

**Spain: Financial Sector Assessment Program—Detailed Assessment of the  
CPSS-IOSCO Recommendations for the Securities Settlement Systems**

This Detailed Assessment of the CPSS-IOSCO Recommendations for the Securities Settlement Systems for Spain was prepared by a staff team of the International Monetary Fund as background documentation for the Financial Sector Assessment Program with the member country. It is based on the information available at the time it was completed in May 2006. 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.

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FINANCIAL SECTOR ASSESSMENT PROGRAM  
**SPAIN**

**DETAILED ASSESSMENT OF  
IMPLEMENTATION OF THE CPSS-IOSCO  
RECOMMENDATIONS FOR THE SECURITIES  
SETTLEMENT SYSTEMS**  
MAY 2006

INTERNATIONAL MONETARY FUND  
Monetary and Financial Systems Department

Contents

Glossary .....3

I. CPSS-IOSCO Recommendations for Securities Settlement Systems.....4

    A. General.....4

    B. Scope of the Assessment.....4

    C. Institutional and Market Structure.....6

    D. Description of Regulatory Structure and Practices .....11

    E. Information and Methodology Used for Assessment.....13

    F. Authorities’ Response to the Assessment.....36

Tables

1. Detailed Assessment of Observance of CPSS-IOSCO Recommendations for Securities Settlement Systems— Iberclear .....14

2. Summary Observance of CPSS-IOSCO Recommendations for Securities Settlement Systems—Iberclear .....34

3. Recommended Actions to Improve Iberclear’s Observance of CPSS-IOSCO— Recommendations for Securities Settlement Systems .....35

**GLOSSARY**

AIAF	<i>Asociación de Intermediarios de Activos Financieros</i> (brokers' association for the corporate fixed-income market)
BE	<i>Banco de España</i>
BIS	Bank for International Settlements
BME	<i>Bolsas y Mercados Españoles</i>
CCP	Central counterparty
CADE	<i>Central de Anotaciones de Deuda del Estado</i> (Central Public Registry) operated by Iberclear
CNMV	<i>Comisión Nacional del Mercado de Valores</i>
CPSS	Committee on Payment and Settlement Systems of the central banks of the Group of 10 countries
ECSDA	European Central Securities Depository Association
EU	European Union
Iberclear	<i>Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.</i>
IOSCO	International Organization of Securities Commissions
Latibex	Spanish market for Latin American stocks traded in euros
MEFF	<i>Mercado Español de Futuros Financieros</i>
MEFFclear	The central counterparty operated by MEFF
MOU	Memorandum of Understanding
MTS	Multilateral Trading System
SCLV	<i>Servicio de Compensación y Liquidación de Valores</i> (Securities Clearance and Settlement Service) operated by Iberclear
SENAF	<i>Sistema Electrónico de Negociación de Activos Financieros</i>
SIBE	<i>Sistema de Interconexión Bursátil Español</i>
SMA	Law 24/1998, the Securities Market Act
SSS	Securities Settlement System
T	Trade date

## I. CPSS-IOSCO RECOMMENDATIONS FOR SECURITIES SETTLEMENT SYSTEMS

### A. General

1. This report describes the assessment of the securities clearance and settlement system in Spain.<sup>1</sup> The assessment is based on the Committee on Payment and Settlement Systems (CPSS)/International Organization of Securities Commissions' (IOSCO) *Recommendations for Securities Settlement Systems* (2001), and performed using the CPSS/IOSCO assessment methodology for *Recommendations for Securities Settlement Systems*, (2002). The system assessed is the *Registradora Central de Valores* (Central Securities Depository, or RCV) that Spain maintains at the national level, known as the *Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, SA* (Management Company for Securities Registry, Clearance and Settlement), which operates under the commercial name of Iberclear.
2. Iberclear was constituted on April 1, 2003, and is the product of the merger into a single corporation of the *Servicio de Compensación y Liquidación de Valores SA* (Securities Clearance and Settlement Service, SCLV) and the *Central de Anotaciones de Deuda del Estado* (CADE). The SCLV platform performs the functions necessary for registration, clearance and settlement relating to the transactions in the securities described below (other than public debt), and the CADE platform performs these functions for the *Mercado de Deuda Pública en Anotaciones* (Book-Entry Public Debt Market).

### B. Scope of the Assessment

3. The securities covered by this assessment are:
  - Shares and rights accepted for trading on more than one stock exchange, or solely on the Madrid Stock Exchange, both those traded by open outcry and those using the electronic continuous trading system, *Sistema de Interconexión Bursátil Español* (SIBE).
  - Securities issued for negotiation on the Latibex market (i.e., Latin American securities traded on the Madrid Stock Exchange).
  - Warrants and certificates accepted for trading in the Warrants, Certificates and Other Products Module of the SIBE.
  - Private fixed-income securities accepted for trading on the Electronic Fixed Income Market, on two or more open-outcry stock exchanges or on the *Asociación de Intermediarios de Activos Financieros* (AIAF) Fixed Income Market.

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<sup>1</sup> This assessment was carried out by Larry E. Bergmann (U.S. Exchange and Securities Commission). The assessment took place from June 22 to July 1, 2005.

- Public debt issued by the central government, by the Autonomous Communities, with the exception of the Autonomous Communities of Cataluña, País Vasco and Valencia, and by local corporations.
4. The institutions that perform critical functions in terms of registration, clearance and settlement for these securities are the following:
    - **Iberclear.** This is the institution responsible, together with its participating entities, for the registration of book entries (*anotaciones en cuenta*), which are constituted as such at the time of registration/issuance, and for keeping this registry of book entries for the securities referred to above. It maintains full details on the securities owned by its participating entities, as well as the overall balance of the securities they hold on behalf of their customers (third parties).
    - **Entities participating in Iberclear.** A number of entities participate in Iberclear, depending on the platform on which they are operating. The entities belonging to the former SCLV are responsible for registering the securities of those natural or legal persons who are not participants in Iberclear-SCLV (customers or third parties). In the case of the CADE platform, the so-called *Entidades Gestoras* (Managing Entities) are responsible for registering the securities of those entities that are not account holders, i.e., that cannot directly maintain accounts in their name in Iberclear-CADE; this is known as the *registro de terceros* (third party or customer registry).
  5. In addition to Iberclear, there are local securities settlement systems (SSSs) in Barcelona, Bilbao, and Valencia.
  6. The local SSSs process transactions involving securities that are listed only on the corresponding stock exchange, i.e., exclusively on the stock exchange of Barcelona, Bilbao or Valencia. Although there are different types of securities registered in these three local SSSs, such as shares or private fixed-income securities, the most important ones in terms of actual volume traded are those issued by the autonomous communities of Cataluña, País Vasco, and Valencia.
  7. The local SSS's systems and procedures for clearance and settlement are very similar to those of Iberclear. They are supervised not by the *Comisión Nacional del Mercado de Valores* (CNMV), but by the corresponding Autonomous Community governments.
  8. Local SSSs have been excluded from the present assessment, because the transactions and volumes they process are insignificant in comparison with Iberclear's activity. In the aggregate, the regional clearance and settlement systems processed only a tiny fraction of the total value of securities processed in Spain in 2004. Iberclear settled a total of €3,457,319 million in value, while the regional settlement organizations processed €83 million by value. The majority of this was the processing of the Autonomous Communities' debt, of which these settlement organizations accounted for 3.5 percent of the

total value of government debt processed. They processed 0.04 percent of corporate bonds by value and 0.24 percent of equities by value.

9. This assessment does not cover MEFFClear, although its principal characteristics are referred to in Recommendation 4 below. This is a Central Counterparty (CCP) belonging to MEFF *Renta Fija* in which transactions negotiated bilaterally or originating from *Sistema Electrónico de Negociación de Activos Financieros* (Financial Asset Electronic Trading System—SENAF) can be recorded simultaneously. Therefore, this CCP is not part of the Iberclear systems. The number of transactions processed daily is low. In 2004, MEFFclear processed a daily average of 13 operations and €1.340 million in value (representing less than 1 percent of the total settlement in the public debt market). An assessment of MEFFClear is planned by the CNMV in accordance with the CPSS/IOSCO *Recommendations for Central Counterparties* (2004).

### C. Institutional and Market Structure

10. There are four stock exchanges (*Bolsas de Valores*) in Spain: the Madrid Stock Exchange, the Barcelona Stock Exchange, the Bilbao Stock Exchange, and the Valencia Stock Exchange.

11. *Bolsas y Mercados Españoles* (BME) is the holding company for the different corporations that run and manage the securities markets and financial systems. It combines the markets for variable-income and fixed-income securities, derivatives, and clearance and settlement systems into a single entity for action, decision and coordination. The BME group consists of Bolsa de Madrid, Bolsa de Barcelona, Bolsa de Bilbao, Bolsa de Valencia, Latibex, MEFF, AIAF, SENAF, and Iberclear.

12. Pursuant to Article 46 of Law 24/1988, the Securities Market Act (SMA), equities (shares, securities conveying the right of acquisition or subscription for shares, and securities convertible into shares) are traded exclusively on the stock markets. Those securities may be admitted for trading on one or more of the four stock exchanges in Spain.

13. There are two trading systems for variable-income securities (i.e., equities), both of them order-driven:

- The *mercados de corros* (trading pits) in each of the four exchanges. These are conventional call (open outcry) markets.
- The *Sistema de Interconexión Bursátil Español* (SIBE). The four Spanish exchanges have constituted the *Sociedad de Bolsas* which is responsible for technical management of the electronically interconnected continuous trading system. The SIBE is used for trading securities approved by the CNMV from among those previously listed on at least two stock exchanges. Securities admitted for the SIBE are traded through an electronic system that allows for real-time execution of orders, from 9:00 a.m. to 5:35 p.m.



14. Thus, some variable-income instruments are being traded on the conventional call markets of one or more of the four stock exchanges, and others are being traded through the SIBE.

15. The SIBE technical platform is also used for Latibex trading. Latibex is a Multilateral Trading Facility (MTF) on which euro-denominated Latin American securities are traded.

16. Warrants and certificates are traded on a special SIBE segment for warrants, certificates and other products.

17. Private fixed-income instruments are also traded on the stock exchanges, although not exclusively. There are two types of fixed-income markets:

- The Electronic Fixed-Income Market trades private fixed-income instruments, as well as debt instruments of the central government and the Autonomous Communities.
- The call markets of the Barcelona, Bilbao, and Valencia Exchanges deal essentially in fixed-income securities issued by the corresponding Autonomous Communities.

18. Market participants may be members of more than one exchange. Members conduct their trades on the exchange, which communicates them to the corresponding settlement system.

