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Abbreviations

ABS	Asset Backed Securities
AIAF	Asociación de Intermediarios de Activos Financieros (Spanish market in fixed-income securitie)
ANCV	Agencia Nacional de Codificación de Valores (Spain's national numbering agency)
ASCRI	Asociación española de entidades de capital-riesgo (Association of Spanish venture capital firms)
AV	Agencia de valores (broker)
AVB	Agencia de valores y bolsa (broker and market member)
BME	Bolsas y Mercados Españoles (operator of all stock markets and financial systems in Spain)
BTA	Bono de titulización de activos (asset-backed bond)
BTH	Bono de titulización hipotecaria (mortgage-backed bond)
CADE	Central de Anotaciones de Deuda del Estado (public debt book-entry trading system)
CDS	Credit Default Swap
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CESFI	Comité de Estabilidad Financiera (Spanish government committee for financial stability)
CESR	Committee of European Securities Regulators
CMVM	Comissão do Mercado de Valores Mobiliários (Portugal's National Securities Market Commission)
CNMV	Comisión Nacional del Mercado de Valores (Spain's National Securities Market Commission)
CSD	Central Securities Depository
EAFI	Empresa de Asesoramiento Financiero (financial advisory firm)
EC	European Commission
ECB	European Central Bank
ECLAC	Economic Commission for Latin America and the Caribbean
ECR	Entidad de capital-riesgo (venture capital firm)
EMU	Economic and Monetary Union (euro area)
ETF	Exchange traded fund
EU	European Union
FI	Fondo de inversión de carácter financiero (mutual fund)
FIAMM	Fondo de inversión en activos del mercado monetario (money-market fund)
FII	Fondo de Inversión Inmobiliaria (real estate investment fund)
FIICIL	Fondo de instituciones de inversión colectiva de inversión libre (fund of hedge funds)
FIL	Fondo de inversión libre (hedge fund)
FIM	Fondo de inversión mobiliaria (securities investment fund)
FTA	Fondo de titulización de activos (asset securitisation trust)
FTH	Fondo de titulización hipotecaria (mortgage securitisation trust)
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IIC	Institución de inversión colectiva (UCITS)
IICIL	Institución de inversión colectiva de inversión libre (hedge fund)

IIMV	Instituto Iberoamericano del Mercado De Valores
IOSCO	International Organization of Securities Commissions
ISIN	International Securities Identification Number
LATIBEX	Market in Latin American securities, based in Madrid
MAB	Mercado Alternativo Bursátil (alternative stock market)
MEFF	Spanish financial futures and options market
MFAO	Mercado de Futuros del Aceite de Oliva (olive oil futures market)
MIBEL	Mercado Ibérico de Electricidad (Iberian electricity market)
MiFID	Markets in Financial Instruments Directive
MMU	CNMV Market Monitoring Unit
MoU	Memorandum of Understanding
OECD	Organisation for Economic Co-operation and Development
OICVM	Organismo de inversión colectiva en valores mobiliarios (UCITS)
OMIP	Operador do Mercado Ibérico de Energía (operator of the Iberian energy derivatives market)
P/E	Price/earnings ratio
RENADE	Registro Nacional de los Derechos de Emisión de Gases de Efectos Invernadero (Spain's national register of greenhouse gas emission permits)
ROE	Return on Equity
SCLV	Servicio de Compensación y Liquidación de Valores (Spain's securities clearing and settlement system)
SCR	Sociedad de capital-riesgo (Venture capital company)
SENAF	Sistema Electrónico de Negociación de Activos Financieros (electronic trading platform in Spanish government bonds)
SEPBLAC	Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales e infracciones monetarias (Bank of Spain unit to combat money laundering)
SGC	Sociedad Gestora de Carteras (portfolio management company)
SGECR	Sociedad gestora de entidades de capital-riesgo (venture capital firm management company)
SGFT	Sociedad Gestora de Fondo de Titulización (asset securitisation trust management company)
SGIIC	Sociedad gestora de instituciones de inversión colectiva (UCITS management company)
SIBE	Sistema de Interconexión Bursátil Español (Spain's electronic market in securities)
SICAV	Sociedad de Inversión de Carácter Financiero (open-end investment company)
SII	Sociedad de Inversión Inmobiliaria (real estate investment company)
SIL	Sociedad de Inversión Libre (hedge fund in the form of a company)
SIM	Sociedad de Inversión Mobiliaria (securities investment company)
SME	Small and medium-sized enterprise
SON	Sistema Organizado de Negociación (multilateral trading facility)
SV	Sociedad de Valores (broker-dealer)
SVB	Sociedad de Valores y Bolsa (broker-dealer and market member)
TER	Total expense ratio
UCITS	Undertaking for Collective Investment in Tradable Securities

I Securities markets and their agents: Situation and outlook

Contents

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1 Executive summary

- Economic recovery proceeded throughout the second half of 2010, with the main emerging economies once more leading the way, while industrialised economies lagged behind to varying extents. Rising world inflation has not yet sparked interest rate hikes in the advanced economies, though some emerging markets have already gone down this path. Short-term risks centre on the wide group of economies striving to ensure the sustainability of their public finances and to round off the restructuring of their financial systems, fears that macro-financial imbalances may be piling up in certain emerging economies, and the increasingly complex landscape for monetary policy, which will have to carefully calibrate the potential impact on prices of a negative supply disturbance, associated to the escalating oil, commodity and food prices of these last few months, in combination with still weak economic recovery.

- The Japan earthquake caused stock markets to falter in mid-March,[1] after the price rally of the second half of 2010. Meantime, long government bond yields in main developed economies settled at more moderate levels after the run-up of 4Q 2010, coinciding with the Irish crisis. Sovereign risk indicators remained at highs over the closing quarter for Europe's peripheral economies, though recently a gap has opened up between Greece, Ireland and Portugal, where indicators have been straining higher since early February 2011, and Italy and Spain, where indicators have stabilised.

- The Spanish economy expanded 0.2% in the fourth-quarter period (-0.1% over full-year 2010), in a context again marked by heavy unemployment (20.3%). Rising commodity prices pushed inflation higher to a February rate of 3.6%, while stretching Spain's differential vs. the euro area to 0.9 percentage points. A restrictive fiscal policy stance sliced two points off the budget deficit, which closed last year at 9.2% of GDP. The short-term prospect is that Spain will continue to grow a little less than other advanced economies, in view of the financial system restructuring still underway and the uncertain outlook for some of its key macroeconomic variables.

- Spanish deposit-taking entities again had to negotiate a complex business landscape characterised by subdued domestic output growth, a mounting bad debt burden, margin erosion, and, in some cases, funding constraints, especially on wholesale markets. It was with this scenario in mind that the Government launched its Financial System Reinforcement Plan in January 2010, intended to restore the markets' confidence in the soundness of Spain's financial system.

1 The closing date for this report is 15 March.

- The aggregate earnings of non financial listed companies climbed by 40% in 2010 to 35.60 billion euros, while their leverage inched down from 1.6 to 1.5 times on moderately decreasing debt levels (-0.5%).

- Main national equity markets got off to a strong start after the losses of 2010. The Ibex 35 posted a quarterly advance of 8.9% after the mid-March losses that followed the Japan earthquake, but before that was registering increases of nearly 13%. Stock market volatility died down to levels bordering on 25% after the peaks reached in 2010 (70% and 40% in May and November respectively). Market turnover continued to expand and liquidity conditions remained comfortable. Of the Ibex 35 participants, financial entities were hardest hit by the turbulence on European public debt markets.

- Yields on Spanish public and private debt rose across all maturities in the fourth quarter of 2010 then eased back in the next three months, more intensely so in shorter segments. The sovereign risk premium receded from the highs reached in November 2010 before entering a stable phase as of end-February. Fixed-income issues registered with the CNMV dropped by 42% in 2010 to 226 billion euros.

- Assets under management in investment funds fell by 15.6% to a year-end total of 144 billion euros. The main force at work was again unitholder redemptions, with fixed-income funds losing out most due to competition from high-interest bank deposits. The proportion of less-liquid assets in fund portfolios hovered between 7.1% and 7.4% in the second-half period. Real estate schemes saw their assets shrink by 5.4% in the full-year period, and hedge funds too suffered something of a setback with a number of entities entering liquidation. But this recession climate did not stop foreign UCITS marketed in Spain from growing their investment 41%, lifting their combined assets to 20% those of Spanish schemes from just 12% in 2009.

- UCITS management companies grew their earnings by 24.5% despite a yearlong decline in managed assets, thanks to a small advance in net fee income and savings in operating costs. Although UCITS managers have been working hard to rationalise their investment fund offerings, we would not rule out some midterm sector restructuring, as counselled by the excess capacity in the system and in view of the gathering consolidation wave among Spanish banks and savings banks. Meantime, stiff competition from products like foreign UCITS and exchange-traded funds and the decline in household savings rates spell a still uncertain outlook for the investment fund industry.

- The crisis continued to take its toll on investment firm business, though with notable differences between types of entity and business lines. Aggregate pre-tax profits were down vs. 2009 at both broker-dealers (-20%) and broker firms (-6%). However fewer entities closed in losses, what losses there were smaller than in 2009, and the sector's capital ratios stayed in safe terrain, with not one firm showing an own funds deficit. The excess capacity in the sector and the mergers underway among the savings banks could herald more restructuring further ahead.

- This report includes seven exhibits focusing on the following issues:

  - The first looks at recent trends in international capital flows, particularly the copious portfolio investment inflows reaching emerging economies in recent quarters. A discussion follows as to whether some of these economies may be storing up macro-financial imbalances

  - The second discusses amendments made to the EU Regulation on credit rating agencies, which transfer registration and supervisory powers in their respect to the new European Securities and Markets Authority (ESMA) as of 1 July 2011.

  - The third exhibit reviews the mechanisms in place to ensure adequate price formation and investor protection in stock market listings, in view of the interest shown by some financial entities in issuing listed shares.

  - The fourth sets out the good practice criteria for liquidity provision to retail bond investors published by the CNMV in October 2010, with the focus on new recommendations on trading practices and disclosure requirements.

  - The fifth describes the latest amendments to UCITS regulations, including the authorisation to create special-purpose schemes or "side pockets", and a series of measures to give the industry more operational flexibility.

  - The sixth explores the key features of U.S. money market funds and the regulatory changes they have undergone since the onset of the crisis. It also summarises the main arguments in the current debate around their future regulation.

  - Finally, the seventh exhibit offers a run-through of the questions and comments arising during the consultation round for CNMV Circular 6/2009 on internal controls in UCITS management companies, particularly those touching on the delegation of key functions.

2 Macro-financial setting

2.1 International economic and financial developments

Economic recovery remains on course ...

Since the last issue of this report, in the CNMV Quarterly Bulletin for the third quarter of 2010, the international macroeconomic climate has been shaken by a new wave of turbulence, coinciding with the Irish debt crisis in early November, and, more recently, by the earthquake in Japan, whose impact on the world financial system is still incalculable.

...despite the European sovereign debt crisis and the uncertainty generated by events in Japan.

The Irish debt episode added a new layer of uncertainty, especially in Europe, but did not palpably alter the economic recovery course the region has been tracing since mid- 2009. Nor did it disrupt the performance of international financial markets in general, and stock markets in particular, though they were later caught up in the aftermath of the disaster in Japan.

Emerging economies conserve their growth lead in 2010, contrasting with the uneven performance of the developed economies.

The IMF estimates that the world economy grew around 5% in 2010, after the 0.6% dip of the previous year. The two-speed pattern was maintained, with the emerging economies (7.1%) continuing to expand ahead of the industrialised contingent (3.0%). Quickening output growth was also reflected in the resurgence of world trade in the last year and a half. However the strength of recovery was notably uneven among the developed economies. This is nowhere clearer than in Europe (see table 1), where 2010 growth was led by the German economy (3.6%), while remaining countries either grew more weakly (around 1.5%) or not at all. Beyond Europe, both Japan (3.9%) and the United States (2.9%) expanded at a healthy rate.

Gross domestic product (annual % change) TABLE 1

					IMF(*)		OECD(*)	
	2007	2008	2009	2010	2011F	2012F	2011F	2012F
World	5.2	3.0	-0.6	5.0	4.4 (+0.2)	4.5 (=)	–	–
United States	1.9	0.0	-2.6	2.9	3.0 (+0.7)	2.7 (-0.3)	2.2 (-1.0)	3.1
Euro area	2.8	0.4	-4.1	1.7	1.5 (=)	1.7 (-0.1)	1.7 (-0.1)	2.0
Germany	2.7	1.0	-4.7	3.6	2.2 (+0.2)	2.0 (=)	2.5 (+0.4)	2.2
France	2.4	0.2	-2.6	1.6	1.6 (=)	1.8 (=)	1.6 (-0.5)	2.0
Italy	1.5	-1.3	-5.0	1.1	1.0 (=)	1.3 (-0.1)	1.3 (-0.2)	1.6
Spain	3.6	0.9	-3.7	-0.1	0.6 (-0.1)	1.5 (-0.3)	0.9 (=)	1.8
United Kingdom	2.7	-0.1	-4.9	1.4	2.0 (=)	2.3 (=)	1.7 (-0.8)	2.0
Japan	2.4	-1.2	-6.3	3.9	1.6 (+0.1)	1.8 (-0.2)	1.7 (-0.3)	1.3
Emerging	8.3	6.1	2.6	7.1	6.5 (+0.1)	6.5 (=)	–	–

Source: Eurostat, IMF and OECD.

(*) Figures in brackets show the change over the previous published forecasts. IMF, forecasts published in January 2011 (versus October 2010). OECD, forecasts published November 2010 (versus June 2010).

Rising inflation has not yet triggered interest rate moves in the main industrialised economies…

Against this backdrop of gathering recovery, the developed economies experienced a year-long rise in inflation, with its main origin in the price of energy and non-energy commodities (see figure 1). However, core inflation held reasonably stable due to the persistence of excess productive capacity, and with unemployment rates remaining stubbornly high despite the better news on growth. So, with the exception of deflationary Japan, inflation expectations remained relatively well anchored in the main advanced economies, implying that official interest rates could be safely kept at lows. In the United States and Japan, concretely, rates had stood at 0%-0.25% and 0.1% respectively since December 2008, while the UK rate had held at 0.5% since March 2009 and the euro area rate at 1% since May 2009.

...though it seems likely that hikes will begin in Europe over the next three months.

In recent weeks, however, this placid scenario has been overturned, with inflation forecasts revised upwards across the board. The cause, basically, has been the build-up of political tensions in a series of oil-exporting Arab countries, which are fuelling expectations of interest rate hikes in the main industrialised countries. This, certainly, is the message being conveyed by three-month forward rates, and some analysts are confidently predicting that UK and euro-area interest rates will be revised upwards in the coming quarter, with the U.S. following some time later, towards the end of this year or in early 2012.

