enable reconstruction of all trading activities.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 34. | There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants. |
| Description | <p>RMs have a direct role on market surveillance for purposes of ensuring orderly trading (real time surveillance). In addition, they have a complimentary role of that of the CNMV in connection with the detection of potential misconduct and market abuse (Article 32 ter of the LMV). The CNMV is the front line supervisor for purposes of detecting unfair trading practices, including market abuse.</p> <p><i>Surveillance by the BME</i></p> <p>The BME has 15 staff dedicated to surveillance of the four official secondary markets.</p> |

Surveillance is done by products, and there is cross surveillance for warrants and ETFs. Each staff member is assigned a group of stocks which they follow through the day.

To support this function, the BME has developed its own automated system. The system has imbedded static and dynamic limits that trigger intraday 5 minute auctions using the pre-opening algorithm or trading halts if parameters are reached. It also generates alerts (based on volumes, prices, concentration, etc) that surveillance staff analyse based on all available information. If necessary staff make follow- up calls during the day to the member who executed the trade. If at the end of the day staff have concerns about a particular transaction, they inform the CNMV.

Market surveillance by the CNMV

The CNMV's Internal Regime Regulation requires the CNMV to supervise markets' management companies and the members of secondary markets, and to supervise and inspect activities on securities markets. This surveillance is performed by the Secondary Markets Department. Within the Department, 23 of its 31 staff members carry out market supervision, in three teams organized along product lines (equities, fixed incomes, and derivatives), regardless of the market on which trading takes place.

The CNMV has a vendor feed giving it real time access to both securities and derivatives markets, with the same view as participants and the market operator (pre-trade and post-trade data). In addition, it receives via a dedicated line a full download of each day's transactions. From 2009, market participants have been required to provide daily to the CNMV a list of the beneficial owners of all transactions entered into on the previous day.

This information is supplemented by weekly reports from the BME with statistical information on trading, significant price movements and data on option volatility. CNMV also meets monthly with BME's compliance department.

The CNMV has developed a monitoring and alert system to identify unusual trading that may indicate non-compliance with relevant legislation, especially with the prohibitions on market abuse and insider trading. Using the trading data described above, the system creates alerts if there are abnormal movements in trading prices or volumes, or concentrations of orders and market trends. Specific surveillance alerts are put in place for each market and for cross-market purposes as well (See also under Principle 36). In addition, for purposes of detecting insider trading, CNMV staff also review media news and reports on listed entities.

Article 86.2 of the LMV was amended to clarify the power of the MEC and, if expressly authorized, also of the CNMV to make rules about, and have access to, all records of market operators and clearing and settlement facilities, including internal records and statistical databases. A Ministerial Order is currently being drafted to give effect to this amended legislation.

CNMV oversight of the BME

The CNMV has several mechanisms to oversee compliance by BME with its obligations, in connection with RMs, including:

- a. immediate reports of incidents;
- b. end of day reports on transactions executed;
- c. weekly reports on market activity, often followed by phone calls;
- d. monthly meetings to discuss market developments and follow-up on any problem detected; and
- e. from time to time, on-site inspections (the last one was conducted two years ago).

For BME's MTFs, BME is also obliged to report incidents immediately, submit the end of the day reports and there are contacts by phone as needed; but no regular meetings are scheduled.