19. The registry, clearance and settlement system which is Iberclear's SCLV platform is used for securities traded through SIBE, the Madrid call market, the call markets of more than one stock exchange, and the Electronic Fixed-Income Market. The exceptions are public debt traded on the stock exchanges, which is settled via Iberclear's CADE platform, and transactions on the Book-Entry Public Debt Market. For variable-income instruments traded exclusively on one of the stock exchanges of Barcelona, Bilbao, or Valencia, transactions are settled through the settlement system of the exchange concerned.

20. Using the means established for this purpose, stock exchange members must report to Iberclear-SCLV the details of every transaction, together with the participating entity that will be responsible for settlement. Thus, the exchange member and the participant responsible for settlement may be different.

21. Although, as noted above, there are private fixed-income instruments listed on the stock exchanges, the AIAF fixed-income market is the principal market for this type of instrument, and most of the volume of private fixed-income securities (more than 99 percent) is traded on this market. This is a telephone market, decentralized and price-driven, in which members negotiate transactions bilaterally and report them subsequently for publication.

22. Public debt is traded on the Book-Entry Public Debt Market. There are two types of trading:

- Trading conducted between members. This may be done through one of the two electronic trading platforms, SENAF and the Multilateral Trading System MTS España, through one of the European platforms (EuroMTS or Brokertec), or directly between participants, in the so-called second tier.
- Trading with third parties. Bilateral transactions negotiated between a member and a third party, or between two third parties. These transactions must be registered with the managing entities, which are authorized to register transactions and ownership by natural or legal persons who do not have or are precluded from holding open securities accounts in the system.

23. All public debt is also admitted for trading on the Electronic Fixed-Income Market, described above, although the volume traded, in terms of number of transactions and value, is insignificant.

24. For transactions conducted on the AIAF market and on the Public Debt Market, the system for registry, clearance and settlement is the CADE platform of Iberclear. In bilateral trading between members, the two parties report directly to Iberclear-CADE, which conducts the settlement.

25. The securities accounts of both registration and clearance systems, SCLV and CADE, are organized in a two-tier system, in which Iberclear, as the central depository, records for each class of instrument the balance of securities that each participant holds for its own account, and is held for customers. In turn, each participant authorized to hold customers' securities is responsible for maintaining a detailed registry showing the owners of the securities recorded in the omnibus customer account that is kept in Iberclear's central registry.

26. Iberclear is supervised by the CNMV, while the powers of supervision and regulation for the settlement systems of the Barcelona, Bilbao and Valencia stock exchanges lie with the respective Autonomous Communities.

27. With respect to derivatives contracts, there are two markets, one dedicated to financial derivatives and the other to raw materials derivatives. MEFF is the Spanish market for futures and options on bonds, interest rates, market indices (IBEX-35) and equities. MEFF settles its contracts through its own clearing house, which is organized as a department of the market. In September 2003 MEFF established a Central Counterparty known as MEFFClear, which allows for registration of simultaneous public debt transactions contracted in SENAF or negotiated bilaterally by members of the public debt market. MFAO is the futures market for olive oil.

### **Description of the Spanish clearance and settlement process**

28. The Spanish clearance and settlement system contains some unique features (such as the registration process); therefore, a description is useful background.

***Iberclear SCLV platform (principally exchange-traded equity securities)***

29. Once transactions have been executed on the market (trade date T) members report to Iberclear on T using the electronic means provided by the stock exchanges, covering the amounts, prices and number of securities for each transaction. Transactions subject to special rules or trading hours must be reported in the same way as other market transactions, but in an appropriately differentiated form. Each contract is assigned a unique reference number that is used to track the transaction from execution through settlement. Iberclear maintains the registry of these reference numbers.

30. Market members must communicate to Iberclear the details on the allocation (*asignación*) of their transactions. This process is called *desglose* in the Spanish systems, and involves a detailed itemization. Each allocation must refer to a single order placer and must contain the following information: type of instrument, amount, and identification of the Iberclear participant appointed to settle the transaction. That entity may be different from the one that executed the transaction.

31. The contract may be allocated at any moment from the time the transaction takes place until the afternoon of the following day. Thus, for a trade that took place on day T, the details of the allocation must be communicated at latest by the afternoon of T+1. Pre-settlement processes for buyers and sellers are done separately.

32. Upon receipt of this information, Iberclear provides it to the participating entity appointed for settlement. That entity must either accept or reject the transaction by the following communication period (or “window”). Thus, an allocation received on the morning of T must be accepted before the end of the afternoon of T, and one received in the afternoon of T must be accepted before the morning of T+1. The final communication of acceptance or rejection must take place on the morning of T+2.

33. Confirmation by the participating entity may be given expressly or tacitly, meaning that any transaction that has not been expressly rejected is understood to be confirmed. Rejected transactions are reported to the member that conducted them on the same day they are rejected, so that another settlement entity can be appointed. Ultimately, it is the exchange member that conducted the transaction that will be responsible for its settlement. Similarly, any transaction that has not been allocated before the close of T+1 will be attributed to the market member that executed it.

34. In addition to the foregoing, the entities responsible for settling sales must perform the process known as justification, as a step prior to settlement of those sales. Justification may be done from T until 3 p.m. on T+3. It consists of identifying to the system the securities that will be delivered in settlement of those sales transactions.

35. Settlement of purchase and sale transactions takes place three days after the contract (T+3), in line with the Bank for International Settlements (BIS) model 2 for delivery versus payment (DVP), i.e., gross settlement of securities and net settlement of funds. Currently

there are two daily multilateral settlement batches (cycles) for purchase and sale transactions, one at 9:30 a.m. and the other at 3:30 p.m.

36. Securities held in the central depository of the Iberclear-SCLV platform at the end of 2004 had a nominal value of €92.9 billion (€95.2 billion at the end of 2003).

37. In 2004, the daily average of transactions processed was 60,820 (73,617 in 2003), for a value of €5.9 billion (€6.5 billion in 2003). The largest daily volume of transactions processed was 429,231 in 2004, while the smallest was 22,729. The system is thus robust to periods of peak demand.

### ***Iberclear-CADE platform for AIAF and Public Debt market instruments***

38. Two types of transactions are distinguished in the AIAF and Public Debt markets: those conducted between participating entities, and those contracted bilaterally by a third party with a managing entity or with another participating entity, or another third party.

39. For transactions contracted between two participating entities, both must report them electronically to Iberclear at the time of the contract. Among the transaction data to be reported, the entities must include a reference number for the transaction, for purposes of relating purchases and sales. Iberclear checks the information received, rejecting any transactions that lack the required data. If the check shows the purchase and sale data to be correct, the transaction is considered *casada* (matched) and it cannot be modified thereafter. If there are discrepancies, the transaction is marked as mismatched. The status of the transaction is communicated electronically to the participating entities. Transactions that have not been matched by the end of the reporting date will be deleted by the system.

40. When the transaction is contracted on an electronic trading platform, MTS España, SENAF, Brokertec or EuroMTS, it is this platform that will report it to Iberclear, without the need for subsequent intervention by the participating entities. Public debt transactions contracted on the Madrid Stock Exchange are communicated by it to Iberclear, in a manner analogous to the electronic platforms.

41. All transactions involving a third party must be entered in the Customer Registry of a managing entity of which that party is a customer. When the sale is conducted bilaterally between a managing entity and one of its customers, or between two customers of the same entity, the transaction will be entered in the Customer Registry of that entity. When the third party conducting the sale is not included in the registry of that entity, but in another one designated by the customer, or the transaction is conducted bilaterally between two customers of different entities, the two entities will exchange the necessary information, giving rise to a transfer of securities between them.

42. When transactions with third parties are contracted prior to settlement date, the entities must reflect them through a change in the balance of their omnibus customer account, which they must communicate to Iberclear on the afternoon of the business day prior to that date. Variations in the omnibus account from transactions contracted on the day of their

settlement may be communicated electronically, using the real-time settlement system. At the close of each daily session, the managing entities will send Iberclear-CADE a file with details, for each security, of the book entries made in their Customer Registry. Iberclear-CADE conducts a daily test of this information, to check the required consistency between the overall balance determined from the detailed information and that resulting from the daily settlement processes.

43. The process of settlement and book entry for transactions is divided into three phases: (a) settlement batch (for transactions reported during the previous night), (b) real-time settlement (from 7 a.m. to 4 p.m.), and (c) end-of-day batch (at 5 p.m.). The settlement follows BIS DVP Model 1, i.e., gross settlement of securities and funds, individually, trade by trade. The central settlement system also treats as individual transactions those communicated daily to Iberclear in the first settlement batch by the managing entities reporting the change produced in their omnibus customer account balances by the book entries they have made in their records as a consequence of the additions and deletions that they have entered for transactions with their customers.

44. AIAF securities held in the Iberclear-CADE central depository at the end of 2004 had a nominal value of €315.3 billion (€204.6 billion at the end of 2003). Public Debt securities held in the Iberclear-CADE central depository at the end of 2004 had a nominal value of €322.8 billion (€313.8 billion at the end of 2003).

45. In 2004, the daily average of AIAF transactions settled was 6,938 (5,980 in 2003), for a cash value of €19.5 billion (€13.6 billion in 2003). The daily average of public debt transactions settled in 2004 was 33,456 (38,510 in 2003), for a cash value of €313.9 billion (€317.7 billion in 2003)

#### **D. Description of Regulatory Structure and Practices**

##### **Regulatory framework**

46. All activities relating to securities markets, including clearance and settlement and the institutions that conduct them, are regulated by Law 24/1988, the Securities Market Act. Subsequently, that law was amended by the following laws: 37/1998, 14/2000, 24/2001, 44/2002, 53/2002, 22/2003, and 62/2003.

47. Regulations of lower legal rank have since been issued for the law: Royal Decrees approved by the government, orders from the Minister of Economy, and circulars and technical standards from the CNMV.

48. In 1999, with approval of Law 41/1999, on payment and securities settlement systems, known as the *Ley de Firmeza* (Finality Act), European Directive 98/26/EC was transposed into Spanish law.

49. Chief among lower-ranking provisions affecting the securities settlement system are the following two decrees:

- Royal Decree 116/1992 on the representation of securities by book entries and clearance and settlement of stock exchange transactions, amended by Royal Decrees 2590/1998 and 705/2002.
  - Royal Decree 505/1987, creating a system of book entries for government debt.
50. Together with this legislation, Iberclear has its own internal bylaws:
- In the first place there is the *Reglamento de la Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores* (Regulations of the Management Company for the Securities Registration, Clearance and Settlement Systems), approved by Order ECO/689/2003, published in the Official Gazette of March 28, 2003. These regulations retain in force the *Reglamento de Organización y Funcionamiento del Servicio de Compensación y Liquidación de Valores* (Organization and Operating Bylaws of the Securities Clearance and Settlement Service, hereafter the SCLV Bylaws) with certain additions and amendments, and the rules that until that time governed registration, clearance and settlement on the public debt market, with the regulatory adjustments established in the fifth section of the first transitional provision of Law 44/2002, the Financial System Reform Measures Act.
  - Circulars and Operating Instructions. These rules are prepared and approved by the Iberclear Board of Directors and must carry the consent of the CNMV before they are effective. Once approved, they are published in the official quotations bulletin (*Boletín Oficial de Cotización*) of the four stock exchanges and are sent out individually to each participant.