Commodity prices[1] FIGURE 1

Source: Thomson Datastream.

1 Thomson Reuters Equal Weight Continuous Commodity Index (formerly CRB index).

Some emerging economies raised their official rates in 2010.

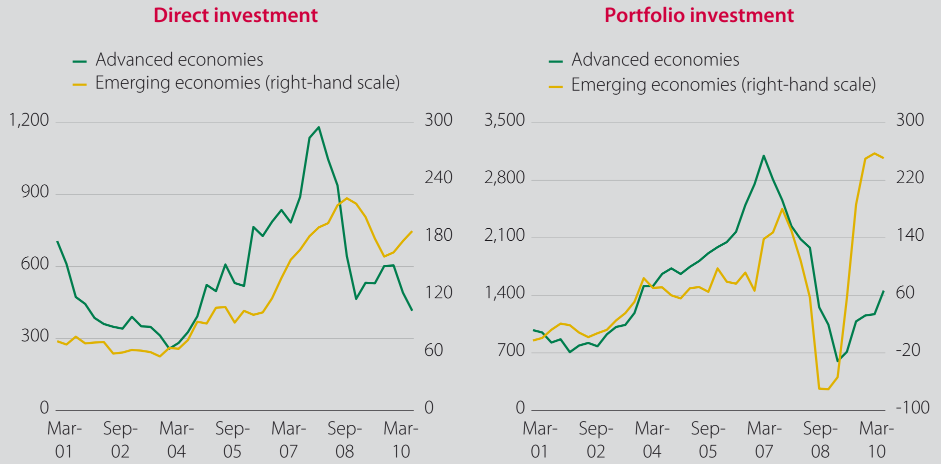
Meantime, a number of the emerging economies tightened their monetary policy stance in the second half of 2010 in the face of growing inflationary pressure stoked by strong external and domestic demand. This was the case of India, China and South Korea, and Chile and Brazil in Latin America.

Exhibit 1: "Recent trends in international financial flows and global imbalances"

For the world's principal emerging economies, the decade preceding the current crisis was one of extraordinary dynamism. Rapidly rising income was in most cases accompanied by high domestic savings rates which could go to feed the growing financing requirements of a series of industrialised economies - the most visible symptom of today's global imbalances. It was in this soil of abundant finance, low interest rates, pockets of high priced assets and fast expanding private credit that the present crisis took root.

The global surge in uncertainty that followed the Lehman Brothers collapse in September 2008 triggered an immediate reaction in international capital flows. But this time something had changed. Unlike in previous crisis episodes, the flow of capital was from the periphery (emerging economies) to the epicentre (the industrialised economies and, above all, the United States). This outpouring of funds from emerging countries was basically instrumented as portfolio divestments, as we can see from figure E1.1.

Capital inflows in billion dollars FIGURE E1.1



Source: Datastream. Cumulative four-quarter data to the third quarter of 2010. Advanced economies are the United States, euro area, United Kingdom and Japan (48% of world GDP in 2001-2010 in terms of purchasing power parity). The emerging economies group comprises Brazil, Mexico, Chile, China, India, Indonesia, Malaysia, Russia and South Korea (27% of world GDP in 2001-2010 in terms of purchasing power parity).

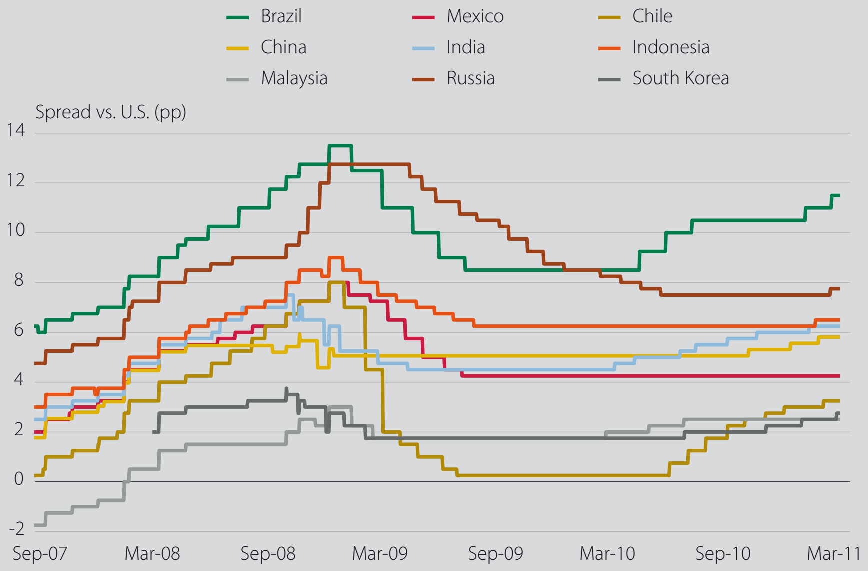
It was soon plain that emerging economies' less developed financial systems had only negligible exposure to the products and practices that had caused the crisis in the first place, and this, allied with the gathering recovery of world trade flows, earned them a renewed growth boost to rates exceeding even those of the immediate pre-crisis years.

In recent quarters, however, signs have emerged that some of these economies may be accumulating macro-financial risks. Among the causes of concern are the rapid run-up in prices in some asset markets, the unchecked expansion of borrowing and, in some cases, mounting inflation and strong currency appreciation. It is reasonable to suspect that some of these trends have been magnified in part by the extraordinarily accommodative monetary policies pursued by the industrialised countries, which may be playing in favour of carry trade strategies. With this kind of operation, investors borrow in a low-yielding currency to fund the acquisition of higher-yielding assets, normally denominated in their own national currency. And we can see from figure E1.2 below how the spreads in official interest rates between emerging economies and the United States have indeed been widening of late.

This partial reversal in the direction of world capital flows with respect to the pre-crisis pattern has raised the spectre of imbalances building up in some emerging economies, with concern that movements of a potentially unstable and/or speculative nature could distort the prices of certain assets. The consequences in this case would be particularly grave for countries that rely most on external financing.

Official interest rate spreads vs. the United States

FIGURE E1.2



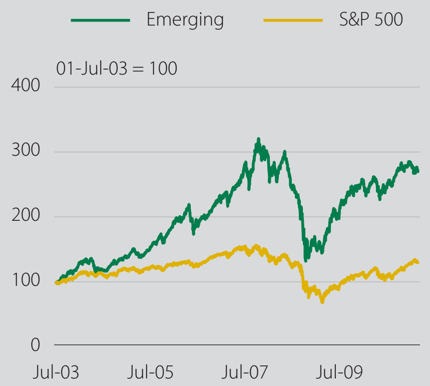
Source: Bloomberg. Data to 15 March.

Similarly, the aggregate equity and bond indices of emerging markets, which are now back to the levels of just before the crisis, may be partly factoring their improved growth prospects but could also betray some undervaluation of the risks they present (see figure E1.3).

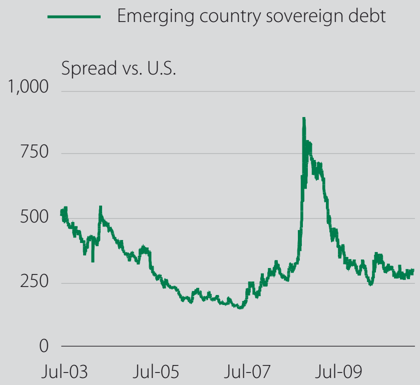
Valuation of the risk of emerging economies

FIGURE E1.3

Emerging market equity index (MSCI)



Risk premium of emerging market debt (EMBI)



Source: Bloomberg and Datastream. Data to 15 March.

Stock indices weathered the turbulence from the Irish crisis but were driven lower by the earthquake in Japan.

Leading industrialised economy stock indices weathered the turbulence caused by the end-2010 Irish crisis and were marking up steady gains until the Japanese earthquake on March 11, 2011 (see table 2). Since then, all reference indices have suffered significant falls, at times wiping out the gains accumulated year to date. By mid-March, Japan's market indices had shed more than 15% of their initial value, while U.S. indices were trading slightly higher. In Europe, the gains of indices like the Ibex 35 and Mib 30 contrasted with the losses of others, like the Dax 30 and Cac 40. Equity market volatility was not overly affected by the earthquake, just as it had largely withstood the shock waves from the Irish crisis. The exception was Japan, where both the Topix and Nikkei 225 were registering above 50% by the middle of March.

Performance of main stock indices[1] (%) TABLE 2

									1Q11 (to 15 March)		
	2007	2008	2009	2010	1Q10	2Q10	3Q10	4Q10	% prior qt.	% Dec	% y/y[2]
World											
MSCI World	7.1	-42.1	27.0	9.6	2.7	-13.3	13.2	8.6	-0.6	-0.6	7.6
Euro area											
Euro Stoxx 50	6.8	-44.4	21.1	-5.8	-1.1	-12.2	6.8	1.6	-0.3	-0.3	-3.0
Euronext 100	3.4	-45.2	25.5	1.0	2.2	-10.5	7.5	2.8	-1.5	-1.5	-0.1
Dax 30	22.3	-40.4	23.8	16.1	3.3	-3.1	4.4	11.0	-3.9	-3.9	12.6
Cac 40	1.3	-42.7	22.3	-3.3	1.0	-13.4	7.9	2.4	-0.6	-0.6	-2.8
Mib 30	-8.0	-48.7	20.7	-8.7	-0.4	-14.7	6.2	1.1	2.6	2.6	-4.1
Ibex 35	7.3	-39.4	29.8	-17.4	-9.0	-14.8	13.5	-6.2	4.8	4.8	-5.7
United Kingdom											
FTSE 100	3.8	-31.3	22.1	9.0	4.9	-13.4	12.8	6.3	-3.5	-3.5	1.8
United States											
Dow Jones	6.4	-33.8	18.8	11.0	4.1	-10.0	10.4	7.3	2.4	2.4	11.4
S&P 500	3.5	-38.5	23.5	12.8	4.9	-11.9	10.7	10.2	1.9	1.9	11.4
Nasdaq-Cpte	9.8	-40.5	43.9	16.9	5.7	-12.0	12.3	12.0	0.5	0.5	12.9
Japan											
Nikkei 225	-11.1	-42.1	19.0	-3.0	5.2	-15.4	-0.1	9.2	-15.9	-15.9	-20.0
Topix	-12.2	-41.8	5.6	-1.0	7.8	-14.0	-1.4	8.4	-14.7	-14.7	-18.3

Source: Datastream.
1 In local currency.
2 Year-on-year change to the reference date .

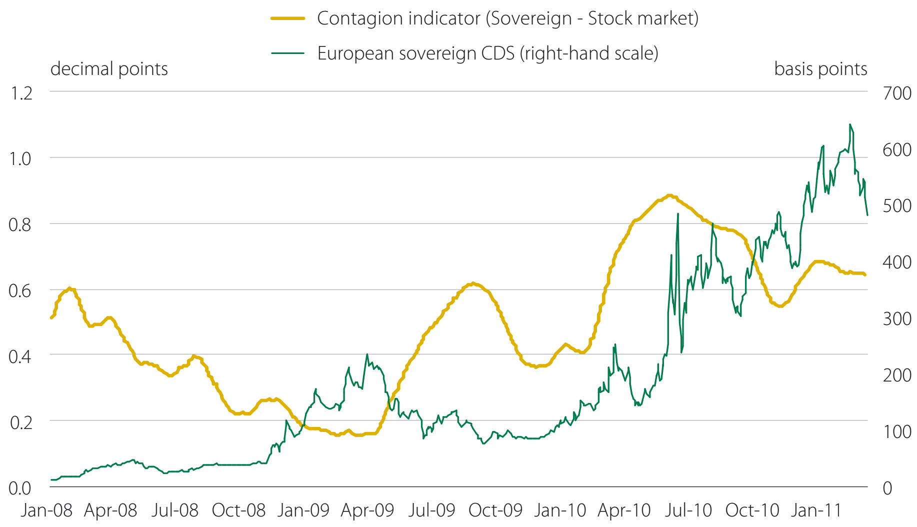
Sovereign risk contagion to equity markets reached its height during the Greek crisis.

Figure 2 offers an estimate of the contagion effect between Europe's sovereign sector and equity markets, based on readings of the sovereign CDS of five European peripheral economies and the performance of the Eurostoxx.[2] What it shows is that

2 The measure we use to gauge this effect is based on calculations of the spillovers of one financial asset on another, starting form the specification used by Diebold and Yilmaz to construct the Global Equity Market Spillover Index, available at: http://data.economicresearchforum.org/en/SpillOverIndex. Spillover is computed by estimating an autoregressive vector model, based on a breakdown of prediction er-

sovereign risk contagion to equity markets was strongest at the height of the Greek crisis (May 2010). In the next turbulence outbreak, coinciding with the Irish crisis, the contagion effect was less severe.

Contagion effect of the sovereign crisis on European equity markets[1] FIGURE 2



Source: CNMV.

1 This figure shows the net percentage change in the European stock index Eurostoxx and the European sovereign CDS index that is not ascribable to these indicators' historic data but to contemporary shocks in their respective returns. The resulting contagion indicator is increasing with the intensity of the effect produced by specific sovereign risk shocks on Eurostoxx returns. The extreme case where the index shows a value of one would indicate that contemporary stock index shocks have a zero impact, while a value of zero would mean sovereign risk shocks have no contemporary influence on the equity market. The sovereign CDS index is obtained from the average of the five peripheral countries: Spain, Greece, Ireland, Italy and Portugal.

The sovereign debt crisis has confirmed the safe haven role of U.S. and German bonds.

In public debt markets, the upswing in aggregate uncertainty caused by successive rounds of the European sovereign debt crisis served to reinforce the "safe haven" status of German, U.S. and, to a lesser extent, British government paper. In effect, last year's turbulence episodes tended to coincide with a fall in the yields of what are viewed as safer assets and a rise in those of the countries displaying elements of fiscal fragility (see figure 3).