| | |
|----------------------|--|
| | <p>Approval of market rules</p> <p>Articles 31bis and 59 of the LMV stipulate that changes to the by-laws and regulations of the governing bodies of RMs and futures and options markets require prior approval from the CNMV. Each exchange's operating standards and proposed amendments to them must be submitted to the CNMV for verification prior to being implemented.</p> <p>The operating regulations of MTFs require the approval of the CNMV (Article 120.3 of the LMV).</p> <p>Powers of intervention</p> <p>Article 15.2 of Royal Decree 726/1989 provides that the CNMV may suspend the application of any rule issued by a management company when it considers that it breaches securities market legislation, or impairs the fairness and transparency of the price formation process or investor protection. For derivatives markets, Article 19 of Royal Decree 1282/2010 empowers the CNMV to suspend a market regulation in the same circumstances. These provisions also give the CNMV power to require management companies to amend market rules. These powers are also applicable in connection with MTFs pursuant to Article 85.e of the LMV.</p> <p>The CNMV also has the power under Article 33 of the LMV to suspend trading in securities if special circumstances exist that may disrupt orderly trading in a financial instrument or if the intervention is necessary to protect investors.</p> <p>Article 31 bis 4 of the LMV stipulates the circumstances in which the authorization of an official secondary market may be removed. Like authorization, withdrawal of authorization requires a decision of the Minister of Economy and Competitiveness.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principle 35. | Regulation should promote transparency of trading. |
| Description | <p>Equity markets</p> <p>Pre and post-trade transparency obligations for shares admitted to trading on aRM (or trading in a MTF when they are also admitted to trading on a RM) stem from EU legislation.</p> <p>In the Spanish legal framework this obligation is included in Article 43 of the LMV for RMs and Articles 123 and 124 of the LMV for MTFs, and the corresponding subsidiary legislation. The information described below must be disclosed on reasonable commercial terms and continuously in normal trading hours.</p> <p><i>Pre-trade transparency</i></p> <p>For equity securities, the five best bid and offers prices, and the volume at those prices, must be displayed. This information is made available through the market facilities (vendor feed); through third party information providers (e.g., Bloomberg, Reuters); or through proprietary arrangements (such as <i>Infobolsa</i>) on commercial terms.</p> <p><i>Exceptions to pre-trade transparency</i></p> <p>There are exceptions to the pre-trade transparency obligations, in line with the waivers available under the MiFID regime. About 35 percent by value of transactions occur with the benefit of these waivers.</p> <p>Trades during normal trading hours</p> <p>Large-scale transactions can be performed in the block segment without pre-transparency for those transactions that are large compared to normal market size, but</p> |

there are limits on the prices at which transactions can occur. Parameters for permissible block trades are:

- i. For listed securities in the Ibex-35 index: Prices must be within +/- 1 percent of the mid-point of the range of the best bid and offer prices on the continuous market; the volume transacted must be higher than € 600,000 and at least 2.5 percent of the average daily turnover in the market in the last calendar quarter.
- ii. For other securities: prices may deviate by up to 15 percent from the static price; the volume transacted must be more than € 1,200,000 and at least 5 percent of the average daily turnover in the market the last calendar quarter.

For iceberg orders, there is pre-trade transparency only for that part of the order that is displayed in the order book. However, transparent orders have priority over the undisplayed parts of iceberg orders so that the undisplayed part of the iceberg order cannot be filled until other displayed orders have been executed.

Trades outside normal trading hours

Other large-scale transactions can be performed without pre-trade transparency after the market is closed in the special transactions segment recognized by Royal Decree 1416/1991. There are three types of special transactions with different prerequisites:

FUERA DE HORA (trades outside-market hours that do not require preauthorization). These trades are subject to price limitations (the price must be within a ± 5 percent interval centered in the volume weighted average price (vwap) or in the closing price of the session); minimum volume requirements (trade value must be at least € 300.000 and represent at least, 20 percent of the daily average traded in the stock during the last quarter); and both the buyer and the seller must be individual beneficial owners. Aggregation of different orders (bunched orders) is not allowed.

AUTORIZADAS (trades that must be authorised in advance by the market supervision department of the stock exchange). These trades normally involve special circumstances such as transmissions related to mergers or reorganization of listed companies, or court rulings. They are subject to minimum volume requirements (€ 1.500.000 and, at least, 40 percent of the daily average traded in the stock on the last quarter).

TOMAS DE RAZON: trades directly agreed to by two non- market members of the stock exchange: Trades under € 300.000 or 20 percent of the daily average traded in the stock on the last quarter need authorization by the market supervision department of the stock exchange.

Special (out of hours) transactions represent only around 2 percent of the aggregate volume traded on the stock exchanges.

Post- trade transparency

For equity securities, the price and volume of all trades executed are made public. At least the following details must be disclosed: trading day, trading time, price and volume, instrument identification, identity of the investment firms which traded the transactions.