### **Oversight, regulatory, and supervisory bodies**

51. SMA Article 84 makes the CNMV responsible for supervision of Iberclear.
52. Until April 1, 2003, the Bank of Spain (BE) was responsible for supervision and oversight of CADE, the former central agency for registration, clearance and settlement of public debt market securities, which was merged with the SCLV, under the supervision of the CNMV, to constitute Iberclear.
53. Iberclear is supervised and controlled at two levels:
- First level. The CNMV exercises direct supervision and control over Iberclear and over its participants. This includes oversight of their processes and activities, and supervision of Iberclear and authorization of its by-laws.
  - Second level. Iberclear supervises and controls the activities of system participants. The rules provide for the necessary coordination between the supervisory bodies. If Iberclear detects any circumstance or action that could indicate a violation of rules or

a deviation from the principles underlying securities market regulation, it will bring this immediately to the attention of the CNMV.

#### **E. Information and Methodology Used for Assessment**

54. This assessment was performed using the CPSS/IOSCO Assessment Methodology for *Recommendations for Securities Settlement Systems* (2002).

55. The principal sources of information used included:

- General Regulations: Law 24/1988 and Law 41/1999, Royal Decrees 505/1987 and 116/1992, Ministerial Orders, CNMV Circulars, and other regulations.
- Detailed regulations from Iberclear: Iberclear Bylaws, Circulars and Operating Instructions
- Iberclear's responses to the questionnaire included in the CPSS/IOSCO Disclosure Framework, for both the SCLV and the CADE platforms.
- Annual reports of CNMV, Iberclear, and BME.
- Interviews with staff of CNMV, Iberclear, BE, BME, and others.

Table 1. Detailed Assessment of Observance of CPSS-IOSCO Recommendations for Securities Settlement Systems— Iberclear

Recommendation 1.	Securities settlement systems should have a well-founded, clear and transparent legal basis in the relevant jurisdiction.
Description	<p><b>Accessibility of laws and rules.</b> The laws applicable to Iberclear, and Iberclear’s rules and procedures are clearly stated, coherent, and available to the system participants. Each new participant receives a copy of the relevant rules and procedures when joining the system. Participants are kept informed of any amendments through published notices and by email. The relevant laws, royal decrees, and ministerial orders are published in the Official Gazette. All of the foregoing, as well as circulars of the CNMV can be found on the CNMV webpage, <a href="http://www.cnmv.es">www.cnmv.es</a>. They are also available on the Iberclear webpage <a href="http://www.iberclear.es">www.iberclear.es</a>, in addition to the procedures and contractual provisions that are found in the private section of the Iberclear website.</p> <p><b>Assurance of legal basis.</b> The formation and operation of Iberclear is specifically authorized by SMA Article 44 bis. Moreover, Spanish law applicable to Iberclear has transposed the EU Settlement Finality and Collateral Directives, and so transfers between participants are legally enforceable under all member states’ jurisdictions and binding on third parties [Law 41/1999 (Finality Law) and Law 5/2005].</p> <p><b>Protection of customer assets.</b> Customer assets held by Iberclear members are held in an omnibus account that must be segregated from the member’s own positions. (SMA Articles 44 bis, 57, and 58.) Customer assets are explicitly protected from the insolvency of the member, and the CNMV has the authority in such a case to transfer, immediately and at no cost to the investor, the book-entry securities to another firm. In addition, individual owners may request their securities to be transferred to another firm. It should be noted in this context that the identification of individual customer assets is made at the intermediary level.</p> <p><b>Arrangements for immobilization and dematerialization of securities.</b> All securities traded on the Spanish stock exchanges and the public debt markets are dematerialized and governed by SMA Articles 5-12 and other decrees and ministerial orders. Although some corporate debt traded in the AIAF market remains in certificated form, it represents less than 1 percent of the instruments, and no certificated securities have been issued in this market since 1998. The only other category of securities that are not dematerialized are foreign securities that are certificated in their home jurisdictions. When any of these securities are entered into the Iberclear system, they are immobilized and transferred by book-entry as are all other securities.</p> <p><b>Netting Arrangements.</b> Finality Law Article 11 specifically recognizes the legal validity of netting arrangements. SMA Article 13 provides that insolvency proceedings against an Iberclear member have no effect on the obligations of that member resulting from netting of transfer instructions carried out until the time that Iberclear becomes aware and should become aware of the insolvency proceeding (i.e., there is no “zero hour” rule).</p> <p><b>Securities lending.</b> Article 1757 of the Civil Code refers to lending in general, and SMA Article 36.7 governs lending on securities traded on secondary markets, including public debt. Royal Decree 116/1992 Article 57 established the system of centralized lending in the SCLV system, and the internal by-laws of the AIAF and Iberclear Circular 1/2004 govern securities lending in debt instruments.</p>



	<p><b>Settlement finality.</b> The Finality Law transposed into Spanish law the EU Finality Directive for payments and securities settlement systems. That law and Iberclear rules also establish that a transfer is irrevocable and unconditional when it is accepted by the Iberclear system.</p> <p><b>Arrangements for delivery vs. payment.</b> Article 56 of Royal Decree 116/1992 establishes DVP as the requirement for the SCLV platform, and is further implemented by Iberclear by-laws. Royal Decree 505/1987 and Ministerial Order of May 19, 1987 (Article 16) establish the principle of DVP for the CADE platform. Circulars and technical instructions from the BE, which formerly ran the system, regulate the settlement procedures in detail.</p> <p><b>Legal decrees.</b> No court has ever failed to uphold the above legal provisions.</p> <p><b>Enforceability notwithstanding the insolvency of a member.</b> Finality Law Articles 12-16 provide that all transactions entered into the Iberclear system by a member are to be settled and that the competent authorities must notify Iberclear when insolvency proceedings are opened against a member. An insolvency proceeding has no effect on any transfers accepted by Iberclear before it is notified of the proceeding, nor will it have any effect on transfer instructions resulting from netting arrangements, or on collateral deposited by the participant to guarantee settlement of its transactions.</p> <p><b>Cross border participation.</b> In 2005, foreign investors accounted for about 34 percent of total activity of the Spanish securities markets. There are foreign participants in SCLV, all of which have an established presence in Spain to enter transactions in Iberclear. There are remote members of the CADE platform, who contract transactions only for their own accounts. All such clearing members are within countries in the EU.</p> <p>Iberclear also maintain links with other central securities depositories (SSSs) within the EU and in Latin America (Argentina and Brazil). In those cases, Iberclear obtains legal opinions from the Spanish and the other jurisdiction to assure the compatibility of laws to address legal assurance and conflict of laws issues. Contracts between Iberclear and the foreign SSS provide that each is responsible for any loss through error or negligence on its part. However, it should be noted that transfers between other SSSs and Iberclear may only be made on a free-of-payment basis.</p>
Assessment	Observed.
Comments	
Recommendation 2.	Confirmation of trades between market participants should occur as soon as possible after trade execution, but no later than trade date (T+0). Where confirmation of trades by indirect market participants (such as institutional investors) is required, it should occur as soon as possible after trade execution, preferably on T+0, but no later than T+1.
Description	<p><b>Trade submission.</b> All trades from the stock exchanges, the AIAF, and the Public Debt Market must be reported to Iberclear on trade date. The exchange transactions are electronic, centralized, and multilateral, and trades cannot be revoked. Transactions are automatically reported to members and to the SCLV system of Iberclear, and therefore considered to be confirmed. Open outcry trades on the exchanges are also reported on T (trade date). Trades conducted on electronic platforms are simultaneously matched and sent to Iberclear.</p>

	<p>Trades on the AIAF and CADE platform require confirmation. Once they have completed trades, the participants must use CADE to report the trades on T. The system processes the information immediately and rejects any unmatched trades. (Both sides of the trade must include a reference number identifying the trade for matching purposes.) If the information agrees, the trade is matched. If not, immediate notice is given to the parties. If not matched by close of trade date, the trade is deleted from the system. During 2004, 1.4 percent of trades were deleted.</p> <p>Iberclear has in development a “Unified Matching System” (SUC) that eventually will be used for all non-exchange trades and transfers to extend the current time limit for deleting unmatched trades to settlement date. Notice of unmatched trades will still occur on T, but the parties will be able to use this system until settlement date to reconcile the trade information.</p> <p>Accordingly, 100 percent of trades are communicated and confirmed (or rejected) on T.</p> <p><b>Settlement instruction matching.</b> All transactions to be settled in CADE must be matched prior to settlement. Transactions in electronic systems are already matched on trade date. In SCLV, purchase and sales are processed separately. Where, however, a participant other than a party to the trade is designated as the agent for settlement, that member must accept or reject the appointment until T+1 (with rare exceptions, to T+2). If rejected, the original party to the trade is responsible for settlement.</p> <p>The Iberclear system does not confirm trades between direct and indirect participants. There is an indirect confirmation of trades within the CADE system, however. Each day the system receives information from indirect participants about securities movements, and compare this information with the information about the relevant participant’s omnibus account for customers. If there is a discrepancy in the totals, the system alerts the member, who must correct the data by T+1.</p>
Assessment	Observed.
Comments	
Recommendation 3.	Rolling settlement should be adopted in all securities markets. Final settlement should occur no later than T+3. The benefits and costs of a settlement cycle shorter than T+3 should be assessed.
Description	<p><b>Settlement period.</b> In SCLV, trades must be settled by T+3.</p> <p>In CADE, parties to bilateral trades may agree to any settlement date. Trades effected on electronic platforms, buys and sells of government bonds and obligations and AIAF fixed income instruments settle by T+3, and treasury bills by T+2.</p> <p><b>Failures to settle.</b> On SCLV, there has been no recorded instance of a failure to make payment on settlement date. During 2004, 0.84% of all transactions failed to settle by T+3, all due to failures to deliver securities. If a seller fails to deliver securities, it will have one more day to deliver.</p> <p>If at the end of T+4 there has not been delivery, then Iberclear buys in the securities. The average duration of fails for 2004 was 1.18 days (average is 1.13 days through May 2005).</p> <p>In CADE, if trades are not matched by settlement date, they are deleted from the system. In 2004, a daily average of about 0.17 transactions (value of €4.47 million)</p>