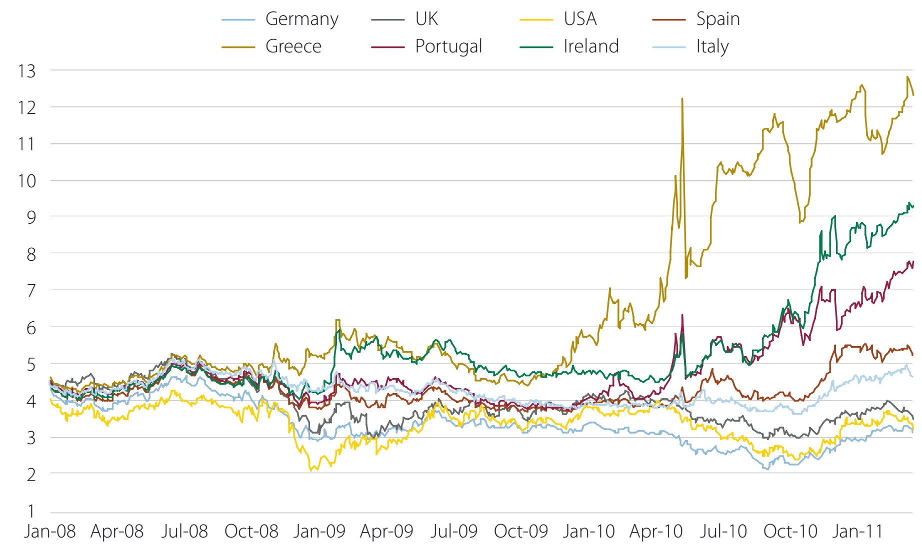
Sovereign risk indicators have been heading higher since February but Spain has so far escaped the trend.

January 2011 brought an easing of sovereign risk concerns, possibly motivated by expectations of an expanded and enhanced EU financial assistance mechanism and the bringing forward of domestic reforms. However, since the start of February, premiums have begun to climb again in Greece, Ireland and Italy, while the situation of Spain has stayed reasonably stable (see figure 4).

ror variance and on the calculation of the fraction of the prediction error variance of each variable that traces to innovations or shocks in the remaining variables. This methodology allows us to measure those effects that cannot be explained by the past information extracted from these indices, but only by contemporary events which initially affect other variables and are then passed on (contagion effect) to the study variable.

Ten-year government bond yields (%)

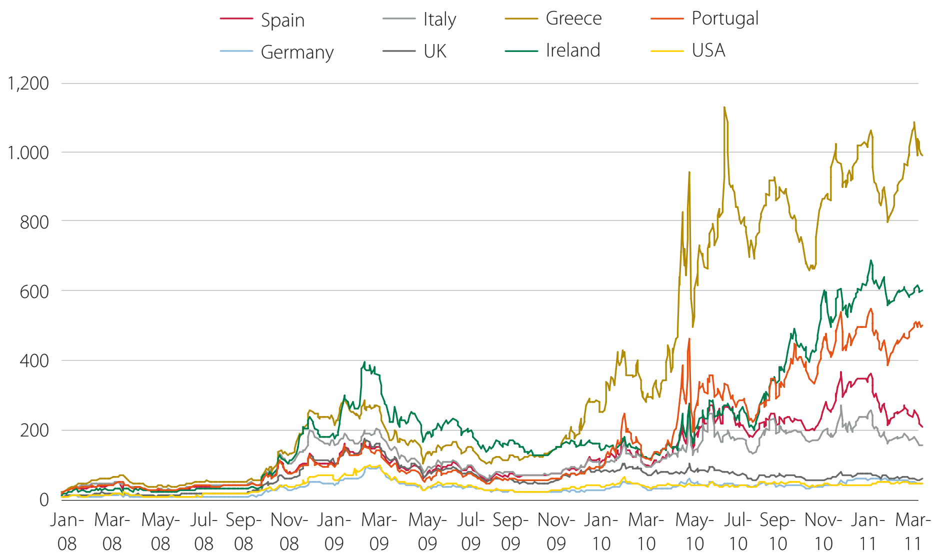
FIGURE 3



Source: Thomson Datastream. Data to 15 March.

Sovereign risk premiums, 5-year CDS

FIGURE 4

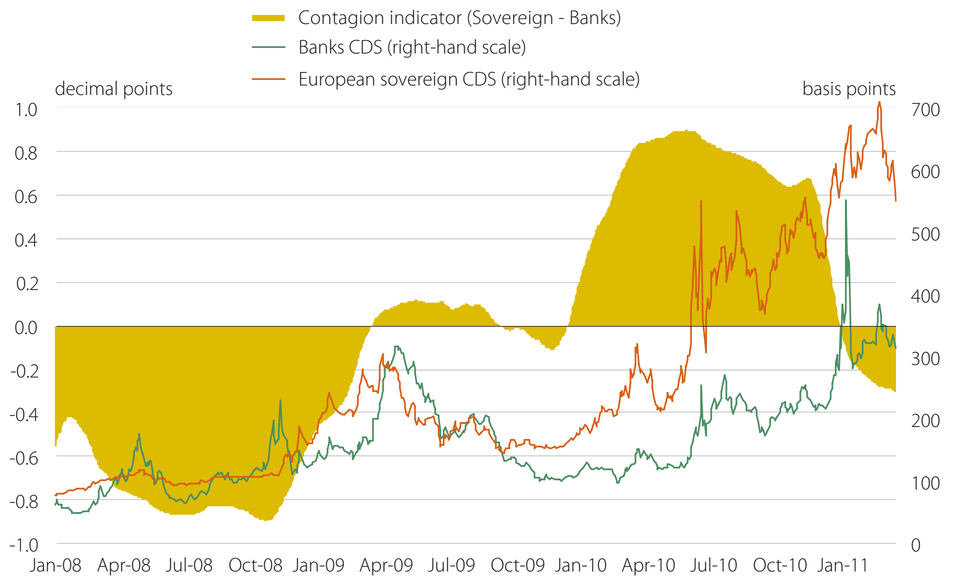


Source: Thomson Datastream. Data to 15 March.

Credit risk transmission between Europe's banks and the public sector has gone through contrasting phases since the crisis broke.

Figure 5, showing the results of a dynamic estimate of credit risk transmission in Europe from the financial to the public sector, reveals that this phenomenon has gone through diverse phases since the crisis broke. In the first, which encompassed the whole of 2008, credit risk was transferred in net terms from the financial sector to sovereign debt. When interpreting these results, it is wise to remember that fears about the health of Europe's banks abounded at that time. The next phase, lasting from the second quarter to year-end 2009, was characterised by the resumption of world growth and a gradual return to stability in the financial systems of many industrialised countries, particularly the United States. As a result, contagion between the two sectors was substantially reduced. In the last phase, starting in early 2010 with the first rumblings of the Greek debt crisis, the source of contagion switched to the public sector of the economy. And it now seems that the direction may have changed once more, since the closing stretch of 2010. One possible cause would be the resurgence of fears about the vulnerability of Europe's banks after the sudden collapse of two Irish entities that had passed the stress tests conducted by European supervisors in July 2010.

Net contagion between the European financial and public sectors[1] FIGURE 5



Source: CNMV.

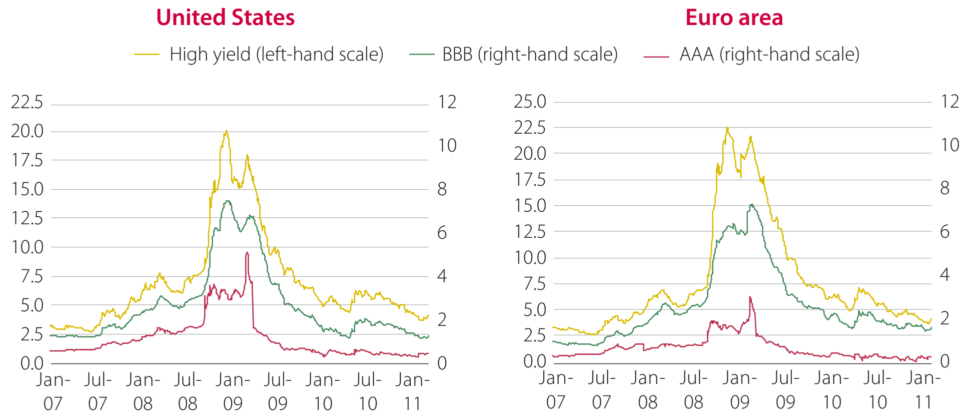
1 This figure shows the net change in the CDS indices of the European banks sector and various sovereign debt benchmarks that is not attributable to their historical information but to contemporary shocks in sovereign and bank sector credit risk. The contagion indicator is positive when the impact of sovereign risk shocks on financial risk indicators exceeds the impact of shocks directly affecting bank sector credit risk. The bank sector CDS index is obtained from the average of the top European Union banks. The sovereign CDS index is the average of the five peripheral countries: Spain, Greece, Ireland, Italy and Portugal.

Corporate spreads are moving close to their pre-crisis levels …

Meantime corporate debt spreads in the United States and euro area closed 2010 at close to their pre-crisis levels across the full range of issuer quality (see figure 6). However, starting in the second quarter, the scale of global corporate debt issuance began to tail off sharply (see figure 7), particularly among European financial entities.

Corporate bond risk premiums[1] (basis points)

FIGURE 6



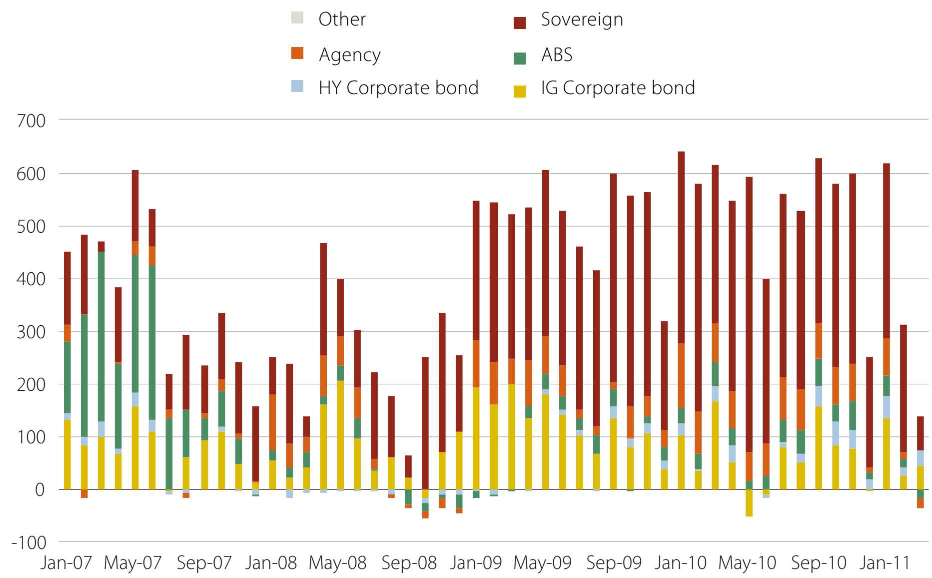
Source: Thomson Datastream (Merrill Lynch, IBOXX indices). Data to 15 March.

1 Expressed as the yield spread between bonds of the same maturity and credit quality belonging to a given index and 10-year government bonds (a synthetic bond in the case of the euro area).

Net international debt issuance, million dollars

By type of financial instrument

FIGURE 7



Source: Dealogic. Monthly data to 15 March.

Exhibit 2: "Changes in the Regulation on credit rating agencies"

The Regulation on credit rating agencies[1] in force in the European Union since late 2009 assigns supervisory and registration powers in respect of these entities to national supervisory authorities. However, following the setup of new EU-wide supervisory authorities, the European Parliament and the Council have amended its terms to the effect that as of 1 July, 2011 these registration and supervisory duties will be transferred to the European Securities and Markets Authority (ESMA). National authorities will continue to resolve on applications for registration received from agencies before 7 September, 2010.

Under the reframed provisions, ESMA will be empowered to request information from the supervised agencies, initiate investigations and conduct on-site inspections. It may also deal with breaches of the Regulation through supervisory measures such as striking agencies off the register, temporarily banning them from issuing ratings valid for the European Union, the publication of warning notices and, finally, the imposition of fines.

Transitional functions of the CNMV

Appointed competent authority in respect of the Regulation on credit rating agencies by Sustainable Economy Law 2/2011 of 4 March, the CNMV is temporarily charged with two kinds of transitional functions. The first relates to rating agency registration and the second to the drafting of the binding technical standards that ESMA will present to the European Commission:

a) Rating agency registration. Applications for registration can come from agencies operating on a stand-alone basis or else belonging to a group. Under the terms of the Regulation, all applications from groups must be examined by colleges of supervisors. The CNMV, for instance, sits on the colleges dealing with the Fitch, Moody's and Standard & Poor's groups. The final decision to grant or refuse registration corresponds to the authority in the agency's home Member State, but must also be agreed consensually by the college. In the absence of such consensus, the competent authority should refuse registration. Between 7 June and 7 September 2010, 45 credit rating agencies applied for registration in the European Union, of which 19 corresponded to individual agencies and the rest to agencies belonging to cross-border groups.

b) Drafting of the binding technical standards that ESMA must present to the European Commission. These standards refer to matters like the information agencies must disclose in their registration applications, the content and format of the statistical data to be published by registered agencies, agency compliance with methodological standards and their reporting requirements with ESMA for supervisory purposes.

Permanent functions of the CNMV

Once the amended Regulation comes into force,[2] the CNMV will retain the following functions with respect to agencies registered in the European Union:

a) Participation in ESMA supervision. ESMA's decisions on rating agencies will be discussed and agreed by members according to the standard decision-making process, with national authorities fully involved at every level: i) on the ESMA Board of Supervisors, national representatives will take top-level decisions concerning agency registration and supervision; ii) on the technical score, ESMA has created a standing committee made up of experts from national authorities, whose job will be to advise the Board on regulatory and strategic matters pertaining to credit rating agencies, as well as on other matters that the Board decides.

b) Obligation to work constructively with ESMA. The Regulation makes it incumbent on national authorities to cooperate with ESMA. This means supplying the new authority with all pertinent information for the fulfillment of its functions and collaborating in supervisory activities. ESMA may also call on the help of CNMV staff for investigative work in Spanish territory, including on-site inspections.

c) Delegation of supervisory tasks. ESMA may delegate certain supervisory tasks (for instance, information requests, investigations or on-site inspections) to national authorities, though note that responsibility will at all times remain with the pan-European authority. Prior to such delegation, ESMA must decide along with the national authority whether this is the most advisable course, and, if so, will subsequently reimburse it for the costs incurred.

d) Reporting infringements of the Regulation. When a competent authority believes it has detected some breach of the Regulation, it should report this to ESMA, proposing supervisory measures or, even, that use of the rating be suspended for regulatory purposes.

1 Regulation (EC) 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies.
2 To be published some time around May 2011 and come into force twenty days later.

The euro has been gaining against the dollar, with occasional setbacks, since mid-2010.