Post-trade information is disseminated in real time through the facilities of the market (vendor feed); through third party facilities (such as Bloomberg, Reuters) or through proprietary arrangements (e.g., *Infobolsa*) on reasonable commercial terms. The BME publishes information free of charge on its website with a 20 minute delay.

Exceptions to post-trade transparency

Although deferral of publication of post-trade information is available under MiFID and Article 43 of the LMV, in practice the BME exchanges at this stage do not make use of these exceptions. As a consequence all market activity is subject to post trade

transparency.

Special transactions entered into under Royal Decree 1416/1991 after market hours (up to 20:00 p.m.) must be reported before the opening of the next trading day.

Other financial instruments

The EU legislation currently does not impose any requirement for public pre-trade or post trade transparency in non-equity financial instruments. In the Spanish market the legal provisions stated above (Articles 43, 123, and 124) allow the MEC, via royal decree, to extend these obligations to other financial instruments. The MEC has not used this power. However, transparency obligations (as stated below) have been established via market rules.

Fixed-income markets (AIAF; Public Debt Book-entry Market and SENAF)

AIAF is a bilateral market for trading corporate bonds. Participants usually perform telephone transactions which are later confirmed by fax or SWIFT messages. Since May 2010 this market has had an electronic trading segment (SEND) which offers information on the bids and offers in the system's order book classified by price, showing the sum of the nominal amount for each of the sale and purchase prices and the number of orders for each price. Information on matched transactions in SEND is made available to participants in real time. Other trading information is published by the market as it is received from the settlement and record-keeping system.

The transparency regime for other fixed income markets (the public debt markets operated by the BdE) is the same as for the AIAF market.

Derivatives markets (MEFF and MFAO)

MEFF regulations require the dissemination of information about bids and offers and completed transactions in real time using the trading terminal used by all participants and professional distributors of financial information. Information to be disseminated in this way includes, for each contract traded on the market:

- a. the best purchase and sale prices offered;
- b. the number of contracts offered at those prices;
- c. the price of the last transaction;
- d. the cumulative number of transactions matched during the session so far at any price; and
- e. in the case of futures, the last settlement price applied, and the maximum and minimum prices of transactions in the session underway.

Pre-trade transparency

For futures and options markets, CNMV Circular 3/99 requires official futures and options markets to disseminate information in real time for each contract and open maturity and (where relevant) series on:

- a. bids and offers—the cumulative volume for each the three best bids and offers;
- b. completed transactions—all transaction executed during the session, showing price, volume and time of execution; and
- c. open positions—volume of open positions.

MEFF provides free access through its website to the best bid and ask prices and volumes at those prices, with a 15 minutes delay.

Exceptions to pre-trade transparency

Circular C-DF-03/2012 of MEFF requires that negotiated transactions off-market must be at or within the spread in the market's electronic order book. For futures or options

| | |
|----------------------|--|
| | <p>transactions whose volume exceeds the threshold, the price must be around the theoretical price at the time of the communication.</p> <p><i>Post -trade transparency</i></p> <p>MEFF regulations require information about completed transactions to be disseminated in real time using the trading terminal used by all participants and professional distributors of financial information.</p> <p>The MFAO provides complete pre-trade transparency in real time and free of charges for the three best bid/ask positions through the market web service facility. Complete post-trade transparency is also provided by the market in real time.</p> <p>Dark trading and dark orders</p> <p>CNMV staff advised that the only dark trading that takes place on Spanish markets is dark orders within the ambit of official secondary markets, not trading in dark pools away from the RMs. Dark orders are “iceberg orders” and for them the market’s governing company and the CNMV have the same information as market participants. For this type of dark order, the visible part is executed, and each new tranche is treated as a new order and so is placed behind other transparent orders which have priority relative to the new tranche.</p> |
| Assessment | Fully Implemented |
| Comments | Since almost all trading in BME stocks takes place on the BME market, there is currently no fragmentation of trading as in other jurisdictions. Thus the need for consolidation of post- trade information does not arise in practice, although it would do so if competing market venues for BME stocks commenced in Spain or elsewhere. |
| Principle 36. | Regulation should be designed to detect and deter manipulation and other unfair trading practices. |
| Description | <p>Prohibition of market abuse</p> <p>A combination of Spain’s Criminal Code and the securities legislation prohibit market abuses.</p> <p>Article 284 of the Criminal Code makes it an offence to disseminate false news or use other forms of deception to change or maintain prices, or give false information about the supply, demand or the price of securities. Article 285 of the Code makes it an offence for a person to directly or indirectly use for their own benefit, or that of other persons, any information relevant to the price of any asset class in any market to which they have had confidential access. These cases can only be pursued by the Prosecutor’s Office. Criminal penalties, including imprisonment, apply.</p> <p>In addition, the LMV makes it an administrative offence to use or to disseminate inside information (Article 81.2 and Article 99.o) as well as to carry out practices that affect price formation including transactions or orders that (i) might convey misleading signals about securities or financial instruments; (ii) maintain an abnormal or artificial price, or (iii) use fictitious devices; and the dissemination of false information or information that might provide false or misleading signals (Article 83 ter and Article 99.i). The CNMV has power to specify other specific practices that are contrary to the principle of free price formation.</p> <p>The sanctions available for administrative breaches are described under Principle 11.</p> <p>Regulatory approach</p> <p>The CNMV has direct responsibility for detecting, investigating and dealing with possible cases of market abuse and insider trading. The supervision system described under Principle 34 is used to monitor trading on the markets. This is supplemented by information received from the information market operators are obliged to report, and</p> |