	<p>was deleted (about 0.003 percent of all trades). It is not possible to calculate a duration for these failed trades, because they must be reentered as new trades by the parties, and the seller frequently assigns a new operation number to the resubmitted trade.</p> <p><b>Incentives to settle.</b> A variety of legal and regulatory provisions provide incentives to settle on a timely basis, including SMA Article 54 and subordinate Royal Decrees and Iberclear (and BDE in the case of CADE) circulars and instructions, which deal with centralized lending and buying procedures, margin, penalties, etc. For SCLV, failure to settle the cash side of a transaction incurs a penalty of €1,000. For failure to deliver securities, Iberclear may charge 0.1 percent of the cash value of the transaction for every day of failure to deliver, and Iberclear keeps any profit obtained from the buying process, in addition to assessing a penalty of 2 percent of the amount of the trade. For CADE, transactions that cannot settle are cancelled. Failures to have securities available for delivery are subject to a fine of €1,000 (to be doubled in 2005). The CNMV is notified of all such instances, and follows up with participants about the cause of the failures. In addition, failures are considered very serious offenses, and can result in expulsion from the system.</p> <p><b>Risk mitigation.</b> SCLV and CADE provide securities lending facilities. It is an automated system in SCLV, and in CADE there is a bilateral overnight repo facility among participants and a BE securities swap facility. In SCLV, if securities are not delivered by T+4, Iberclear conducts a buy-in as agent for the failing participant. Iberclear also maintains a line of credit with a group of banks to provide immediate cash to settle trades (it has never been used). Participants also must post collateral based on the daily average amount of their purchases and sales over the prior quarter. To this average amount, Iberclear determines the maximum price changes in the securities over the prior 2 years. Collateral must be topped up on a daily basis if the current trading exceeds the amount of collateral collected. In CADE, BE provides an intraday financing facility for participants that have a shortage of cash for settlement. It is essentially a repo collateralized by equivalent securities.</p> <p><b>Consideration of shorter settlement cycle.</b> Iberclear, together with its participants, the CNMV, and the BE considered the possibility of shortening the settlement cycle. Given the very low level of fails, their short duration, and the not insignificant amount of trades that are not fully “justified” (have securities identified for settlement) by T+2, it was determined that the benefits of a shorter settlement did not exceed the risks. In addition, a substantial portion of trades settled by Iberclear involve non-Spanish participants. Therefore, time-zone differences also affected the evaluation of a shorter settlement period. This was not a formal cost/benefit analysis, and it is not documented. It should be noted that there are ongoing discussions in the EU on harmonizing settlement cycles.</p>
Assessment	Observed.
Comments	
Recommendation 4.	The benefits and costs of a central counterparty should be assessed. Where such a mechanism is introduced, the central counterparty should rigorously control the risks it assumes.
Description	Spain has one central counterparty (CCP), MEFFClear, which clears public debt repos negotiated in the electronic SENAF system and bilaterally-negotiated trades. There is some consideration being given to expanding the scope of the instruments covered. MEFF also clears trades in derivative bond products negotiated on the MEFF Renta Fija market. MEFFClear was not assessed by the CNMV because its transaction volume is quite low (about 3.05 percent of total repos in 2005). The

	<p>CNMV plans to conduct an assessment in the future using the CPSS/IOSCO Recommendations for Central Counterparties.</p> <p>An informal study of the costs and benefits of establishing a CCP for securities trades was conducted, but it is not documented. The conclusion was that, given the characteristics of the market, a CCP would not produce a net benefit.</p>
Assessment	Observed.
Comments	Even though a formal cost/benefit study was not made, the risk control mechanisms and the extremely low amount of fails and their duration are consistent with the conclusion that a CCP is not required for the securities or public debt markets. CNMV should schedule and conduct an assessment of MEFFClear using the CPSS/IOSCO <i>Recommendations for Central Counterparties</i> .
Recommendation 5.	Securities lending and borrowing (or repurchase agreements and other economically equivalent transactions) should be encouraged as a method for expediting the settlement of securities transactions. Barriers that inhibit the practice of lending securities for this purpose should be removed.
Description	<p>Securities lending activities are clearly supported by Spanish legal, accounting, and tax systems. The relevant legal provisions include: Article 1753 of the Civil Code, applying to lending in general; for SCLV, SMA Article 36.7 and Ministerial Order ECO/764/2004; for CADE. Additional Provision 12 of Law 37/1998. Tax considerations are addressed in Additional Provision 18 of Law 62/2003. CADE also has circulars applying to its centralized lending facility.</p> <p>Three types of lending take place in SCLV:</p> <ul style="list-style-type: none"> <li>- bilateral lending (daily average €244.1 million in 2004);</li> <li>- lending under SMA Article 36.7;</li> <li>- centralized lending through SCLV (daily average €14.9 million in 2004).</li> </ul> <p>In the public debt market, the following are possible:</p> <ul style="list-style-type: none"> <li>- repos and simultaneous transactions between two entities (very active: about 50 percent of daily market volume);</li> <li>- centralized lending through CADE (daily average €18.5 million in 2004).</li> </ul> <p>Iberclear never acts as principal for securities loans.</p> <p>CNMV receives daily reports on securities loans. Iberclear monitors all centralized lending to cover inadequate securities positions, and sends regular reports of this activity to CNMV.</p>
Assessment	Observed.
Comments	
Recommendation 6.	Securities should be immobilized or dematerialized and transferred by book entry in CSDs to the greatest extent possible.
Description	<p>All securities are dematerialized at origin in SCLV, pursuant to SMA. The only exceptions are the securities in the Latibex market and foreign securities listed on other stock exchanges that are not dematerialized in their home jurisdictions. The latter securities are immobilized in their home countries on behalf of the Spanish system, and transferred by book-entry in Iberclear.</p> <p>In the AIAF market, less than 1 percent of securities are in physical form, but no issues have been certificated since 1998. For certificated issues, CADE will immobilize the securities and transfers are made via book-entry. Public debt must be dematerialized at origin by law.</p>

	<p>Therefore, all securities registered in Iberclear are dematerialized or immobilized. All transfers are done via book entry.</p> <p>Registration of transfers takes place immediately upon settlement. Iberclear is the official registrar.</p>
Assessment	Observed.
Comments	
Recommendation 7.	Securities settlement systems should eliminate principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment.
Description	<p>Transfers of securities on securities clearance and settlement systems must be done simultaneously (Article 56 of Royal Decree 116/1992). SCLV rules provide for delivery vs. payment mechanisms using a BIS Model 2 (securities gross, cash net settlement).</p> <p>At the beginning of each multilateral settlement cycle, SCLV blocks securities deliveries in the account of the selling participant and sends each entity a statement of its provisional settlement account with the amount of payment needed for settlement. The cash amount is the result of netting the amounts receivable from sales with the amounts payable from purchases to be settled. The participant will not receive payment for the sale until it has identified and delivered to the system the securities sold. As well, the participant will not receive the securities purchased until it credits the value of the purchases to the system.</p> <p>The participant has 30 minutes to report any shortage of funds. Then SCLV sends to the BE the corresponding payment orders. The participants then have 30 minutes to make the payment. The BE then reports the cash settlement to Iberclear. At that moment, SCLV unblocks the securities and makes the corresponding book entries in the securities accounts. Settlement of the transaction coincides with the time of registration of the transfer.</p> <p>The CADE platform follows BIS Model 1 (securities and cash gross settlement). The system checks whether the seller has sufficient securities, and if so it immediately checks (through an interface with the payment system at BE) whether the buyer has sufficient cash in its account. If so, the system settles the transaction, producing finality. If the buyer does not have sufficient cash, the instruction is rejected and sent back to CADE. There is no blocking of securities in the accounts. If there are insufficient securities or cash, the process is repeated every five minutes until there are sufficient securities in the seller's account and sufficient cash in the buyer's account. If settlement has not occurred by the end of the day, the transaction is cancelled. Transactions that are settled are irrevocable and unconditional. This is true for the batch and real-time processes.</p> <p>All transactions are settled according to the delivery-versus-payment (DVP) principle. Securities are delivered if and only if payment is received.</p>
Assessment	Observed.
Comments	<p>It might be argued that the creation of debit balances in securities accounts discussed in Recommendation 9 is relevant here as well. However, these balances are insignificant and do not implicate principal risk, which is the focus of Recommendation 7. In fact, securities are delivered in Iberclear if and only if payment is received, and payment is effected if and only if securities are received. Therefore, the DVP principle is satisfied.</p>

Recommendation 8.	Final settlement on a DVP basis should occur no later than the end of the settlement day. Intra-day or real-time finality should be provided where necessary to reduce risks.
Description	<p>Spain has implemented the EU Settlement Finality Directive (Law 41/1999). Securities trades are final, in the sense of irrevocable and unconditional, from the moment that the trades are reported to the SCLV platform through the stock exchanges. Therefore, participants may not unilaterally revoke trades, and the trades reported to the system cannot be disrupted by a bankruptcy proceeding. And, as discussed in Recommendation 7, settlement transfers are final at the moment that the securities are transferred on Iberclear's books. Accordingly, completed transfers may not be unwound by a bankruptcy proceeding.</p> <p>There are currently two multilateral batches, at 9:30 am and 3:30 pm. At that time, securities may be fully used and retransferred. This provides a measure of intraday finality, and finality occurs no later than the end of settlement day. Because participants are able to reuse securities from the time that the trades are reported to the exchange, although the trades still must be settled, participants have not asked for more frequent settlement times.</p> <p>In CADE, settlement and finality occur when the seller has sufficient securities in its account and the buyer has sufficient cash in its account, and the corresponding transfers are effected (BE Circular 3/2003.). Trades processed in the overnight batch become final at 7:00 am on settlement date. Trades processed during real-time settlement (7:00 am to 4:00 pm) become final at the time of their settlement. Trades settled in the end-of-day batch are final as of 5:00 pm on settlement day. BE uses this platform for monetary policy operations and to guarantee intraday credits in the payment system.</p> <p>Free-of-payment transfers made through links with other CSDs are final as of the moment that they are recorded in Iberclear's records. No provisional transfers are permitted.</p> <p>Unilateral revocation of unsettled transfer instructions is prohibited after they are accepted by SCLV (Finality Law ), and in CADE after the transactions are matched.</p>
Assessment	Observed.
Comments	
Recommendation 9.	Deferred net settlement systems should institute risk controls that, at a minimum, ensure timely settlement in the event that the participant with the largest obligation is unable to settle. In any system in which a CSD extends credit or arranges securities loans to facilitate settlement, best practice is for the resulting credit exposures to be fully collateralized.
Description	<p>SCLV is designed to ensure that it can complete settlement in case of default by the participant with the largest obligation. Royal Decree 116/1992 provides that Iberclear may not assume risk of any kind. If the participant defaults, Iberclear first attempts to obtain securities through its centralized lending system. In 2004, this resolved about 66 percent of failures to deliver. If there are no securities available at the end of T+4, Iberclear proceeds to buying the securities for the account of the defaulting participant, and uses the cash received from the buyer on the failed transaction. Any potential pricing difference is covered by the participant's collateral in the guarantee fund.</p> <p>Its guarantee fund collects collateral on the assumption that all buyers and sellers</p>

default on a single settlement day, assuming normal market conditions. It is important to note that collateral is assessed on buys and sells separately (i.e., buys and sells are not netted). The amount required is the average of each participant's settlement activity over the prior quarter (on a daily rolling basis), plus the maximum price differential observed in the prior two years, with a confidence level of 97 percent. This therefore covers the principal risk of a default by the participant based on the level of its recent activity. This differential is applied for the number of days between the trade date of the failed transaction and the trade date of the buy-in or the replacement sale (four days for both failed sales and failed purchases). It is estimated that 27 percent of the clearing fund would cover all unsettled trades in the system at the present time. In addition, the system accounts for market risk by performing a daily check of each participant's activity to determine if it is exceeding the amount that it has contributed to the guarantee fund. This calculation also includes stressed market conditions, resulting in an additional cushion of 10-18 percent over the basic amount, depending on the market segment in which the security trades. These percentages were established based upon the largest market price movements over the past five years.