In currency markets, the euro pulled out of its first-half slide against the dollar[3] thanks partly to the decision by the U.S. Federal Reserve to resume its quantitative easing policy. The uptrend, however, was cut short in the closing months by the onset of the Irish crisis (see figure 8). Even so, the European currency gained over 16% against the dollar between the lows of June 2010 and mid-February 2011. Against the yen, it has held relatively flat at around 110 yens/euro since end-May 2010 after depreciating over 18% since the start of that year.

The yen soared after the earthquake on expectations of capital repatriation, but was restored to stability thanks to coordinated moves by the G7 central banks.

The yen appreciated sharply in the days following the Japan earthquake on expectations of a massive sell-off of foreign assets, particularly by insurance companies, to release funds for the country's reconstruction. Subsequently, however, a large liquidity injection from the Bank of Japan and the decision by the G7 countries to intervene jointly to buy dollars helped take some of the heat off the Japanese currency.

2.2 National economic and financial developments

Spanish GDP grows 0.2% in the fourth quarter for a full-year average of -0.1%,...

Quarterly National Accounts data for the fourth quarter of 2010 show that Spain's GDP grew 0.2% in quarterly terms (against the zero rate of the preceding quarter) and 0.6% annually (0.2% in the third quarter), leaving the full-year average at a mildly negative -0.1%. This is a notable improvement on the -3.7% of the previous year, but also puts Spain some way behind a number of its partner economies (the euro area grew 1.7%). As we can see from table 3, the incipient recovery was largely driven by private consumption (up from -4.3% in 2009 to 1.2% in 2010), equipment

3 The euro lost almost 15% against the dollar over the first six months of 2010.

investment (-24.8% to 1.8%), and a positive contribution from the foreign sector, especially on the exports side (up 10.3% in the full-year period).

On the supply side, both industry (0.2%) and services (0.2%) input positively, while the decline in construction value-added slowed to -0.4% from the -1.9% of the third quarter. Over full-year 2010, the industrial and service branches added 0.9% and 0.5% to Spanish GDP against a negative 6.3% from construction.

...with positive input from industry and services.

Inflation built up from around 1% in January 2010 to 3.6% in February 2011 on rising commodity prices, of energy goods particularly, and higher indirect taxation. For the moment, the modest recovery in private consumption has not exerted that great a pressure on domestic prices. Core inflation rates also worked their way up from an initial 0.1% to 1.5% in the month of December (1.8% in February 2011). Spain's inflation differential vs. the euro area, which had moved in negative terrain over 2009, began widening in 2010 as far as 0.7 points at the December close (0.9 points in February 2011).

Rising commodity prices have pushed up Spanish inflation and widened the differential with the euro area.

The mild upturn in domestic activity has brought little relief to labour market figures. The number of employed workers continued to decrease, albeit at a slower pace than in 2009 (2.3% versus 6.8%), while the unemployment rate remained dug in at around 20% of the labour force, two points more than in 2009.

Tentative recovery has yet to spell good news for employment.

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

	2007	2008	2009	2010	European Commission* 2011F	European Commission* 2012F
GDP	**3.6**	**0.9**	**-3.7**	**-0.1**	**0.8 (+0.1)**	**1.7**
Private consumption	3.7	-0.6	-4.3	1.2	0.9 (-0.3)	1.6
Government consumption	5.5	5.5	3.2	-0.7	-1.3 (-0.1)	-0.3
Gross fixed capital formation, of which:	4.6	-4.4	-16.0	-7.6	-3.1 (-1.3)	2.7
Equipment	9.0	-1.8	-24.8	1.8	3.7 (+3.5)	6.0
Exports	6.6	-1.0	-11.6	10.3	5.5 (+0.8)	5.6
Imports	8.0	-4.9	-17.8	5.4	1.4 (-0.4)	4.5
Net exports (growth contribution, pp)	-0.9	1.4	2.7	1.1	1.1 (+0.4)	0.3
Employment	3.1	-0.5	-6.8	-2.3	-0.3 (-0.2)	1.1
Unemployment rate[1]	**8.3**	**11.3**	**18.0**	**20.1**	**20.2 (+0.4)**	**19.2**
HICP	**2.8**	**4.1**	**-0.2**	**1.8**	**2.4 (+0.9)**	**1.4**
Current account (% GDP)	**-10.0**	**-9.7**	**-5.5**	**-4.5**	**-3.8 (+0.7)**	**-3.6**
General government (% GDP)	**1.9**	**-4.1**	**-11.2**	**-9.2**	**-6.4 (-2.2)**	**-5.5**

Source: Ministry of Economy and Finance, National Statistics Office (INE) and European Commission.

1 Eurostat definition.

* Forecasts published in autumn 2010 (with respect to spring 2010), except GDP and inflation forecasts, published in March 2011 (with respect to autumn 2010).

Spain's public deficit came down almost two percentage points in 2010 after the 2009 leap from 4.2% to 11.1% of GDP, as Government spending cuts began to take effect. Indeed, according to IMF estimates,[4] Spain's fiscal policy stance has been the

Expenditure cuts reduce the public deficit by almost two full points to 9.2%.

4 IMF Fiscal Monitor, January 2011.

most restrictive of any developed economy's.[5] Meantime, public indebtedness moved up from 53.2% of GDP in 2009 to 60% in 2010 - the third consecutive increase albeit on a more moderate scale than the previous year (when the ratio jumped by over 13 points).

The outlook for Spanish deposit-taking entities has been further unsettled by the debt crisis.

National deposit-taking entities have had more uncertainties to contend with since successive waves of the European debt crisis engendered new financing difficulties in segments of the wholesale markets. Further, weak domestic activity and loan book impairment have continued to bear down on sector income statements.

The sector's aggregate net profits decreased sharply in 2010.

Finally, Spanish deposit-taking entities posted aggregate full-year net profits of 9.60 billion euros, 26% less than in 2009. The fall traced mainly to net interest income (down from 43 billion euros in 2009 to 34 billion in 2010), higher provisioning and lower extraordinaries. On the upside, operating expenses held reasonably flat while impairment losses (both financial and non financial) eased considerably.

Outstanding loans have trended lower since mid-2010...

After years of decline, the year-on-year change in aggregate outstanding loans to Spanish businesses and households turned timidly upwards in the year's second half on emerging from its April low (-1.5%). The latest available figures, for December 2010, show a small advance in lending (0.8% year on year), but also major differences in the mix, with loans to business expanding 1%, and loans to households by 0.4%. This two-speed growth, which has been kept up over several quarters, stands in contrast to the experience of the euro area. There, lending growth was higher overall but with business lending in retreat and lending to households up by nearly 3%.

…at a time of persistently advancing bad debt ratios.

The non performing loan ratios of Spanish entities continued to advance, with some interruptions, though at a lower rate than in previous years. Between December 2009 and December 2010, the NPL ratio climbed from 5.1% to 5.8% (3.4% in 2008 and 0.9% in 2007, see figure 9). And in January 2011 it rose again to 6.1%. Construction and real estate developers were again the main source of NPL growth, while the percentage of delinquent home purchase mortgages declined in the year to around 2.6%.

The sovereign debt crisis has made it harder for banks to raise funds on wholesale markets…

Financial entities had to work hard to raise funds in 2010's wholesale markets, due to the uncertain climate in sovereign debt. Overall, Spanish banks made less call on more extraordinary financing sources. Issuance of guaranteed bonds, for instance, barely exceeded 13 billion euros compared to almost 48 billion in 2009, while recourse to Eurosystem credits retreated from the highs of mid-2010 (130 billion) to 49 billion in February 2011 (see figure 8).

…persuading many to step up issuance of higher quality products likes mortgage bonds.

Funding constraints on wholesale markets caused a sizeable dent in financial institutions' outright issuance, down from 376 billion euros in 2009 to 223 billion in 2010. Many Spanish entities did like their European peers and switched their attention to the debt products viewed as strongest in credit quality, particularly mortgage

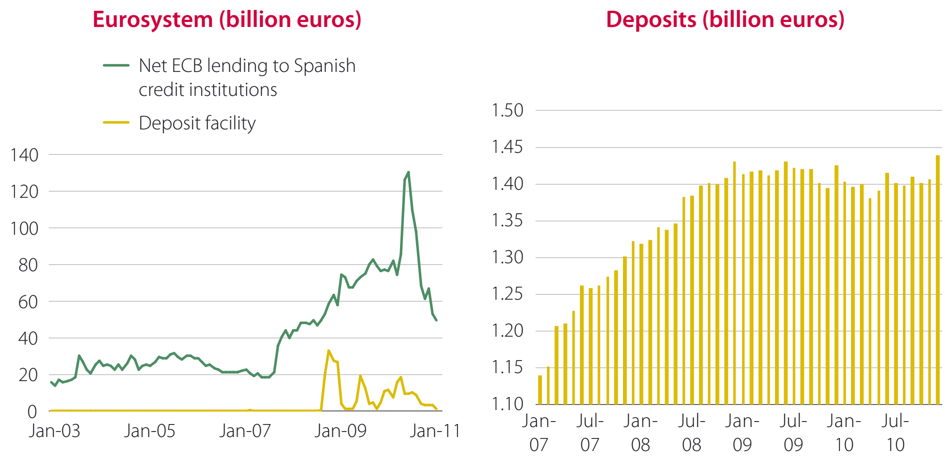
5 The structural deficit of the Spanish economy is estimated to have dropped from 9.7% of GDP in 2009 to 7.5% in 2010, contrasting with this indicator's growth from 5.5% to 5.9% across the world's developed economies (the trend being expansionary in all except the United Kingdom, where it is projected to be neutral).

bonds. As figure 9 shows, covered bond issues expanded their share in the debt mix of Spanish financial entities from 22% in 2009 to 35% in 2010. Among European entities, the equivalent increase was from 20% to 25%.

Finally, some Spanish entities have made increased use of the LCH.Clearnet and Eurex Repo platforms, which channel interbank loans collateralised by government bonds and also cover default risk. In the case of LCH.Clearnet, the value of repos transacted by Spanish banks between August 2010, when this trading modality had its debut, and January 2011 exceeded 800 billion euros.

Larger entities have the advantage of access to platforms like LCH.Clearnet and Eurex Repo.

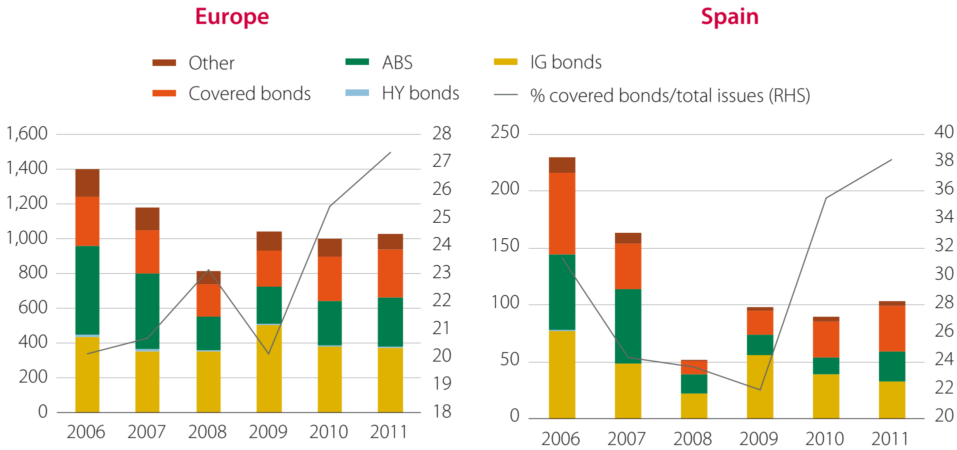
Financing of Spanish credit institutions FIGURE 8



Source: Banco de España. Eurosystem data to February, deposit data to December.

Gross long-term debt issuance by financial entities FIGURE 9

Billion euros



Source: Dealogic. The 2011 figure is the sum of the issuance of the last four quarters to the first quarter of 2011.

The aggregate net profits of non financial listed companies climbed 40.1% vs. 2009 to 33.6 billion euros. As table 5 shows, the earnings advance was common to all sectors, in tune with the general upturn in domestic activity. The strongest contributor in absolute terms was the energy sector, which grew its profits more than four billion to a year-end

Non financial listed companies grow their profits 40% in 2010.

total of 15.76 billion euros. Percentagewise, however, it was industry that took the lead with an earnings leap from 140 million euros in 2009 to 1.61 billion 2010. Also faring well was the retail and services sector with profits up by 27.4% to 14.35 billion euros.

Breaking down listed companies in terms of their net profit for the year (see figure 10, left panel), we find that the number reporting sizeable losses (over 200 million euros) was lower than before, thanks largely to the improved performance of companies in construction and real estate. At the same time, a rather higher number reported smallish profits (from 0 to 100 million euros), including real estate and industrial firms that had posted minor losses (below 100 million) in 2009. Finally, among the listed companies in profit over 2009 and 2010 (see figure 10, right panel), a larger number had managed to grow their earnings from one year to the next.

Earnings by sector:[1] non financial listed companies TABLE 5

	EBITDA[2]		EBIT[3]		Net profit	
Million euros	2009	2010	2009	2010	2009	2010
Energy	28,486	34,974	18,034	23,315	11,472	15,761
Industry	2,712	4,087	1,181	2,453	140	1,607
Retail and services	29,780	34,197	17,933	21,863	11,268	14,356
Construction and real estate	4,644	8,936	1,596	5,658	1,084	1,855
Adjustments	-279	-178	-106	-38	15	16
AGGREGATE TOTAL	**65,343**	**82,016**	**38,638**	**53,251**	**23,979**	**33,595**

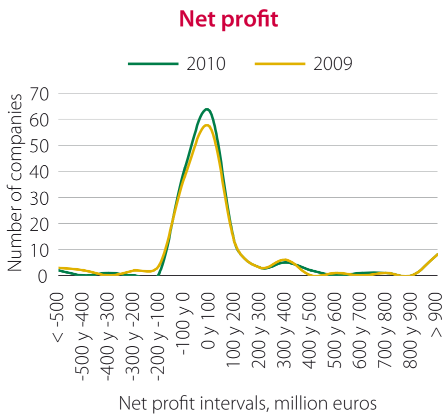
Source: CNMV.

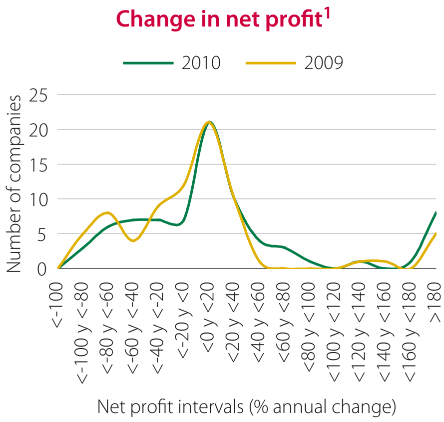
1 Year-to-date.