| | |
|----------------------|--|
| | <p>information available from other regulatory departments (such as information about material event disclosures and corporate actions such as takeovers).</p> <p>If the relevant market supervision department identifies transactions or activity that may indicate a breach of the market abuse or the insider trading prohibition, it refers the matter to a specialist unit within the Market Directorate, the MMU. The MMU gathers additional information using the power to gather information described under Principles 10 and 11. If the MMU reaches the view that an actionable breach of the law has taken place, it refers the matter for sanctioning or for potential criminal prosecution (using the process described under Principle 12).</p> <p>As noted under Principle 12, the CNMV has in the past imposed sanctions on insider trading and it has currently in the pipelines cases for market manipulation. A number of market abuse cases have in recent years been referred to the prosecution authorities, but none has yet been finalized. Information about referrals to the prosecutorial authorities for these 2 years is set out in Principle 12. In the period before these referrals, there seems to have been a long period when there were no examples of criminal action for market abuse and insider trading cases,</p> <p>Cross market supervision</p> <p>The monitoring and alert system used by the CNMV highlights potential misconduct in each market and this can be checked with staff in the other market teams to see if it has cross market implications. In addition, the monitoring system includes some cross-market alerts designed to detect potential misconduct affecting more than one market (such as warrants linked with their underlying). The CNMV is in the process of developing a more integrated system that will not only contain data from all markets but also will collect price sensitive information disclosed releases and other information data bases not fully integrated in the current monitoring system. The new system will provide integrated data, including about the ownership of instruments and other elements which can help the in the detection processes.</p> <p>Foreign linkages</p> <p>At present there is limited trading of stocks listed on BME in market venues outside Spain. However, given remote participation, the CNMV often requires information from other regulators for its investigations on market abuse (in particular the U.K., FSA). CNMV staff indicated that through the MMoU the CNMV is able to request and receive the information that it needs for such investigations. In addition, the CNMV participates in the ESMA-POL information sharing network.</p> <p>Commodity markets</p> <p>The only commodity futures market in Spain is MFAO, and trading activity on it is very small. There is no regulatory authority responsible for the underlying physical market. The market does allow participants to exceed position limits when the positions are hedges against physical positions. The Olive Oil Agency (a public agency) publishes monthly data market conditions.</p> |
| Assessment | Fully Implemented |
| Comments | <p>The authorities have demonstrated that they have been active in the investigation of market abuse cases, and that sanctions have been imposed. Successful criminal enforcement of market abuse provisions is also a key component of an effective enforcement program. The assessors note that the CNMV has been more active in referring cases to the criminal prosecutors in recent years but there are not yet sufficient results that send clear signals to the market, as only one conviction took place recently. These challenges are common to many regulators. They have been considered in the grade of Principle 12.</p> |
| Principle 37. | Regulation should aim to ensure the proper management of large exposures, default risk and market disruption. |
| Description | Monitoring of large positions |