No participant has ever defaulted on the cash side. In case of such a default, however, Iberclear would cancel the first multilateral batch settlement, carrying all settlements forward to the 3:30 batch. If the default persists, Iberclear will resort first to its line of credit with a consortium of banks. On the following day, it will place on the market the securities delivered by the non-defaulting seller. If prices have fallen in the interim, the shortfall will be covered by the guarantee fund. The defaulting participant's collateral is used first, and then the collateral of the other participants. If all that collateral is used, Iberclear can assess the participants for additional collateral.

The clearing fund is valued at €783 million as of June 2005. The collateral in the clearing fund must be liquid, and consist of the following (with the composition as of June 2005):

- Cash (24.59 percent)
- Pledge of public debt (48.87 percent)
- Bankers' acceptances and surety bonds (16.42 percent)
- Insurance (10.13 percent).

CADE provides a centralized mechanism to provide securities whereby a participant that at the end of the day lacks sufficient securities may obtain them on loan from other participants that have previously signed a contract with Iberclear to loan the securities on a one-day basis. This loan is subject to the availability of sufficient cash in the defaulting participant's account. If the securities are not available through this mechanism, the BE may act as lender against equivalent securities of the defaulting participant through a one-day swap transaction.

In the event of a cash shortfall, the BE provides credit against a pledge of securities (full collateralization following European Central Bank rules). This intraday financing is done via a one-day sale and a reverse transaction with the same value day.

If none of these facilities is feasible, CADE will cancel the transaction. Iberclear never acts as principal in these transactions.

In SCLV, if on T+3 a participant fails to deliver securities, SCLV will invoke the centralized securities lending facility. However, if there are insufficient securities

	<p>from that process and the buyer has cash in its account, SCLV will credit the securities buyer’s account, despite the fact that the seller has not yet delivered.</p> <p>CADE prohibits overdrafts and debit balances in securities accounts. If there are insufficient securities in the account to settle a trade (after lending mechanisms have been attempted), the transaction is cancelled and must be reentered.</p> <p>As described above, SCLV calculates the guarantee fund on the assumption that all sellers and buyers default, thereby covering the possibility of multiple failures. In CADE, defaults will relate only to individual transactions, which in the worst case will be cancelled. The Iberclear system does not extend credit of any kind. Cash credit may be obtained from the BE only on a fully collateralized basis.</p>
Assessment	Broadly observed.
Comments	<p>As described above, while SCLV is designed to avoid overdrafts in securities accounts, there are instances where SCLV will credit securities to a buyer’s account even though the selling participant has failed to deliver the securities. This creates temporary short position in the selling participant’s account, and in order for the register to balance, this must result in a debit in its securities account. The Recommendations report states: “No CSD should permit overdrafts or debit balances in securities.” This SCLV process is inconsistent with this statement. However, while the assessment methodology provides that permitting debit balances in securities accounts results in a “Non-observed” rating, this does not seem appropriate in light of the negligible risk that the SCLV process poses to Iberclear. First, only about 0.3 percent of settlements fail in SCLV. Of those, approximately 66 percent are covered by securities lending through the system. Therefore, only about 0.1 percent of trades may result in this situation. Finally, the average duration of fails is 1.13 days, indicating that any debit balances are of extremely short duration. Third, the system has more than adequate financial resources to cover any potential loss that the defaulting participant may suffer. In addition to the cash from the buyer, the positions are marked to market, and the defaulting participant will have made deposits in the guarantee fund. The Iberclear system, therefore, is exposed to negligible risk of loss.</p> <p>While the potential loss has been negligible, the process nevertheless contravenes a basic risk control. Therefore, a “broadly observed” rating is appropriate. Iberclear could improve to “observed” by prohibiting credits in a participant’s securities account in the SCLV platform that are balanced by debits in other participants’ accounts.</p>
Recommendation 10.	Assets used to settle the cash leg of securities transactions between CSD members should carry little or no credit risk. if central bank money is not used, steps must be taken to protect CSD members from potential losses and liquidity pressures arising from the failure of a settlement bank.
Description	<p>BDE is the settlement agent for payments resulting from the settlement of trades on the stock exchanges, the public debt market, and the AIAF market. Both the SCLV and the CADE platforms settle accounts in the BE, which is a member of the European System of Central Banks. In fact, Finality Law provides that, in order for a settlement system to be recognized in Spain, it must settle cash transfer accounts in the BE. Participants that do not have an account at the BE must appoint another participant that does as settlement agent.</p> <p>All transactions are settled in euros.</p> <p>Iberclear is not a bank.</p>



	<p>The proceeds from the settlement of securities trades can be reused as soon as the BE credits the participant's account.</p> <p>The BE complies with the Core Principles for Systemically Important Payment Systems (CPSIPS), as reflected in this FSAP report.</p>
Assessment	Observed.
Comments	
Recommendation 11.	Sources of operational risk arising in the clearing and settlement process should be identified and minimized through the development of appropriate systems, controls and procedures. Systems should be reliable and secure, and have adequate, scalable capacity. Contingency plans and back-up facilities should be established to allow for timely recovery of operations and completion of the settlement process.
Description	<p>SCLV and CADE have established security measures such as control of access to computers, user profiles, etc. These are contained in Iberclear Instructions. On a daily basis, Iberclear performs daily checks of data processing times, data storage capacity, and the safeguarding of data. There is a dedicated team responsible for examining processes and taking necessary measures to improve their functioning. Changes to systems require a specific risk analysis.</p> <p>Iberclear has a contingency plan and backup facilities to assure that all critical business functions will continue running to minimize the impact on participants. The contingency plan is managed by a group of specialists that are part of an Emergency Team. This team consists of about 11 information technology (IT) staff and five management members who have remote access to the system, and so Iberclear systems are controllable if access to the main site is not possible.</p> <p>Iberclear systems are located in a secure, underground environment. Its backup center is located at a site approximately 20 km from the main site. The backup site receives simultaneous mirror data from the main site. This site is operated by a vendor with operational standards covered by Service Level Agreements.</p> <p>Iberclear tests its contingency plan internally at regular intervals and whenever significant system changes are made, in order to verify that operating systems function properly and that all personnel have appropriate training and qualifications. Fold over to the backup site (starting the operating platform and switching communication lines) can be accomplished in two hours. All operations data are preserved by the synchronous copying between the two sites, and data are not written to the system until the backup site acknowledges that they have been received. All messages received by the Iberclear system are validated and acknowledged.</p> <p>Operational reliability is regularly reviewed by senior BME management. The IT systems are audited as part of annual external audits. The IT department reports directly to BME. The CNMV IT department also examines Iberclear systems on a semi-annual basis.</p> <p>No key system has failed in the past year. Capacity checks of key systems are conducted systematically and tested every six months. At peak levels, only about one-third of total system capacity is utilized. Capacity is easily expandable.</p>
Assessment	Partly observed.
Comments	Iberclear has not tested its contingency plans with participants in the past year. Iberclear should test its backup facility with its participants more frequently, including testing with the participants' backup sites. Iberclear's backup facility is 20 km from the main site and appears to rely on many of the same resources, which

	<p>may represent a risk. The proximity of the sites should be evaluated, and the actual independence of critical services (i.e., whether they are in fact separate) such as telecommunications facilities, should also be evaluated.</p>
Recommendation 12.	<p>Entities holding securities in custody should employ accounting practices and safekeeping procedures that fully protect customers' securities. It is essential that customers' securities be protected against the claims of a custodian's creditors.</p>
Description	<p>The first protection for customer securities relates to the fact that (virtually) all securities in the Iberclear system are dematerialized. The small amount of corporate bonds in the AIAF market that are certificated will be immobilized when entered into the CADE system and held in custody for Iberclear by a financial institution with the necessary expertise and security systems.</p> <p>Customer securities are required to be specifically identified. SMA Article 44 bis requires Iberclear participants to maintain individual accounts of their customers. At the Iberclear level, the participants must segregate their own securities from those of their customers, which are identified in an omnibus account. (Articles 30 and 31 of Royal Decree 116/1992 and SMA Articles 57 and 58.)</p> <p>Iberclear SCLV reconciles participants' aggregate positions on a daily basis. Twice a year, it also performs a reconciliation between the balance in the customer omnibus account and the aggregate amount reflected in the participant's records. CADE participants submit daily information on the balances in customer accounts, the net change from the previous day, and details of book entries for each security code. Iberclear processes these data and calculates the aggregate balance and checks those balances against its settlement records. Discrepancies must be rectified by the next day.</p> <p>SMA Article 86 requires entities that perform custody services to submit a semiannual report prepared by an independent expert to the CNMV to confirm the balances held by its customers. The portion of the report dealing with public debt must also be sent to the BE. CADE also performs daily checks that the total of all entities' balances is equal to the number of securities outstanding at any time.</p> <p>In the case of a participant's insolvency, customer securities in these accounts are protected from claims of the participant's creditors, and may be transferred at the request of the customer. If no firm is in a position to take over the records of the customer holding, Iberclear will temporarily assume this function.</p> <p>SMA Article 77 establishes the general features of the Investment Compensation Scheme to which all Spanish investment service firms must belong. The fund covers bankruptcy, suspension of payments, and declaration by the CNMV that the investment firm cannot meet its obligations to customers whose demands have been unsatisfied. The maximum amount payable to each investor is €20,000.</p> <p>The entities authorized to hold securities in custody are subject to the supervision of the CNMV or the BE. Iberclear also exercises supervision over its participants and verifies that they maintain their book-entry records in accordance with segregation rules and Iberclear technical standards. The CNMV and the BE include a review of custody functions during inspections of their supervised entities.</p>
Assessment	Observed.
Comments	