2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

Non financial listed companies by: FIGURE 10





Source: CNMV.

1 Number of entities distributed according to the change in their net profit, including only those with a positive net outcome in both years.

Non financial listed companies reduce their leverage by a small margin in 2010 (from 1.6 to 1.5)…

The debt of non financial listed companies fell by 0.5% in 2010 to 326.17 billion euros (see table 6), in a break with the rising trend of previous years (between 2005 and 2009 companies' debt grew by 100%). By sector, energy, industrial and real estate and construction firms managed to pay down debt by between 2% and 9%. Conversely, those in retail and services saw their debt swell by 6.3% to 115 billion euros. Financial leverage - the ratio of debt to net equity - dropped from 1.6 in 2009 to 1.5 in 2010, in line with the reduction in aggregate debt, with all sectors except industry sharing in the decrease.

The debt coverage ratio, measuring the years needed to repay existing debt assuming constant EBITDA, fell from 4.8 in 2009 to 4 in 2010, with improvement mainly gleaned from operating profit growth (see table 6). Construction and real estate fared particularly well by this yardstick with a reduction from 22.5 in 2009 to 11.2 in 2010. Meantime, growth in earnings before interest and taxes strengthened non financial companies' interest coverage ratios (EBIT/interest expenses up from 2.4 to 3). All sectors participated in this improvement except for industry, where interest expenses grew faster than EBIT, driving the ratio down from 3.1 to 2.7.

Gross debt by sector: listed companies

TABLE 6

Million euros		2006	2007	2008	2009	2010
Energy	Debt	59,191	69,172	82,608	100,572	98,283
	Debt/ Equity	0.9	0.8	0.9	1.1	0.9
	Debt/ EBITDA[1]	2.2	2.5	2.8	3.5	2.8
	EBIT[2]/ Interest expenses	4.7	4.1	3.7	3.4	4.2
Industry	Debt	15,684	13,312	15,645	15,953	14,508
	Debt/ Equity	0.8	0.6	0.7	0.7	0.8
	Debt/ EBITDA	2.1	1.8	2.7	3.0	3.5
	EBIT/ Interest expenses	5.7	5.9	3.4	3.1	2.7
Construction and real estate	Debt	111,000	138,933	119,788	104,762	99,763
	Debt/ Equity	3.1	3.1	3.8	4.1	3.4
	Debt/ EBITDA	11.5	10.8	31.9	22.5	11.2
	EBIT/ Interest expenses	2.0	1.2	0.0	0.3	1.0
Retail and Services	Debt	91,522	96,941	112,322	108,579	115,407
	Debt/ Equity	2.5	1.7	2.1	1.8	1.6
	Debt/ EBITDA	3.6	3.0	3.6	3.7	3.4
	EBIT/ Interest expenses	2.4	3.2	2.9	3.3	3.9
Adjustments[3]	Debt	-11,199,0	-17,391,0	-20,802,0	-1,908	-1,793
AGGREGATE TOTAL[4]	**Debt**	**266,198**	**300,967**	**309,561**	**327,958**	**326,168**
	Debt/ Equity	1.7	1.5	1.6	1.6	1.5
	Debt/ EBITDA	3.9	4.0	4.6	4.8	4.0
	EBIT/ Interest expenses	3.3	3.0	2.0	2.4	3.0

Source: CNMV.

1 Earnings before interest, taxes, depreciation and amortisation.

2 Earnings before interest and taxes.

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

4 This table did not previously include any financial entities, comprising credit institutions, insurance companies and portfolio companies. However as IPP (Periodic Public Information) forms are the same for portfolio companies as for non-financial companies starting in 2008, it has been decided to include them in the aggregate figure. Data for the 2007 close have been restated to factor the impact of Criteria Caixacorp.

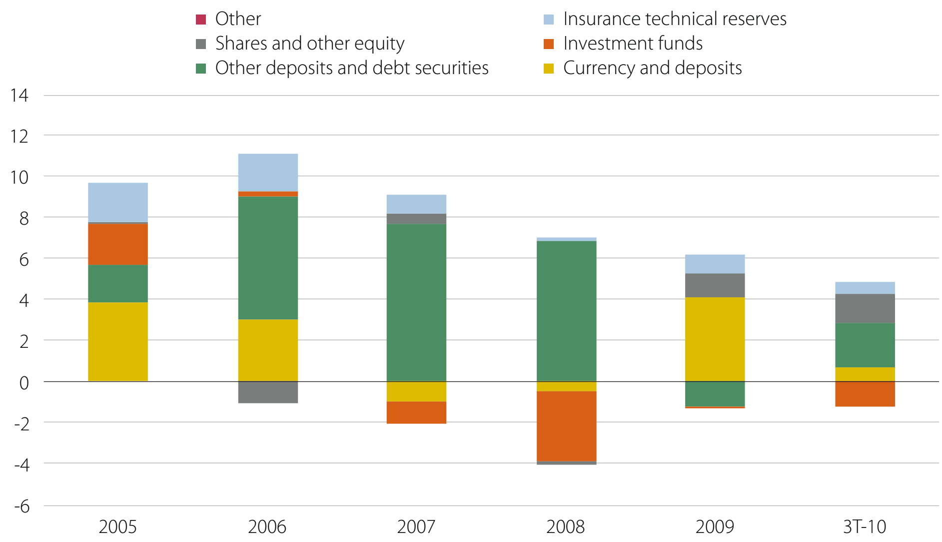
Households are saving less after the large increases of 2008 and 2009, while their indebtedness ratios have tended to stabilise.

Household asset indicators for the third quarter of 2010 show that savings rates prolonged their slide to just under 15% of disposable income, after the strong advances of 2008 and 2009, on a combination of lower income and moderately rising final spending. Household indebtedness had held stable for a number of quarters in the region of 125% of gross disposable income, while the decline in net wealth lasting through 2008 to mid-2009 began to level off thereafter, as the rising prices of financial assets cancelled out the (slower) depreciation of real estate.

Household investment is increasingly geared to term deposits and shares.

Where we can see new patterns emerging is in the make-up of financial assets and liabilities. In particular, households' net financial asset purchases, which by last September were slightly down on the levels of 2009,[6] showed a substantial reallocation from currency and deposits and investment funds into term deposits and shares (see figure 11 and table 13). Part of this shift was presumably due to the abundant choice of high-interest deposits in today's markets. Finally, household liabilities moved up once more (by 0.7% of GDP) after dropping back 1.3 points in 2009.

Households: financial asset acquisitions (% GDP) FIGURE 11



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

2.3 Outlook

Recent forecasts augur world growth of around 4.5% in 2011 and 2012.

The latest forecasts from the IMF and OECD, predating the Japan earthquake and therefore subject to some uncertainty, suggest the world economy will expand around 4.5% in 2011 and 2012, some way below the 2010 estimate (+5%). Emerging economies, they project, will remain notably dynamic, with the Asian contingent pulling ahead with aggregate growth of 6.5%, while the developed economies, led by the United States, will advance at more measured rates of around 2.5%.

The big risks have to do with the Japan earthquake, the outlook for public finances, the build-up of imbalances in some emerging economies and the complex monetary landscape.

Leaving aside the economic effects of the Japanese earthquake - reasonably manageable to judge from the latest data - the main downside risks for forecasters' baseline

6 4.1% of GDP (cumulative four-quarter data) against 4.5% in 2009.

scenarios have to do with: (i) the challenges faced by many economies in securing public finance sustainability while rounding off the restructuring of their financial systems; (ii) the possibility that imbalances may be building up in some emerging markets in view of the abundant capital inflows reaching their economies, the escalating prices of their assets and their rapidly falling risk premiums; and, finally, (iii) the increasingly complex landscape for monetary policy implementation, which will have to carefully calibrate the potential impact on prices of a negative supply disturbance, associated to the escalating oil, commodity and food prices of these last few months, in combination with still weak economic recovery at a time when standard monetary policy transmission mechanisms may see their functionality impaired by fragile elements in the financial system, thinking particularly of interbank markets. This complexity is nowhere more patent than in the euro area, given its considerable heterogeneity with regard to the inflation pass-through of rising oil prices, the pace of economic recovery and the impact of interest-rate movements on household and business wealth. To add to this, concerns about the health of Europe's financial sector and the effectiveness of recent restructuring measures threaten to block the flow of finance to the continent's most vulnerable economies.

Spain is not only set to grow less than other advanced economies, but must contend with the perceived vulnerability of part of its financial system and concerns about its mid-term growth potential.

Leading forecasters are less than optimistic in their 2011 growth projections for the Spanish economy. Specifically, Spain's GDP is tipped to expand between 0.6% and 0.9%, compared to the 1.5% of the euro area and the 3% of the United States. In 2012, however, domestic and euro area growth stand to converge around the 1.5% mark. Note also that employment statistics are not expected to accompany the upturn to any great extent. The risks for this recovery scenario centre on the financial system restructuring still underway and the uncertain outlook for some of the country's key macroeconomic variables. And these factors could hold back a return to normality in public and private sector financing conditions. On the upside, Spain has already made significant strides in fiscal consolidation and structural reforms (labour market, pensions system) and, more recently, has launched its Plan for the Reinforcement of the Financial System, which raises core capital requirements for Spanish entities ahead of the Basel III provisions timetabled for 2013, and imposes an immediate core capital requirement of 8% of risk-weighted assets.

3 Spanish markets

3.1 Stock markets

Spanish stock markets pull out of the dip experienced in the final months of 2010.

After the price falls of late 2010, Spain's stock markets rallied to varying degrees in the first quarter of 2011,[7] outperforming other world bourses more deeply affected in the uncertain aftermath of the Japan earthquake (see table 2 and table 7). The sole exception was the trading segment specialised in Latin American securities.

7 To 15 March.

Performance of Spanish stock indices (%)

TABLE 7

Index	2007	2008	2009	2010	3Q10[1]	4Q10[1]	1Q11 (to 15 March) % prior qt.	% Dec	% y/y
Ibex 35	7.3	-39.4	29.8	-17.4	13.5	-6.2	4.8	4.8	-5.7
Madrid	5.6	-40.6	27.2	-19.2	12.9	-7.5	5.5	5.5	-6.8
Ibex Medium Cap	-10.4	-46.5	13.8	-5.6	13.7	-0.5	2.6	2.6	-2.5
Ibex Small Cap	-5.4	-57.3	17.6	-18.3	3.6	-4.3	9.8	9.8	-7.9
FTSE Latibex All-Share	57.8	-51.8	97.2	9.0	1.5	8.3	-7.0	-7.0	-3.9
FTSE Latibex Top	33.7	-44.7	79.3	9.7	-2.2	7.3	-6.3	-6.3	-1.4
Sector[2]									
Oil and gas	1.8	-30.8	-20.1	0.3	7.1	11.0	15.5	15.5	24.2
Chemicals	-58.4	-67.8	3.4	-60.0	-49.8	-6.2	21.0	21.0	-51.9
Basic materials	-17.2	-45.4	23.1	-5.6	3.0	0.5	2.0	2.0	-0.4
Construction mat. and construction	-12.0	-51.0	25.5	-14.4	15.1	-0.1	9.0	9.0	-0.2
Industrial goods and services	6.9	-41.9	29.3	-1.9	16.9	-1.3	-1.7	-1.7	-1.5
Health	19.2	-45.0	17.7	-22.2	17.1	-9.5	9.5	9.5	-15.0
Utilities	18.5	-31.0	-7.8	-14.3	10.2	3.4	5.8	5.8	-3.5
Banks	-4.5	-47.9	46.3	-32.3	8.8	-16.2	9.9	9.9	-15.6
Insurance	-13.3	-25.0	19.8	-26.8	2.0	-7.1	19.5	19.5	-7.5
Real estate	-42.6	-58.6	-43.8	-53.2	-13.5	-29.7	17.3	17.3	-44.9
Financial services	-35.6	-44.3	20.8	12.8	14.1	2.5	20.1	20.1	26.8
Telecommunications and media	26.3	-31.4	23.5	-13.4	18.1	-5.8	2.0	2.0	-3.1
Discretionary consumption	-7.7	-39.2	37.0	20.6	22.2	-1.7	-3.8	-3.8	10.7
Basic consumption	6.9	-22.5	-8.4	15.8	4.3	10.6	-4.6	-4.6	9.6

Source: Thomson Datastream.

1 Change vs. previous quarter.

2 Classification according to Thomson Datastream.

The Ibex 35 advances 4.8% in the first quarter of 2011 (-17.4% in 2010)...

The Ibex 35 managed a first-quarter gain of 4.8%[8] after slipping back 6.2% in the fourth quarter of 2010 (-17.4% in the full-year period) (see table 7). Looking closer, however, we observe that this index too closed the quarter with falls in the wake of the Japan disaster, after registering advances at some points of nearly 13%. Meantime, small and medium cap indices notched up first-quarter gains of 9.8% and 2.6% on the heels of their 4.3% and 0.5% losses in the fourth quarter of 2010 (-18.3% and -5.6% in the full-year period). In contrast, the bull run enjoyed by Spain's trading platforms for Latin American securities (Latibex) since the year 2009, began to lose steam in 2010. And finally, the FTSE Latibex All-Share and FTSE Latibex Top accumulated first-quarter losses upwards of 6%, after gaining over 8% in the fourth quarter and more than 9% over the length of last year.

...led by chemicals, real estate, insurance and finance.

The sectors spearheading the first-quarter rally were those that lost most heavily in 2010, namely chemicals (21% in the first quarter of 2011 against -60% in 2010), insurance (19.5% after the -26.8% of 2010), real estate (17.3% after -53.2%), banking (9.9% after -32.3%) and construction and related materials (9% after -14.4%). Non

8 The Ibex 35's year-to-date advance to 30 March was 8.9% after prices rallied from mid-month onwards.

bank financial services, energy and healthcare also recorded first-quarter advances, leaving only consumption-related sectors and, to a lesser extent, industrial goods and services in negative terrain.

Figure 12 charts the relative performance of the financial and non financial companies making up the Ibex 35. We can see that the period starting in January 2010 splits into three distinct phases, which are mainly correlated with successive episodes of the European sovereign debt crisis.

Financial entities in the Ibex 35...

In the first phase, which spanned the first half of 2010 and coincided with the Greek debt crisis, the shares of both groups ran down sharply in a climate of heightened uncertainty that pushed market volatility to the region of 70%. Financial institutions recorded deeper losses during this period (over 35%) than non financial listed companies.