Monitoring of large positions is achieved by the rules of the settlement systems used for BME markets, IBERCLEAR, MEFF and MEFFCLEAR, and it is also applicable for MFAO. The rules of these clearing systems (which are approved by the CNMV) have quantitative and qualitative triggers that allow the monitoring of large positions:

IBERCLEAR

Quantitative triggers are based on the collateral by firms deposited by participants. Royal Decree 116/92 and IBERCLEAR's own rules create criteria for calculating daily risk traded by each clearing participant, and hence their collateral obligations. Market collateral guarantees are initially set at 80 percent of the average daily risk for the preceding 3 months. Additional guarantees are required if a participant's transaction risks exceed their collateral cover.

The CNMV receives information daily about collateral cover.

MEFF, MEFFCLEAR, and MFAO

Initial margins are required for contracts and monitoring of positions and risks is monitored in real time. The futures exchanges can set position limits (for both participants and clients) to prevent a build-up of risk.

Regulator's access to information

Both system operators and the CNMV have access to information about risk positions. In IBERCLEAR only aggregate client positions are recorded but IBERCLEAR can require a participant to provide information about the ownership of positions. For MEFF and MFAO, omnibus client accounts are not permitted, so client positions are held in separate accounts at the clearing house.

If required, the CNMV can use its broad information gathering powers to identify the ultimate holders of positions.

Failure of a system participant to supply information about client positions to the system operator is a breach of system rules, and the system operator has an obligation to report it to the CNMV.

Intervention measures

The IBERCLEAR system does not set position limits but does request additional collateral if positions pending settlement exceed collateral held.

The MEFF derivatives markets, MEFFCLEAR and MFAO have limits on participants' and clients' open positions. These limits depend on the equity of the participant or client, and the size of position relative to the total market. If a participant or a client nears that limit, the market operator issues a warning and will not permit any transaction that will result in the limit being exceeded.

Default procedures—transparency and effectiveness

The regulations of each market and clearing and settlement facility set out the procedures to be followed in the event of the default of a participant.

Law 41/1999 recognizes the IBERCLEAR, MEFF, MEFFCLEAR, and MFAO systems as clearing and settlement systems for the purposes of Spanish law. This means that settlement finality is determined under market rules, and that protection of client assets is provided if a participant fails, and clients are entitled to have their funds or positions kept separate from any insolvency proceedings, and that they can be transferred to another participant to enable the client to continue its trading activities (see also Articles 12 bis of

| | |
|---|---|
| | <p>the LMV for IBERCLEAR, Article 44(ter) of the LMV for CCPs, Article 59 of the LMV for futures markets).</p> <p>Short selling on equities markets</p> <p>Naked short selling is banned in Spain under market rules.</p> <p>In 2010, CNMV implemented the model for reporting short positions proposed by CESR (now ESMA). A reporting and publication system based on 2 thresholds is established:</p> <ol style="list-style-type: none"> short positions equal to or higher than 0.2 percent of the issuer's share capital must be notified to the CNMV but t are not reported to the market. Increases or decreases of more than 0.1 percent are treated in the same way; and short positions equal to or higher than 0.5 percent of the issuer's share capital must be notified to the CNMV and are individually reported to the market. <p>The CNMV publishes and updates the total aggregate short positions in each security every fortnight as a minimum.</p> <p>CNMV takes the view that concealment of information on short positions and the conveying false information to participants in official secondary markets on the availability of securities before a transaction is a breach of the prohibition on market manipulation.</p> <p><i>Failed trades</i></p> <p>Market operators are required to report daily to the CNMV on failed transactions. CNMV follows with the brokers on a daily basis too. Failed trades on the equity markets are low and run at around 0.2 percent by volume. Iberclear is empowered to order replacement purchases in the market at the expense of the seller to deal with failed trades. In addition, penalties apply for failing to settle trades in a timely way. CNMV monitors settlement daily and analyses delays in settlement.</p> |
| Assessment | Fully Implemented |
| Comments | |
| Principles Relating to Clearing and Settlement | |
| Principle 38. | Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk. |
| Description | |
| Assessment | Not assessed |
| Comments | |