Recommendation 13.	Governance arrangements for CSDs and CCPs should be designed to fulfill public interest requirements and to promote the objectives of owners and users.
Description	<p><b>Organization.</b> Iberclear must have a Board of no fewer than five persons. (Royal Decree 116/1992.) Members of the Board must meet the general conditions of suitability established in the SMA (fit and proper requirements). The appointment of Board members must be approved by the CNMV. Currently, Iberclear is overseen by a Board of 15 directors, consisting of representatives from the following:</p> <ul style="list-style-type: none"> <li>- 2 stock exchanges</li> <li>- 2 major Spanish banks</li> <li>- 2 major savings banks</li> <li>- 2 major international banks (custodians)</li> <li>- 1 representative of the AIAF market</li> <li>- 4 members from BE</li> <li>- 1 non-voting member from CNMV</li> <li>- chairman from Iberclear management.</li> </ul> <p>The Board has delegated executive powers to a delegated member (the Chief Executive Officer of Iberclear), and appointed a general director and two assistant general directors from Iberclear management to assist the delegated member.</p> <p>The Board establishes general policy, approves the annual budget, and supervises the operation of the company. It also approves the circulars governing the operation of the clearance and settlement systems. The Board meets monthly.</p> <p>There is also a Technical Advisory Committee (TAC) that is responsible for monitoring and examining Iberclear's operational systems, and advising the Board on matters such as efficiency and security and other matters referred to it by the Board or the chairman. TAC includes participant representatives who are experts in the technical and procedural aspects of registry, clearance and settlement. The following constitute the TAC:</p> <ul style="list-style-type: none"> <li>- Chairman of the Iberclear Board</li> <li>- the delegated member</li> <li>- 10 members appointed by the Board             <ul style="list-style-type: none"> <li>- 3 members proposed by the Spanish Bankers Association</li> <li>- 1 member proposed by the Spanish Confederation of Savings Banks</li> <li>- 1 member proposed by AIAF</li> <li>- 4 members proposed by the stock exchanges</li> <li>- 1 member proposed by the Spanish Association of Stock Exchange members.</li> </ul> </li> </ul> <p>Iberclear is 100 percent owned by the BME group. Its shareholding structure and composition is public, and is governed by SMA Article 44 bis(4). BME's shareholders are not limited to Iberclear's users, so it is a demutualized structure. According to the BME 2004 Annual Report, the three largest BME shareholders are: Banco Bilbao Vizcaya Argentaria (10.4 percent), the BE (9.8 percent), and Caixa D'Estalvis I Pensions de Barcelona (5.5 percent). Iberclear was the second largest source of income for BME group in 2004.</p> <p>It should be noted that the BME is in the process of becoming totally demutualized and listing its shares on the exchange.</p> <p><b>Disclosure.</b> Information about Iberclear is public on its webpage, which includes information about the Board, management, and organization of Iberclear.</p>

	<p><b>Operation.</b> SMA Article 44 bis(1) authorizes Iberclear to maintain a registry of securities represented in book entries, to clear and settle transactions on the stock markets, AIAF, and public debt market. It may also perform other functions assigned to it by the government with the advice of the CNMV. In November 2004, Iberclear was selected to operate as the official manager of the Spanish Registry for Emission Rights for Greenhouse Gases under the jurisdiction of the Ministry of the Environment.</p> <p>While SMA Article 44.bis.11 provides for competition in clearance and settlement services, in fact Iberclear operates as an effective monopoly in the Spanish market. Iberclear’s annual budget must observe the principles of financial equilibrium, cover the cost of providing services to its users, and earn a return on equity. (Ministerial Order ECO/689/2003.) CNMV must approve the fee structure proposed by the Iberclear Board annually. In 2003, following a review by an ad hoc committee established by the Iberclear Board, the fee structure was substantially revised to rationalize the fees and reduce overall settlement costs. (Iberclear Circular 4/2003.) This was approved by the CNMV.</p> <p>Participants may influence the decision-making process through representation on the Board and the TAC. The public is not part of the decision-making process, although decisions that are taken are publicly available. The current owners of Iberclear (BME) are kept informed by the Board, and system users are kept informed through circulars, instructions, and bulletins, as well as by participation in TAC and other Iberclear bodies that include user representatives.</p> <p><b>Management incentives.</b> The CNMV must approve the Board of Directors, and assesses candidates for professional experience, character, and technical knowledge. Senior management are appointed by the Board and must be approved by the CNMV. Senior management regularly attends Board meetings. A significant portion of management’s total remuneration is based on incentives approved by the Board in light of performance. Senior management’s variable compensation is linked to achievement of the profit projected in Iberclear’s annual budget. Board members receive compensation for participation in Board meetings. Mismanagement is a basis for dismissal by the Board.</p>
Assessment	Observed.
Comments	<p>CNMV should review the participation of its representative on the Iberclear Board. The CNMV has a nonvoting membership who, among other things, may request that the chairman of the Board convene a meeting and to include specific items on the agenda. The CNMV believes that its presence on the Board contributes positively to the observance of public interest objectives by Iberclear. While this potential benefit should not be discounted, and this situation has existed for some time without apparent adverse consequences, it potentially complicates the governance of Iberclear. This issue may be brought into sharper focus if BME carries through with its plans to fully demutualize and list its shares in the near future. (See also the discussion of this issue in the Comment to Recommendation 18.) It should also be noted that BE has 4 of the 15 seats on the Iberclear Board. This is a consequence of the BE’s substantial share ownership in BME resulting from the transfer of the CADE system to Iberclear in 2003. This also has the possibility of complicating the governance of Iberclear, although BE is in a posture different from CNMV because BE is a substantial user of CADE and is not the statutory supervisor of Iberclear. In any event, it is understood that BE’s share ownership, and potentially its Board participation, is not a permanent situation.</p>

Recommendation 14.	CSDs and CCPs should have objective and publicly disclosed criteria for participation that permit fair and open access.
Description	<p><b>Membership eligibility.</b></p> <p>The access criteria for Iberclear membership are public. See, e.g., Articles 76-78 of Royal Decree 116/1992; Ministerial Order of July 6, 1992; SMA Article 44. bis.4; Iberclear by-laws.</p> <p>The following entities are eligible for membership in SCLV according to Article 76 of Royal Decree 116/1992:</p> <ul style="list-style-type: none"> <li>- members of one or more stock exchanges</li> <li>- banks</li> <li>- savings institutions</li> <li>- official credit institutions</li> <li>- BE and the <i>Caja General de Depósitos</i></li> <li>- brokerage companies and agencies that are not stock exchange members</li> <li>- foreign entities that conduct activities similar to Iberclear.</li> </ul> <p>Applicants must have suitable control systems and technical means to fulfill their functions, and must satisfy the Schedule of Technical and Functional Requirements approved by Iberclear circular. Iberclear must prepare a report assessing the applicant's compliance with the requirements, which must be approved by the CNMV.</p> <p>CADE applicants must satisfy the requirements of the fixed income markets in which they operate, i.e., AIAF and public debt markets. (Ministerial Order of May 19, 1987, and Article 10 of AIAF rules of procedure and Circular 1/1997.) Article 1 of BE Circular 16/1987 and BE Circulars 5/1989 and 3/1990 set forth professional and organizational requirements. In addition, CADE members must meet the requirements for settling payments through the BE Settlement Service (SLBE), and must provide BE with accounting and financial information.</p> <p>There are differences in eligibility based on location of the applicant. Entities with an EU passport are automatically eligible if they fit one of the participant categories and satisfy the financial and operational requirements. Entities that are not resident in the EU can become members of Iberclear, but the application would be subject to rigorous analysis of insolvency law, conflict of laws provisions, oversight, etc. In addition, these firms would need to establish a clearing relationship with a participant in the EU, because a participant must have an account at the BE to settle transactions. In practice, this has meant that all foreign participants have established branches or subsidiaries in the EU.</p> <p>As discussed in Recommendation 19, Iberclear has established links with a number of foreign RCVs.</p> <p><b>Termination of membership</b></p> <p>Membership in Iberclear may be terminated by reason of:</p> <ul style="list-style-type: none"> <li>- renunciation</li> <li>- loss of status as an exchange member</li> <li>- loss of license to operate as a bank, savings institution, or investment services company</li> <li>- failing to deposit all or a portion of required collateral</li> </ul>

	<ul style="list-style-type: none"> <li>- failure to conform to technical, legal, accounting, and record keeping requirements</li> <li>- failure to make required payments</li> <li>- failure to achieve minimum settlement volumes established by the ME (Article 12.10.a of Royal Decree 505/1987 and Article 79.4 of Royal Decree 116/1992)</li> <li>- repeated failures to settle transactions</li> <li>- penalty imposed by law</li> <li>- insolvency proceedings.</li> </ul> <p>Proposals to terminate membership in SCLV must be presented to the CNMV. Termination of membership in CADE is made upon the recommendation by the BE to the ME with the advice of the CNMV.</p>
Assessment	Observed.
Comments	<p>It may be noted that membership eligibility of non-EU entities is different from entities with an EU passport. This is said to be justified on the basis of risk control in that the supervision and qualifications of EU entities is known. There is merit to this view, although some argue that membership should be permitted upon a showing that a non-EU entity is subject to appropriate prudential supervision and satisfies Iberclear's financial and operational requirements. This is a complex issue that is under discussion within the EU and in other countries. It should be noted that Iberclear stated that it has not received any requests from non-EU entities to gain membership. Rather, foreign entities operate through branches or subsidiaries in the EU. It is not known if this situation arises from the fact that the cost and process for establishing such affiliates is not burdensome, or the alternative process is very burdensome, or in fact there is no interest in foreign direct membership in Iberclear. Therefore, there is no evidence concerning the treatment of non-EU entities by Iberclear. If there were evidence of clear discriminatory treatment, the assessment of this recommendation would have to be reconsidered.</p>
Recommendation 15.	While maintaining safe and secure operations, securities settlement systems should be cost-effective in meeting the requirements of users.
Description	<p><b>Budget matters.</b> Iberclear's rules, approved by Ministerial Order ECO/689/2003, provide that the annual budget of Iberclear must observe, among other things, the principles of financial equilibrium, and cost recovery in providing services to users. It also provides that Iberclear must observe cost optimization and objectivity and equity in setting fees. (Article 71 of Royal Decree 116/1992.)</p> <p>The Iberclear Board presents its budget and fees to the BME Board on an annual basis, and includes a benchmarking of fees against other RCVs. This is done on the basis of available information of fees charges by other RCVs, although it is difficult to assess comparative costs in the benchmarking process. The BME Board also is advised monthly of trends in Iberclear's revenues and costs.</p> <p>Iberclear's annual budget must be presented to the CNMV for approval. BME, Iberclear's sole shareholder, must also present its consolidated budget to the CNMV for approval. Iberclear's fee schedules must be presented to CNMV which may require changes to the fees if they do not follow these principles or discriminate among users.</p> <p>In 2003, the Iberclear Board formed an ad-hoc committee that included participants, the CNMV, and the BE to review the fee structure. The result was a major restructuring and rationalization of fees. <i>See</i> Iberclear Circular 4/2003. Iberclear claims that it now has one of the lowest cost structures in Europe and obtains adequate financing for its operations through its revenues by means of a consistent</p>