... have underperformed non financial listed companies throughout successive rounds of the sovereign debt crisis…

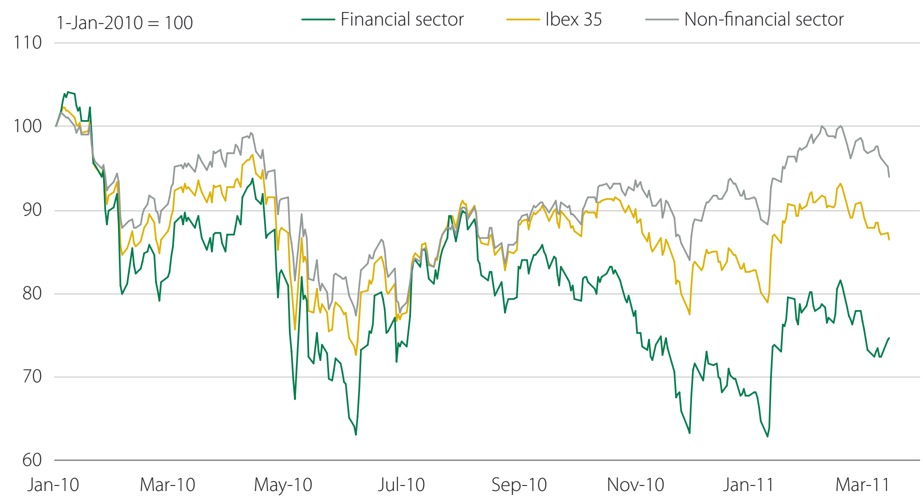
The second phase occupied the middle months of 2010. At this point several factors combined to power financial sector prices higher, to more or less the level of their non financial peers. Chief among them were the Greek rescue deal, the approval of a European assistance mechanism to operate within the European Union, the adoption of fiscal austerity plans in a series of European economies, ECB measures to boost public debt market liquidity, and publication of the results of the stress tests conducted on Europe's financial institutions.

…despite a strong rally in the middle months of 2010.

From September 2010 to date what we see is renewed underperformance by the financial sector. During this time, financial markets were rocked by a new wave of turbulence generated around the Irish crisis, which bore down more heavily on financial sector shares amid growing concerns about the strength of Europe's banking sector. By the end of first quarter 2011, non financial shares were back to the price levels of early 2010, while financial shares were trading 20% lower, despite substantial advances in the intervening period.

Financial sector shares are trading 20% lower than at the start of 2010, when the Greek crisis broke.

Ibex 35: financials vs. non financials[1] FIGURE 12



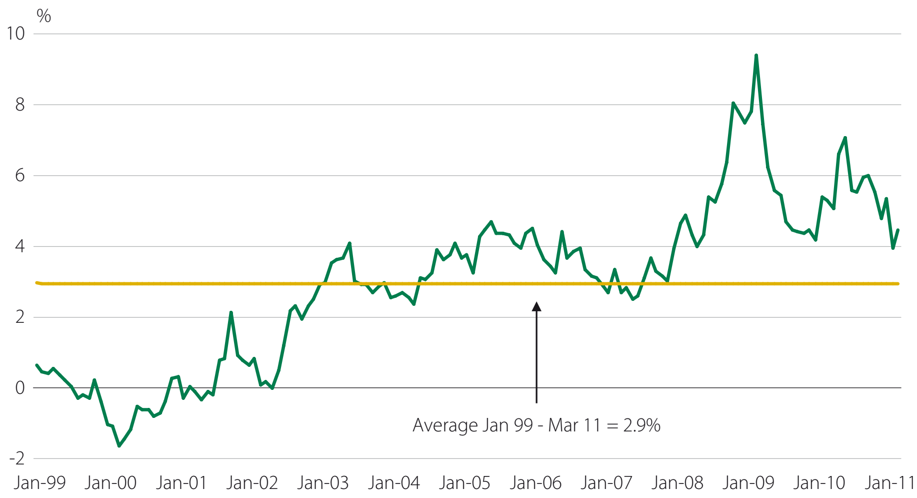
Source: Thomson Datastream. Data to 15 March.

1 Each company is weighted according to the share of its market cap. in the prior-year-end capitalisation of the Ibex 35.

Ibex 35 P/Es are buoyed slightly by the share price rally.

The share price rally of the first quarter of 2011 lifted the price-earnings ratio[9] (P/E), to 10.3 times from the 9.7 of the 2010 close. Despite this growth, the Spanish multiple remained in the lower reaches of the international stock index table. The increase also offset the marginal decline in Spanish ten-year bond yields, causing a fall in the earnings yield gap[10] which reflects the return premium required to be invested in equity versus long-term government bonds (see figure 13). Although this indicator's performance is normally driven by movements in equity rather than government bond prices, in 2010 it was mainly debt markets that called the tune.

Earnings yield gap[1] of the Ibex 35 FIGURE 13



Source: Thomson Datastream and own preparation.

1 Difference between stock market yield, taken as earnings/price and ten-year Spanish government yields. Monthly data to 15 March 2011.

Spanish stock market volatility settles down near 25% after 2010 peaks coinciding with the worst of the sovereign debt crises...

As we can see from figure 14, stock market volatility fluctuated widely in the course of 2010, surging to peak levels of 70% and 40% respectively during the tensest moments of the Greek and Irish debt crises. In both cases, the spikes in Spanish market volatility came close to mirroring those of the indices in Europe's most vulnerable economies, while other leading world indices were barely perturbed, in particular by the Irish episode. In the first quarter of 2011, Ibex 35 volatility died down once more to the region of 25%.

...while liquidity conditions remain supportive...

Meantime, the bid/ask spread reflecting the liquidity available in the Spanish stock market moved lower in the opening months of 2011 after the slight increase of late 2010, taking monthly averages to their lowest levels in recent years (see figure 15).

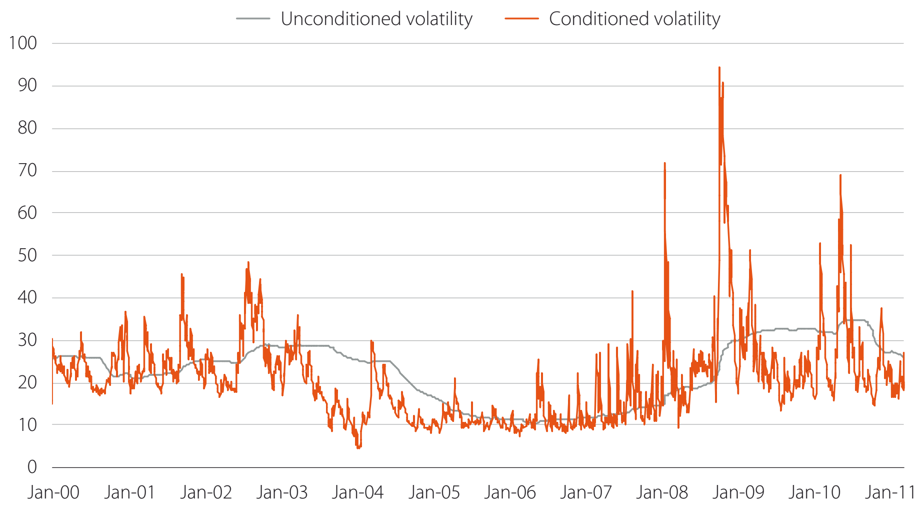
---

9 On the basis of one-year forward earnings.

10 This indicator rests on the assumption that a share's price (P) is, in any given moment, the present value of the future cashflows (Π) to which its ownership gives rise (see equation 1). The discount factor applied includes both ten-year government bond yields (r) and a risk premium (ρ) known as the earnings yield gap, which seeks to reflect the difference in risk between public debt and shares. Stripping ρ out of equation 1, we find that $\rho = \frac{1}{PER} - r$, where $PER = \frac{P}{\Pi}$.

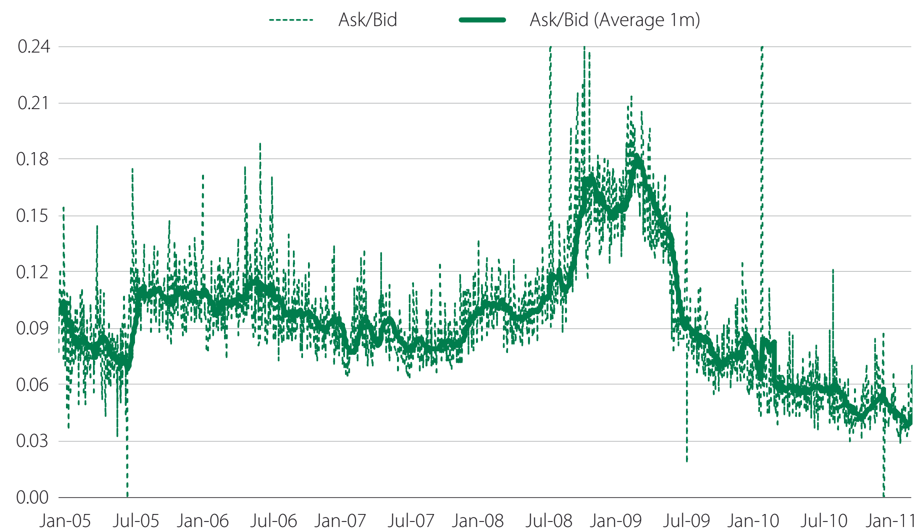
$$(1)\quad P = \frac{\Pi}{1+r+\rho} + \frac{\Pi}{(1+r+\rho)^2} + \frac{\Pi}{(1+r+\rho)^3} + \frac{\Pi}{(1+r+\rho)^4} + \dots = \Pi \cdot \sum_{i=1}^{\infty} \frac{1}{(1+r+\rho)^i} = \frac{\Pi}{r+\rho}$$

Historical volatility. Ibex 35 FIGURE 14



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

Ibex 35 liquidity. Bid-ask spread (%) FIGURE 15



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

…and turnover on the rise.

The Spanish stock market reached 203.90 billion euros turnover in the first three months of 2011 (data to 15 March), 6.7% more than in the same period last year (see table 8). Average daily trading stood at 3.92 billion, significantly down vs. the last quarter of 2010 (4.60 billion) but similar to the 2010 average of 4.05 billion.

Equity issuance picks up slightly in 2010.

Surprisingly perhaps, in view of the uncertainties and falling prices that characterised financial markets for most of 2010, equity issuance staged something of a comeback, to more than 16 billion euros in full-year terms. This was 41% more than in 2009 and on a par with the figure for 2008 (see table 9), though still a long way short of pre-crisis levels.

Turnover on the Spanish stock market

TABLE 8

Million euros

	2007	2008	2009	2010	3Q10	4Q10	1Q11[1]
Electronic market	1,658,019	1,235,330	880,544	1,032,447	214,267	292,819	203,116
Open outcry	1,154	207	73	165	54	82	18
of which SICAVs[2]	362	25	20	8	1	0	2
MAB[3]	6,985	7,060	5,080	4,145	768	1,147	683
Second Market	193	32	3	3	1	1	1
Latibex	868	758	435	521	93	119	85
All exchanges	**1,667,219**	**1,243,387**	**886,135**	**1,037,282**	**215,183**	**294,168**	**203,902**

Pro-memoria: non resident trading (% of all exchanges)

	61.6	65.5	64.2	n.a.	n.a.	n.a.	n.a.

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

1 Cumulate data from 1 January to 15 March.

2 Open-end investment companies.

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

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

Equity issues and public offerings[1]

TABLE 9

	2007	2008	2009	2010	3Q10	4Q10	1Q11[2]
CASH AMOUNTS[3] (million euros)	**69,955**	**16,349**	**11,391**	**16,018**	**2,323**	**8,339**	**3,217**
Capital increases	67,887	16,340	11,389	15,412	2,323	8,267	3,217
Of which, through POS	8,503	292	17	964	6	20	0
National tranche	4,821	292	15	67	6	19	0
International tranche	3,681	0	2	897	0	0	0
Public offerings	2,068	10	2	606	0	71	0
National tranche	1,517	10	2	79	0	71	0
International tranche	551	0	0	527	0	0	0
NUMBER OF FILINGS[4]	**100**	**54**	**53**	**69**	**12**	**29**	**12**
Capital increases	91	53	53	67	12	28	12
Of which, through POS	8	2	2	12	2	4	0
Of which, bonus issues	19	18	11	15	3	7	2
Public offerings	12	2	1	3	0	1	0

Source: CNMV.

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

2 Data to 15 March 2011.

3 Excluding amounts recorded in respect of cancelled transactions.

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

Exhibit 3: "Procedures for stock market listing"

In the past few weeks, following approval of Royal Decree Law 2/2011 of 18 February for the reinforcement of the financial system, a number of institutions have expressed an interest in issuing listed shares. The process of stock market flotation must meet a series of conditions whose aim is to guarantee the correct formation of prices and ensure investors adequate protection.

Price formation in the primary market

Among the pre-conditions for orderly price formation in the stock listing process is that placements should incorporate a substantial tranche for professional investors - those with the knowledge and means to competitively determine a reference price for the share at the outset of trading. This will then be the price at which retail investors place their orders. It follows that the greater the number of institutional investors participating in the process, the smaller the difference will be between the placement price and the share's subsequent market quotes.

As we can see from table E3.1, in placements taking place from 2007 to the present day, the tranche reserved for institutional investors averaged 80% of the offering, and was invariably higher than 40%. Further, a third of the transactions registered had no retail tranche, meaning the offering was directed exclusively at professional investors. Finally, the number of financial institutional investors taking part was above 300 in every case, and usually above 1,000.

Stock market listings since 2007 TABLE E3.1

Name	Year	Capitalisation at final price (million euros)	% free float post offering (*)	% professionals targeted in the offering	No. of financial institutional investors
LABORATORIOS FARMACÉUTICOS ROVI, S.A.	2007	480	40	100	506
ALMIRALL, S.A.	2007	2,027	30	75	1,170
FLUIDRA, S.A.	2007	732	43,49	70	1,110
CLÍNICA BAVIERA, S.A.	2007	108	41,33	85	341
CRITERIA CAIXACORP, S.A.	2007	17,259	22	40	2,213
REALIA BUSINESS, S.A.	2007	1,803	47,74	67,73	733
RENTA 4 SERVICIOS DE INVERSIÓN, S.A.	2007	376	43	75	307
CODERE, S.A.	2007	1,156	30,2	100	
IBERDROLA RENOVABLES, S.A.	2007	22,387	20	80	4,209
SOLARIA ENERGÍA Y MEDIOAMBIENTE, S.A.	2007	961	28,75	100	1,234
AMADEUS HOLDING, S.A.	2010	4923,40	29,41	100	1,212

(*) Including the purchase option granted to placement coordinators (greenshoe).

In transactions where the institutional tranche cannot be covered due to insufficient demand, the usual practice is for the issuer to desist and withdraw its offering. This occurred on three occasions during the period considered.

The above points are especially important in the market flotations of financial entities. Firstly, because of the complexities involved in valuing this type of entity and, secondly, because of the conflicts of interest inherent to any retail placement where issuer and distributor are one and the same.

Price formation in the secondary market

The orderly functioning of the market for a newly listed security depends not only on the placement price but also on the fluidity of its trading. For this to be achieved, a sufficient percentage of the shares representing the issuer's capital must be available for transacting, so investors who have taken up the placement or those wishing to acquire shares on the market can find a counterparty for their buy or sell orders.

In this respect, article 9.7 of Royal Decree 1310/2005 of 4 November, partially implementing Securities Market Law 24/1988 of 28 July as regards the admission of securities to trading on regulated markets, public offerings and prospectuses provides that "a requirement for the admission of shares to stock market listing shall be that the said shares are sufficiently widely distributed prior to or, at the very latest, on the date of admission to trading [...]. This condition shall be deemed to be met when at least 25 percent of the shares for which listing is requested are distributed among the public, or when in view of the large number of shares of the same class and the extent of their distribution among the public, the market can operate properly with a lower percentage."

From table E3.1 we can see that the proportion of shares offered in the placements conducted since 2007 was generally equal to or greater than 25% of the issuer's share capital. In fact there are only two cases where the company offered a number of shares falling below this threshold, on the understanding that the market could operate properly with a smaller percentage given the large quantity of shares being issued, far exceeding those involved in the other transactions registered.

Investor protection

To ensure that investors' interests are adequately protected, the entities applying for stock market listing must pay due and careful heed to good corporate governance rules and recommendations, particularly those referring to the number of independent board members and the appointment and make-up of board committees.

Finally, entities taking part in the placement process must adhere to all relevant rules of conduct, including those to do with appropriateness and suitability testing. They should also refer to the good practice standards set out in the CNMV document "Conditions for the marketing of securities market instruments", dated 7 May 2009.[1]

1 Available at: http://www.cnmv.es/Portal/AlDia/Comunicaciones.aspx.

3.2 Fixed-income markets

Interbank markets begin to price in hikes in official rates .

For months now, the rising prices of commodities in general, and energy products in particular, have been putting renewed pressure on euro area inflation. And the odds are increasingly on a near-time hike in official interest rates. Indeed it appears this possibility is already being discounted in interbank markets, where the upward curve initiated in mid-2010 has accelerated in recent weeks.

The rates run-up of fourth-quarter 2010 gives way to renewed decline in short tenors...

In this context, short-term rates in public and private debt markets headed lower in the first quarter of 2011 after a steep run-up at the end of last year coinciding with the Irish crisis. Note that these movements were more intense in government than private instruments, as has indeed been the dominant pattern since the first signs of turmoil on European sovereign debt markets. Hence average rates of Spanish treasury bills (Letras del Tesoro) climbed by 100 to 160 bp, depending on the tenor, from October to December 2010, only to fall back 64 to 140 bp in the first quarter of 2011[11] as far as 1%, 1.4% and 2.1% at three, six and twelve months respectively. Short-term rates on private fixed-income markets traced a similar but smoother course with rises of 16 to 36 bp in the fourth quarter of 2010 giving way to falls of 9 to 50 bp in the first months of 2011 (see table 10).

Short-term interest rates[1] (%) TABLE 10

	Dec-07	Dec-08	Dec-09	Dec-10	Jun-10	Sep-10	Dec-10	Mar-11
Treasury bills								
3 month	3.88	2.03	0.44	1.63	0.79	0.66	1.63	0.99
6 month	4.03	2.10	0.61	2.76	1.41	1.16	2.76	1.36
12 month	4.03	2.09	0.88	3.26	2.27	1.79	3.26	2.06
Commercial paper[2]								
3 month	4.54	3.09	0.76	1.37	0.93	1.21	1.37	1.28
6 month	4.83	3.63	1.25	2.52	1.44	2.21	2.52	2.02
12 month	4.87	3.74	1.63	3.04	3.12	2.68	3.04	2.65

Source: Banco de España and CNMV.

1 Average daily data. March data correspond to the average for the period 1/03 to 15/03.

2 Interest rates at issue.

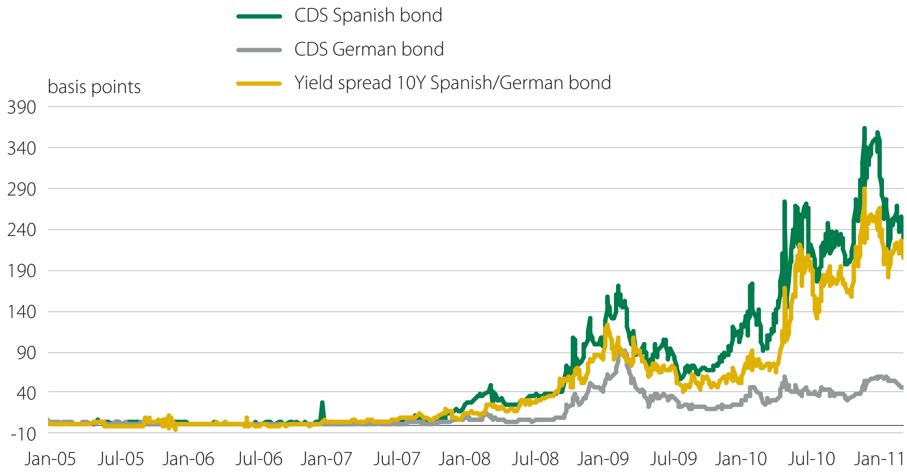
...and in long. Sovereign risk premiums ease in the opening months but remain at highs .

Long-term government yields also moved sharply higher in the last quarter of 2010, with increases ranging from 130 to 150 bp, before dropping back in the first quarter, albeit rather more slowly in shorter maturities. Yields on three-, five- and ten-year instruments closed the first quarter of the year at 3.5%, 4.4% and 5.4% respectively, between 3 and 35 bp down on their end-2010 levels. The risk premium of Spanish public debt, measured as the spread vs. the German ten-year benchmark, accordingly retreated from the 291 bp peak reached in late November 2010 and by March 2011 was hovering just below the 210 bp mark (see figure 16). The credit risk premium inferred from Spanish CDS traced a broadly similar course, peaking at 364 bp towards the end of November and then settling back to around 240 bp on a par with

11 March average up to 15/03.

the levels of mid-year 2010. But these more moderate readings cannot detract from the fact that sovereign risk remains unaccustomedly high.

Risk premium of Spanish government debt[1] FIGURE 16



Source: Thomson Datastream.

1 Data to 15 March.

The outstanding stock of Spanish government bonds has swelled from 28% of GDP in 2007 to 50% in 2011.

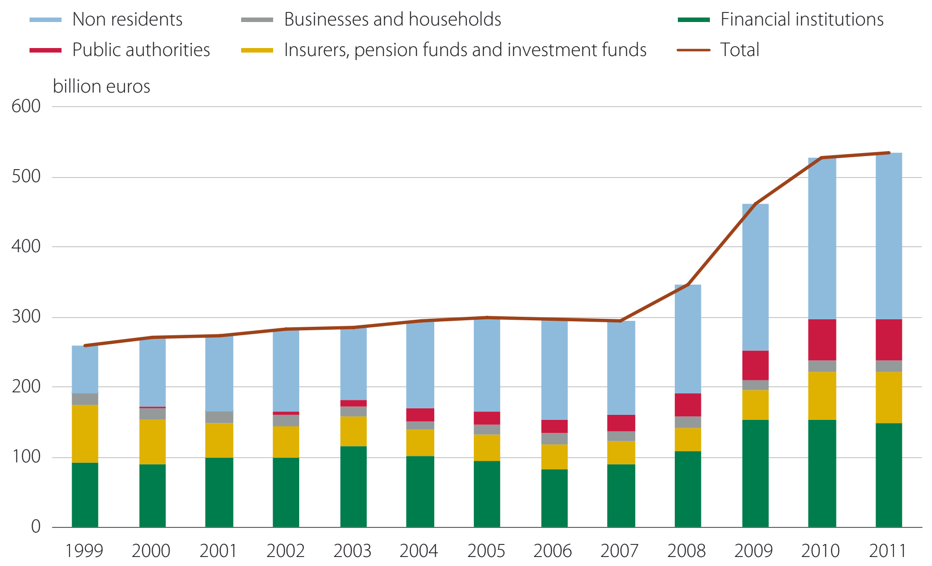
Figure 17 offers a breakdown of Spanish government debt outstandings by investor category from 1999 to January 2011. We can see that the outstanding balance rose from 1999 to 2005 at an annual average rate of 2.4%, then held more or less flat until 2007. From this point on, however, issuance was stepped up sharply to cope with burgeoning government funding requirements. By January 2011, the outstanding stock of Spanish government bonds was up to 535 billion euros (50.4% of GDP) compared to the 294 billion of 2007 (27.9% of GDP). Meantime general government indebtedness amounted to 60% of GDP in 2010 compared to 53.2% the year before (and just 36.1% in 2007).

Debt in non resident hands stays at 45% of the total, accompanied by changes in the mix of resident investors.

Looking at the public debt investor mix, the first thing we note is the onward advance of the non resident sector, whose share of the central government debt has risen from 26% in 1999 to 45% in January 2011. Since 2009, however, we can see that its percentage weight has tended to stabilise, coinciding with a shift in the mix of resident investors, with insurance undertakings, pension funds and investment funds all gaining ground at the expense of resident financial entities. In fact, since November 2010 the public debt holdings of resident financial entities have begun declining in absolute terms.

Spanish public debt holdings by sector[1]

FIGURE 17



Source: Ministry of Economy and Finance (Tesoro Público).

1 Held-to-maturity portfolio. Data for 2011 correspond to the month of January.

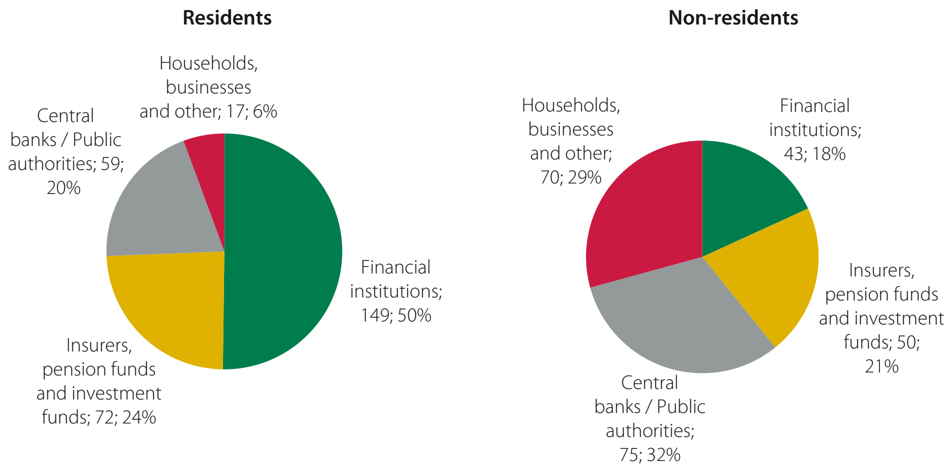
A breakdown of non resident public debt holdings reveals that the ownership share of businesses and households stands higher than among resident investors, while financial institutions take a relatively smaller slice (see figure 18).

Households and companies account for a large share of non resident holdings.

Ownership of Spanish public debt. Residents vs. non residents[1]

FIGURE 18

(billion euros; percent)



Source: Ministry of Economy and Finance (Tesoro Público).

1 Held-to-maturity portfolio. Data for January 2011.

Long-term corporate bond yields raced upwards in the last quarter of 2010 before falling moderately, in line with government yields, in the first three months of 2011. Specifically, three-, five- and ten-year corporate bonds closed last year at 4.3%, 5.4% and 6.4% respectively after gains ranging from 80 to 130 bp, then eased by between 30 and 50 bp in the opening quarter of 2011 (see table 11).

Long corporate bond yields trace a similar course to their sovereign counterparts.

Medium and long corporate bond yields[1]

TABLE 11

%	Dec-07	Dec-08	Dec-09	Dec-10	Jun-10	Sep-10	Dec-10	Mar-11
3 year	5.32	5.45	3.14	4.31	4.13	3.53	4.31	3.87
5 year	5.36	5.99	4.30	5.44	4.59	4.15	5.44	4.92
10 year	5.40	6.08	4.88	6.42	5.16	5.42	6.42	6.10

Source: Reuters and CNMV.

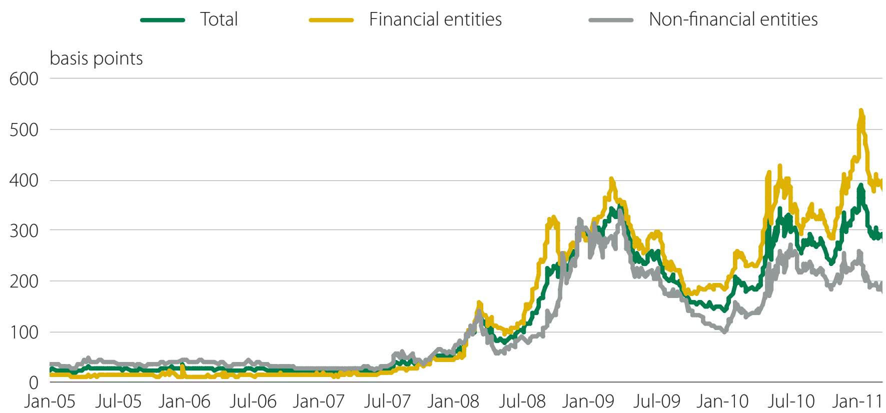
1 Average daily data. March data to 15/03.

The risk premiums of Spanish corporate issuers have likewise moved in line with those of sovereign debt.

In the last two quarters, the risk premiums of Spanish corporate issuers have tended to mirror the progress of sovereign spreads. Looking closer, however, we see a gap opening up between financial and non financial entities, with significantly larger increases in the former case (see figure 19). Indeed the CDS spreads of Spanish financial issuers leapt from around 330 bp at the end of the third quarter of 2010 to peaks nearing 550 bp at the start of 2011, while those of non financial entities traced a more moderate rise from 220 bp to almost 260 bp. Spreads have since come down to 390 bp and 190 bp respectively, i.e., leaving financial entity risk premiums at historic highs, in the same boat as sovereign spreads, while those of non financial entities have eased to below the levels of two years back.

Aggregate risk premium[1] based on the 5-year CDS of Spanish issuers

FIGURE 19



Source: Thomson Datastream and CNMV.