	<p>pricing structure for the different markets whose securities and trades it registers and settles.</p> <p><b>Service levels.</b> Iberclear has in place processes and structures to obtain the views of participants about its operations. In addition to Board representation, participants are represented on the TAC (see Recommendation 13). The TAC has regular meetings, and considers operations, projects, fees, and participant demands for new services. Iberclear does not regularly survey its members regarding service levels.</p> <p>Iberclear is also considering the possibility of establishing a help desk or call center, and a “customer relationship management” function in order to obtain more direct and continuous contact with participants. (This would be an expansion of the facilities that Iberclear is establishing to administer the Emissions Registry. See Recommendation 18.)</p> <p>Iberclear prepares daily internal reports on operational availability, and capacity levels against projected demand are revised continuously. The CNMV also receives daily data about settlement operations. CNMV conducts operational examinations twice a year.</p> <p>A limited survey of users (2 major banks) indicated satisfaction with Iberclear’s services and fee levels. One bank noted that the cost to settle a trade through Iberclear was less than through Clearstream.</p>
Assessment	Broadly observed.
Comments	<p>The requirement to regularly survey members regarding service levels is lacking, resulting in a broadly observed rating. However, Iberclear does have mechanisms to obtain the views of its members, such as the TAC. Another example of Iberclear’s examination of efficiency matters is the review of the settlement system conducted in 2004 following discussions with the TAC and the CNMV. This resulted in changes to: the settlement calendar in the Spring 2004 to conform to TARGET timeframes; the timing of the second multilateral settlement cycle to delay it 1.5 hours to allow participants additional time to justify sales that could not be settled in the first cycle; and the buy-in cycle by conducting the procedure on T+4 rather than T+5. Also, if Iberclear institutes the call center and relationship management facilities described above and it operates in a manner to allow participants to provide information and views to Iberclear management about service levels and costs, then this Recommendation should be considered observed, notwithstanding the lack of a regular survey of members.</p>
Recommendation 16.	Securities settlement systems should use or accommodate the relevant international communication procedures and standards in order to facilitate efficient settlement of cross-border transactions.
Description	<p>In the links between Iberclear and other European and Latin American depositories, message standards conform to those established by ECSDA and meet ISO standard 15022, an internationally recognized message standard.</p> <p>Information exchanged with participants currently uses proprietary formats that are not translatable into international formats. However, Iberclear is developing a “Single Matching System” which will provide a common procedure for communication, matching and registration of all bilateral transactions conducted on any type of security using ISO 15022.</p> <p>With respect to communication protocols for cross-border transactions, Iberclear uses the international SWIFTNet-FIN network. This is the same platform used to carry</p>

	messages of domestic participants.
Assessment	Partly observed.
Comments	Although Iberclear uses international message standards for links with foreign SSSs, it uses proprietary protocols to exchange data with members, including cross-border transactions, that are not translatable into international formats. Therefore, this Recommendation is only partly observed. As part of its ongoing Single Communication Window project to facilitate and standardize communications with its members, it can be anticipated that implementation of the Single Matching System using international standards will bring this Recommendation to the Observed level.
Recommendation 17.	CSDs and CCPs should provide market participants with sufficient information for them to accurately identify the risks and costs associated with using the CSD or CCP services.
Description	<p><b>Disclosures to market participants.</b> As discussed in Recommendation 1, the laws and subordinate provisions governing its operations are available to Iberclear participants on the private section of its website, <a href="http://www.iberclear.es">www.iberclear.es</a>. Whenever a new circular or instruction is issued by Iberclear, it is placed on the website and published in the official bulletins of the stock exchanges and sent to all members individually. The basic laws and rules governing clearance and settlement are published in the public Official Gazette. The rights and obligations of participants in SCLV are contained in Article 15 of the SCLV rules of procedure. For CADE, they are found in Royal Decree 505/1987 and in the membership rules of AIAF. Each new member receives a complete set of the rules.</p> <p>The fees and penalties that will apply in the coming year are published by Iberclear in a circular to the members.</p> <p>The provisions applying to the supervisory structure for Iberclear are also publicly available.</p> <p><b>CPSS/IOSCO Disclosure Framework.</b> Iberclear completed the disclosure framework for the SCLV and CADE platforms and posted it on its website in 2004. The CNMV reviewed the responses. The CNMV plans to regularly review the disclosures for any needed updating.</p> <p><b>Format of disclosures.</b> The disclosures to market participants discussed above are available in Spanish on the Iberclear webpage. General information about Iberclear in English is also available there. The answers to the Disclosure Framework are available in Spanish and English, and on the BIS (<a href="http://www.bis.org">www.bis.org</a>) and IOSCO (<a href="http://www.iosco.org">www.iosco.org</a>) websites.</p>
Assessment	Observed.
Comments	
Recommendation 18.	Securities settlement systems should be subject to regulation and oversight. The responsibilities and objectives of the securities regulator and the central bank with respect to SSSs should be clearly defined, and their roles and major policies should be publicly disclosed. They should have the ability and resources to perform their responsibilities, including assessing and promoting implementation of these recommendations. They should cooperate with each other and with other relevant authorities.
Description	<b>Relevant authorities.</b> SMA establishes the principles and contains the main provisions regarding clearance and settlement systems. The creation of Iberclear is authorized in Article 44bis. It also provides that Iberclear shall be governed by a Regulation approved by the Ministry of Economy and Finance on the advice of the CNMV. The Regulation was approved by Ministerial Order ECO/689/2003. (See also



	<p>Royal Decrees 505/1987 and 116/1992.)</p> <p>SMA Article 84 states that the CNMV is the supervisory authority for Iberclear.</p> <p>The BE also has a significant role in the oversight of the clearance and settlement system. This stems from its responsibility to prevent systemic risk in the financial system. It also is the authority responsible for the payments system in which the cash portion of all securities transactions are settled (every Iberclear settling participant must have an account at the BE). As a member of the European System for Central Banks, the BE assesses the performance of CADE against the standards for using securities settlement systems in credit transactions of the Euro system. It also assesses the performance of the SCLV platform with specific reference to the pledging procedure in obtaining financing from the BE. The BE is also a substantial user of CADE in conducting monetary policy operations. Iberclear is the operator of the Registry and Settlement System for Public Debt Securities (CADE), and BE is the governing body of that market. Finally, BE is the supervisor of credit institution participants of Iberclear.</p> <p>Approval of Iberclear rules of procedure are subject to a report by CNMV and BE (SMA Article 44.bis.4.)</p> <p>The provisions governing the supervision of Iberclear are published in the Official Gazette upon adoption, and are available on the CNMV and BE websites. All are in Spanish, although the CNMV has produced an unofficial translation of SMA into English.</p> <p>The General Directorate of the Treasury also has a role in the oversight of the settlement system. The Director General of that department is a member of the CNMV Board.</p> <p><b>Supervisory coordination.</b> The responsibilities of the CNMV and the BE are set forth in the provisions applying to the operations discussed above. The principal source is SMA. SMA Article 84 assigns responsibility for the surveillance, supervision, and sanction of Iberclear (and CCPs) to CNMV.</p> <p>The CNMV has specialized staff dedicated to supervising Iberclear as follows:</p> <ul style="list-style-type: none"><li>- Secondary Markets Directorate (surveillance and oversight)</li><li>- Entities Directorate (custody risk)</li><li>- President Directorate (regulation, collateral, budget).</li></ul> <p>A member of the President Directorate also attends Iberclear Board meetings as a nonvoting member.</p> <p>The BE also has specialized staff focused on the areas of its responsibility discussed above.</p> <p>There is close cooperation, consultation, and coordination between the CNMV and the BE.</p> <ul style="list-style-type: none"><li>• The two organizations have cross-representation on each other's governing bodies. The vice-president of CNMV is a member of the BE Board, and the deputy governor of BE sits on the CNMV Board.</li></ul>
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	<ul style="list-style-type: none"> <li>• SMA Article 88 directs CNMV and BE to coordinate their actions where their powers of surveillance and supervision overlap. Each has responsibility for oversight of the solvency of the organizations for which it keeps the respective register. Oversight of the operation of the securities markets resides with the CNMV.</li> <li>• Article 88 specifically directs CNMV and BE to sign agreements specifying their respective responsibilities. A Memorandum of Understanding was signed on June 9, 2004.</li> <li>• With regard to credit institutions, SMA Article 90.7 directs CNMV and BE to exchange information likely to contribute to the proper performance of the activities for which each is responsible.</li> <li>• Certain actions regarding the securities markets require consultation by CNMV with BE.</li> </ul> <p><b>Cooperation with foreign authorities.</b> SMA Article 90 provides that CNMV shall cooperate with foreign authorities regarding functions of surveillance and supervision, and may provide information about market participants, including information relating to irregular conduct. CNMV has signed various memoranda of understanding with its foreign counterparts.</p> <p>Pursuant to Article 16 of Law 41/1999, CNMV must provide immediate notice to EU member states whenever insolvency proceedings are opened against an Iberclear participant.</p>
Assessment	Observed.
Comments	<p>Discussions with the relevant parties in Spain (<i>e.g.</i>, CNMV, BE, Iberclear, and treasury) confirm that the cooperative arrangements between CNMV and BE work well. However, the respective roles assigned to CNMV and BE are located in numerous separate provisions of the law, and in some cases appear to overlap. The latter is explicitly acknowledged in SMA Article 88, which requires CNMV and BE to sign a cooperation agreement. An MOU was signed in June 2004. The supervisors' views of their responsibilities may not be clear to the public (or perhaps to some market participants). The MOU does not appear to be public. As recommended in the review of Transparency in this FSAP report, it would assist in understanding of the supervisory structure if the MOU were made public (excluding any possible sensitive provisions). The situation is a dynamic one, considering such factors as:</p> <ul style="list-style-type: none"> <li>- the role of BE as a major user of CADE;</li> <li>- the relatively recent transfer of CADE to Iberclear;</li> <li>- the BE's significant ownership of BME shares, and its substantial representation on Iberclear's Board; and</li> <li>- the impending listing of BME shares.</li> </ul> <p>Therefore, it is recommended that the CNMV and the BE continue to coordinate closely and clearly define their oversight roles as events unfold.</p> <p>As noted above, CNMV participates on the Iberclear Board as a nonvoting member and observer. CNMV should review this role. While this practice has existed for some time without apparent adverse consequences, it apparently is unique in the Spanish regulatory system. The situation apparently is a carryover from the time when SCLV was operated by the stock exchange and CNMV participation in the governance of the system was deemed to be beneficial. The relevant legal provision, Article 68 of Law 116/1992 states that a member of the Board appointed by CNMV</p>

	<p>may attend Board meetings without voting rights. It does not appear that appointment is mandatory, or that the person belong to the CNMV, or that the person attend all meetings. If the law requires the current arrangement, however, consideration should be given to changing it. As noted above in the comment to Recommendation 13, CNMV participation on the Iberclear Board potentially complicates the governance of Iberclear. More importantly, it could present regulatory and reputational problems for the CNMV if Iberclear should adopt inappropriate measures (which then must be reviewed by the CNMV), or if Iberclear should experience operational or other difficulties. While these instances may not have arisen in the past, there may be greater potential for such situations if BME follows through with its plan to become a publicly traded company, and if Iberclear continues to expand its activities beyond core clearance and settlement operations.</p> <p>Currently, the CNMV does not conduct on-site examinations of Iberclear, other than with regard to information technology matters. While CNMV receives a large quantity and variety of data about Iberclear activities on a daily basis, and has programs to detect unusual activity, a program that includes on-site examination of SSS operations is usually essential to gain a complete picture of the way in which it implements its rules and conducts member surveillance. It is therefore recommended that CNMV consider including on-site examinations in its oversight program.</p> <p>As noted above, Iberclear has expanded its activities beyond core clearance and settlement operations by becoming the manager of the Registry for Emission Rights for Greenhouse Gases, which is under the supervision of the Ministry of Environment. While this may be a beneficial leveraging of Iberclear’s resources, it has the potential to complicate CNMV’s oversight of Iberclear. It will be important for CNMV to monitor Iberclear’s activities, and in particular its risk management, to verify that the pursuit of other activities does not impair its provision of safe and sound settlement services.</p>
<p>Recommendation 19.</p>	<p>CSDs that establish links to settle cross-border trades should design and operate such links to reduce effectively the risks associated with cross-border settlement.</p>
<p>Description</p>	<p>SMA Article 44 bis(7) empowers Iberclear to establish links with nonresident entities performing similar functions, provided that Spanish regulations are respected. Royal Decree 116/1992 allows a foreign CSD to become a participant in Iberclear, with prior approval of the CNMV. That law also allows Iberclear to open accounts with foreign CSDs. Establishing a link requires an examination of the legal framework governing the foreign RCV, and its compatibility with the Spanish legal framework. Chief among these concerns are insolvency and conflicts of laws provisions. Currently, Iberclear maintains direct links between SCLV and:</p> <ul style="list-style-type: none"> <li>- Monte Titoli (Italy)</li> <li>- Euroclear France (France)</li> <li>- Euroclear Netherlands (Netherlands)</li> <li>- Caja de Valores (Argentina)</li> <li>- CLBC (Brazil).</li> </ul> <p>The last two links were opened to facilitate operation of Latibex. With the exception of CLBC, all of these links are reciprocal, meaning that all securities registered in SCLV are transferable to and from the other CSDs, and the securities registered on the foreign CSDs are transferable to SCLV via the link. For CLBC, the link allows only for the transfer of Brazilian securities. For some foreign securities admitted to trading on Spanish exchanges or on Latibex, these links are not used. Instead, indirect links are used, <i>i.e.</i>, transfers take place through the accounts of entities that have</p>

	<p>accounts in both CSDs.</p> <p>Iberclear also maintains links between CADE and the following CSDs:</p> <ul style="list-style-type: none"> <li>- Monte Titoli</li> <li>- Euroclear France</li> <li>- Euroclear Netherlands</li> <li>- Clearstream Banking Frankfurt (Germany).</li> </ul> <p>The direct links between Iberclear and other CSDs in the EU have been established in accordance with ECSDA standards, described in ECSDA cross-border settlement (2002). (See also Iberclear Circulars 4/1999 and 5/1999.) Accordingly, for each link an analysis of legal, settlement, custody, and operational risks was carried out. In all cases, Iberclear obtained an opinion of counsel on the Spanish and relevant foreign law.</p> <p>Indirect links are governed by Iberclear Circular 6/1999. For each of the links with EU SSSs, BE conducted an analysis of compliance with the standards of the European System of Central Banks. The standards address settlement, custody, operational risks, legal soundness, access, efficiency, and finality. The links are approved by the Eurosystem, and are eligible for use in Eurosystem credit transactions, through free transfers.</p> <p>In all of these links, only free-of-payment transfers are permitted. Iberclear and the linked CSDs do not advance securities or make provisional transfers. Transfer is made only when the availability of securities is assured.</p> <p>In the indirect links, Iberclear will credit an account only after checking that the securities are in the account in the foreign CSD.</p> <p>Iberclear assumes no credit or liquidity risk with respect to any transfers via these links.</p>
Assessment	Observed.
Comments	

Table 2. Summary Observance of CPSS-IOSCO Recommendations for Securities Settlement Systems—Iberclear

Assessment grade	Principles grouped by assessment grade	
	Count	List
Observed	15	1,2,3,4,5,6,7,8,10,12,13,14,17,18,19
Broadly observed	2	9,15
Partly observed	2	11,16
Non-observed	0	
Not applicable	0	

Table 3. Recommended Actions to Improve Iberclear’s Observance of CPSS-IOSCO—  
Recommendations for Securities Settlement Systems

Reference principle	Recommended action
<b>Legal risk</b>	None
<b>Pre-settlement risk</b>	None
<b>Settlement risk</b> Recommendation 9	Iberclear should improve risk controls by prohibiting debit balances in a participant’s securities account in the SCLV platform (to balance credits in other participants’ accounts).
<b>Operational risk</b> Recommendation 11	Iberclear should test its backup facility with its members more frequently. Its backup facility is 20 km from the main site and appears to rely on many of the same resources, which represents a risk. The actual independence of critical services, such as telecommunications facilities, should also be evaluated.
<b>Custody risk</b>	None
<b>Other issues</b> Recommendation 15  Recommendation 16  Recommendation 18	<p>Iberclear should implement an effective process to obtain the views of its participants on the efficiency and costs of its services and operations, or it should regularly survey its participants on these matters.</p> <p>Iberclear should implement international communication standards for all participant communications.</p> <p>CNMV should review the participation of its personnel on the Iberclear Board. While this practice has existed for some time without apparent adverse consequences, it apparently is unique in the Spanish regulatory system, and potentially complicates the governance of Iberclear. More importantly, it could present regulatory and reputational problems for CNMV if Iberclear should determine to adopt inappropriate measures (which then must be reviewed by CNMV), or if Iberclear should experience operational or other difficulties.</p> <p>In addition, the scope of oversight of the Iberclear system and its participants exercised by the CNMV and the Bank of Spain is complex, and may not be fully transparent to users and the public. The current environment is a dynamic one (considering, for example, the role of BE as a major user of the CADE platform, the recent transfer of the CADE platform to Iberclear, the BE’s significant ownership of BME shares and substantial representation on the Iberclear Board, and the impending listing of the BME), and CNMV and the BE should continue to coordinate closely and clearly define their oversight roles.</p>

## F. Authorities' Response

56. The Spanish authorities thank the assessor for his analysis and concur with his evaluation, but wish to make the following comments:

### Recommendation 9

57. The rules of the clearing and settlement system prohibit participants from having debit balances and no participant has ever had a net overdraft. Bearing that in mind, possible, exceptional short positions that are temporarily held by **private customers** should not be confused with debit balances on the accounts of **participants** (namely, institutions participating in Iberclear), which are prohibited. In addition, it should be noted that the system does not recognize securities with economic and political rights in excess of the recorded totals for each issue.

58. Regarding the actions recommended for eliminating possible debit balances, it should be noted that the rules prohibit such balances on **participants'** accounts. With respect to temporary short **customer** positions, the Iberclear Strategic Plan includes the T+3 repurchase mechanism, anticipated for the second quarter of 2006, which will totally eliminate these positions.

### Recommendation 15

59. The composition of the TAC and its regular meetings guarantee that all direct **participants** have detailed information on Iberclear activities and projects. With respect to the **customers** of these participants, Iberclear is beginning to engage in more dissemination activity, in addition to the existing customer care procedures, whereby, on an ongoing basis, the different departments respond to inquiries by phone or through the mailbox on their website.

### Recommendation 16

60. Since the IMF FSAP mission to Spain, there have been developments in at least partial compliance with the recommended actions. The "Unified Matching System" (SUC)—Transfers (03/07/05) and SUC—Loans (November 21, 2005), which use SWIFT communications based on ISO standard 15022, are already on stream. In addition, the third part of this project (SUC—Fixed Income), which is structured in three stages (the first of which was published on February 8, 2006), is scheduled to take effect over the first semester of 2006. Therefore, the requirement for using international communication standards is already over 75 percent implemented.

### Recommendation 18

61. Since the IMF FSAP mission to Spain, there have been developments in at least partial compliance with the recommended actions. On September 22, 2005, the CNMV

Executive Committee approved the work plan for conducting an on-site supervision mission to Iberclear, which began on October 19, 2005, with the collaboration of Banco de España. The basic purpose is to verify compliance with the functions assigned to Iberclear in the standards, including its supervisory functions.

62. Regarding the maintenance of the Registry for Emission Rights for Greenhouse Gases, clearing and settlement are not the only core activities of Iberclear. These activities also encompass the **registration** of rights represented by annotations to the accounts. Therefore, the keeping of the registry is indeed one of Iberclear's natural activities. Regarding the management risk associated with the maintenance of this new registry, the CNMV's report was in favor of Iberclear assuming these functions, having considered whether the resources used on that activity could undermine Iberclear's efficiency in the area of securities. Furthermore, the inspections that have just begun are reviewing the maintenance of this new registry and how it impacts on Iberclear's other functions.