1 Simple average. Data to 15 March.

Exhibit 4: "Good practice criteria for liquidity provision to retail bond investors"

A recent development in the Spanish fixed-income market has been the growing volume of issues directed at retail investors. Normally, the prospectuses on preference share issues filed with the CNMV specify the existence of a liquidity contract whereby an intermediary undertakes to act as counterparty for the buy and sell orders of investors wishing to transact in these securities. In the case of subordinated debt securities it is rare to find reference to this kind of liquidity provider. However, in both these cases, the issuing entity will usually undertake to seek a counterparty for clients through its own branch network.

It was to facilitate such liquidity provision, and to enhance the transparency of the market in fixed-income and mezzanine securities, that the AIAF market launched its electronic debt trading system SEND (Sistema Electrónico de Negociación de Deuda) in May 2010. This multilateral trading facility, based on the Spanish stock exchange's electronic platform for fixed-income instruments, supports trading in a series of securities listed on the AIAF. The system has a central order book in which the best bid and ask prices are collated, giving investors an objective handle on the price a security is likely to fetch.

On 16 June 2010, the CNMV sent a letter to the issuers of retail bonds and their placing agents, updating the conditions to apply in verifying this kind of issue and identifying instances of good practice in their sale and subsequent trading, the aim being to enhance small investor protection through improvements in market liquidity and transparency.

In this letter, the requirement to present a report by an independent expert in issues without institutional tranches was extended to all fixed-income issues targeting the retail public, regardless of their maturity, seniority or the sector the borrower belongs to. It also stipulated that a liquidity provider should in future be appointed for all retail issues, with the obligation, among others, to quote bid and ask prices. Among its good practice indications for assessing the liquidity of an issue was that the provider entity should operate through at least one multilateral trading facility and with multiple participants, so as to ensure adequate price formation and disclosure.

By the same token, it is considered bad practice for a liquidity provider to quote bid and ask prices that deviate significantly from fair value, as gleaned from the security's usual market spreads, or to operate some mechanism for internalising transactions between the retail clients of the securities issuer and/or distributor, or between clients and the entity offering the investment service, unless the potential conflicts of interest are appropriately managed. This condition will be deemed to be met when the result obtained for clients is equal to or better than could be obtained by going to the liquidity provider or multilateral electronic platform, or when the transaction can be shown to have gone through at close to fair value in the event that there is no liquidity contract or its ceiling has been reached.

The CNMV followed this up on 25 October 2010 with a new document titled "Good practice criteria for liquidity provision to retail bond investors", setting out the regulator's good practice recommendations in this respect. Although these are not binding rules, the CNMV is convinced that their application will be a major step to enhancing the transparency and liquidity of fixed-income trading, and ensuring that investor interests are adequately protected. These criteria furthermore can serve as a benchmark for borrowers and financial entities when negotiating liquidity provision contracts for bonds to be quoted on Spanish regulated markets. The document introduces two novelties touching on trading practices and disclosure requirements.

It will be good practice for liquidity providers to discharge this function in any multilateral electronic trading facility that meets the conditions of non-discriminatory access, ongoing display of bid and ask prices, and adequate public disclosure regarding the liquidity entity and the prices and volumes of executed trades.

The document urges liquidity entities to enter buy and sell orders during a preset interval, with a minimum volume and a maximum spread (though note that this last recommendation will not prevent entities varying the spread in extraordinary market circumstances). It also enumerates cases where liquidity providers may be released from their commitments (for instance, when they have reached their contractual ceiling vis à vis securities acquired in own-account transactions, in the event of substantial changes in the legal or economic status of the securities or their issuer, when the issuer's solvency is seriously impaired or in cases of force majeure). In these circumstances, a series of disclosure requirements come into play so the market is immediately advised of the situation, and of subsequent return, as the case may be, to normal operation of the liquidity function.

The communication also comes with a standard liquidity contract drawn up by the CNMV to guide issuers in the application of the above criteria. Its text binds the liquidity provider to a maximum bid/ask spread equivalent to 10% in terms of yield, up to a limit of 50 basis points, and not exceeding 3% in terms of price. It also establishes a standard minimum of 25,000 euros for buy and sell orders, though this can vary depending on the bond's outstanding amount and availability for sale at each point in time.

Funding constraints cause a 42% slump in fixed-income issuance.

Spanish issuers reduced their borrowings in 2010 in response to access constraints in wholesale financing markets. The gross volume of fixed-income issues registered with the CNMV was accordingly 42% lower than in 2009 at 226 billion euros (see table 12). Financial entities, which account for over 98% of total issuance, lowered their issue volumes by 41% to 223 billion euros, while non financial companies lowered theirs by around 70% to 3.50 billion. The issuance slump extended to all debt instruments with the exception of territorial bonds, up from 500 million euros in 2009 to almost six billion euros in 2010, and mortgage bonds, which managed to keep up their 2009 levels (at around 35 billion euros). The biggest slides were reserved for commercial paper, whose issuance was down by 49% to 97 billion euros, and non convertible bonds, down by 61% to 24.3 billion euros. Finally, asset-backed securities closed the year with an issue volume of just over 63 billion, 22% lower than in 2009.

Mortgage bonds were again among the most popular vehicles in the first quarter of 2011.

Since the start of 2011[12] total debt issuance has reached 54 billion euros, a full 36% more than in the same period last year. By instrument, certain trends have been carried over from last year, among them the dynamism of mortgage bond issuance and the fading popularity of bonds, though we can also point to a certain advance in securitisation issues.

Foreign debt financing declines for the first time in several years.

Foreign debt financing shrank by 15% in 2010 to 128 billion euros in a break with the upward trend of recent years.[13] Note that this fall traced exclusively to shorter-dated instruments (-25%), while long-term issuance climbed by 23% to 51 billion, with bonds and debentures featuring strongly.

12 11 To March 15.

13 Increases of 8% in 2008 and 33% in 2009.

Gross fixed-income issues

TABLE 12

filed[1] with the CNMV	2007	2008	2009	2010	3Q10 (2010)	4Q10 (2010)	1Q11[2] (2011)
NUMBER OF ISSUES	**335**	**337**	**512**	**349**	**60**	**98**	**ƒ**
Mortgage bonds	32	47	75	88	24	21	20
Territorial bonds	8	8	1	9	1	2	4
Non convertible bonds and debentures	79	76	244	154	19	38	14
Convertible/exchangeable bonds and debentures	0	1	6	3	0	3	2
Asset-backed securities	101	108	76	36	7	15	6
Commercial paper facilities	107	88	73	59	9	19	15
Securitised	3	2	2	2	0	1	0
Other commercial paper	104	86	71	57	9	18	15
Other fixed-income issues	3	0	0	0	0	0	0
Preference shares	5	9	37	0	0	0	2
FACE VALUE (million euros)	**648,757**	**476,276**	**387,476**	**226,449**	**61,635**	**55,737**	**54,321**
Mortgage bonds	24,696	14,300	35,574	34,378	10,317	8,519	13,280
Territorial bonds	5,060	1,820	500	5,900	300	500	2,935
Non convertible bonds and debentures	27,416	10,490	62,249	24,356	1,287	7,525	2,039
Convertible/exchangeable bonds and debentures	0	1,429	3,200	968	0	968	277
Asset-backed securities	141,627	135,253	81,651	63,261	28,190	16,497	15,335
Domestic tranche	94,049	132,730	77,289	62,743	28,190	16,473	13,662
International tranche	47,578	2,522	4,362	518	0	24	1,673
Commercial paper[3]	442,433	311,738	191,342	97,586	21,541	21,728	20,255
Securitised	465	2,843	4,758	5,057	1,723	1,409	546
Other commercial paper	441,969	308,895	186,583	92,529	19,818	20,319	19,709
Other fixed-income issues	7,300	0	0	0	0	0	0
Preference shares	225	1,246	12,960	0	0	0	200
Pro memoria:							
Subordinated issues	47,158	12,950	20,989	9,154	1,839	2,048	2,155
Covered issues	86,161	9,170	4,794	299	0	0	10
abroad by Spanish issuers	**2007**	**2008**	**2009**	**2010**	**3Q10 (2010)**	**4Q10 (2010)**	**1Q11[4] (2011)**
FACE VALUE (million euros)	**103,631**	**112,366**	**149,686**	**127,731**	**38,063**	**28,686**	**8,879**
Long-term	65,629	39,894	47,230	51,107	16,072	10,053	1,769
Preference shares	2,581	0	3,765	0	0	0	0
Subordinated debt	8,984	70	2,061	0	0	0	0
Bonds and debentures	53,327	39,360	41,404	50,807	16,072	10,053	1,769
Asset-backed securities	736	464	0	300	0	0	0
Short-term	38,003	72,472	102,456	76,624	21,991	18,633	7,110
Commercial paper	38,003	72,472	102,456	76,624	21,991	18,633	7,110
Securitised	12,119	425	108	248	37	49	0

Source: CNMV and Banco de España.

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

2 Available data to 15 March.

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

4 Data for the month of January.

4 Market agents

4.1 Investment vehicles

Financial UCITS[14]

Investment fund assets shrank by 15.6% in 2010 on the continuing wave of redemptions …

Investment fund assets dropped by over 7% to 144 billion euros from June to December 2010 in line with their first-half performance. The fall was again attributable to abundant net withdrawals - over 13.6 billion euros (see table 13) - far exceeding the portfolio gains of the 3Q10, powered by the rally in equity prices. In full-year terms, investment funds scraped an overall return of 0.3%, while their assets shrank by 15.6% (see table 14).

…with fixed-income funds as the worst affected. Fixed-income guaranteed and international equity funds buck the trend with net subscriptions.

Fixed-income funds, as table 13 shows, suffered the largest outflows in the period, due to stiff competition from the banks and their high-interest deposits. Among remaining fund categories, salient developments were the switch from euro equity to international equity funds and a strong movement into fixed-income guaranteed funds. The result was a substantial shift in the distribution of assets across fund industry categories. Specifically, the share of fixed-income funds fell by over ten points to just under 40%, while fixed-income guaranteed funds moved up six points to 18% of the total.

Investment fund subscriptions and redemptions (million euros)[1] TABLE 13

	Subscriptions				Redemptions			
Category	1Q10	2Q10	3Q10	4Q10	1Q10	2Q10	3Q10	4Q10
Fixed income[2]	15,240.8	13,605.3	6,206.7	6,603.3	19,940.5	22,951.2	12,006.3	13,908.1
Balanced fxd income[3]	1,243.5	1,082.2	571.7	641.4	1,106.0	1,653.8	812.4	1,383.5
Balanced equity[4]	292.1	556.5	118.5	254.6	225.7	601.2	168.0	316.9
Euro equity [5]	582.5	464.0	291.1	335.4	709.6	673.9	452.4	534.0
Intern. equity[6]	1,259.1	1,190.3	778.5	1,227.3	704.9	991.1	625.5	981.8
Fxd-income guaranteed	2,359.6	3,244.1	3,403.9	2,505.8	2,135.7	1,529.0	1,414.2	1,718.5
Equity guaranteed[7]	1,607.4	1,539.4	726.8	1,246.5	1,818.0	1,852.4	1,399.8	2,550.0
Global funds	545.0	440.6	265.4	1,767.1	269.3	461.1	382.9	1,581.1
Passively managed[8]	242.6	271.1	73.7	96.4	396.2	682.1	141.6	254.2
Absolute return[8]	1,853.3	1,778.8	959.1	1,333.6	1,018.9	1,645.3	1,039.3	1,349.5
Hedge funds	107.9	45.9	20.7	n.a	52.6	81.9	72.2	n.a
Funds of hedge funds	21.4	2.2	13.9	n.a	48.0	36.2	23.7	n.a
TOTAL	**25,355.2**	**24,220.4**	**13,430.0**	**16,011.4**	**28,425.4**	**33,159.2**	**18,538.3**	**24,577.5**

Source: CNMV.
1 Estimate only.
2 Includes: Euro and international fixed income and money market funds.
3 Includes: Balanced euro fixed income and balanced international fixed income.
4 Includes: Balanced euro equity and balanced international equity.
5 Includes: Euro equity.
6 Includes: International equity.
7 Includes: Guaranteed and partially guaranteed equity.
8 New categories as of 2Q09. All absolute return funds were previously classed as global funds.
n.a.: Not available.

14 Although this classification includes hedge funds and funds of hedge funds, we make no separate reference to them here, since they are the subject of their own sub-section further ahead.

Main investment fund variables

TABLE 14

				2010			2011
Number	**2008**	**2009**	**2010**	**2Q**	**3Q**	**4Q**	**1Q***
Total investment funds	**2,912**	**2,536**	**2,408**	**2,436**	**2,421**	**2,408**	**2,405**
Fixed income[1]	629	582	537	547	540	537	539
Balanced fixed income[2]	195	169	160	168	162	160	160
Balanced equity[3]	202	165	138	143	140	138	138
Euro equity[4]	237	182	172	179	174	172	172
International equity[5]	330	242	232	233	233	232	230
Fixed income guaranteed	260	233	276	251	261	276	280
Equity guaranteed[6]	590	561	499	530	518	499	493
Global funds	469	187	192	181	189	192	192
Passively managed[7]		69	61	64	61	61	61
Absolute return[7]		146		140	143	141	140
Assets (million euros)							
Total investment funds	**175,865.3**	**170,547,7**	**143,918,2**	**155,295.5**	**152,646.5**	**143,918.2**	**143,388.9**
Fixed income[1]	92,813.1	84,657.2	56,614.6	69,654.5	64,102.1	56,614.6	53,941.3
Balanced fixed income[2]	5,803.0	8,695.5	7,319.0	8,264.2	8,109.9	7,319.0	7,118.8
Balanced equity[3]	3,958.8	3,879.6	3,470.5	3,441.5	3,520.2	3,470.5	3,544.3
Euro equity[4]	5,938.9	6,321.6	5,356.8	5,181.2	5,504.4	5,356.8	5,542.9
International equity[5]	4,254.7	5,902.4	8,037.3	6,682.5	7,203.6	8,037.3	8,161.8
Fixed income guaranteed	21,150.3	21,033.4	26,180.2	23,520.3	25,795.6	26,180.2	27,806.4
Equity guaranteed[6]	30,873.7	25,665.8	22,046.5	23,981.7	23,600.0	22,046.5	21,858.1
Global funds	11,072.8	3,872.5	4,440.3	3,991.1	4,093.9	4,440.3	4,887.5
Passively managed[7]		3,216.6	2,104.8	2,350.2	2,323.6	2,104.8	2,203.7
Absolute return[7]		7,303.0	8,348.1	8,228.4	8,393.2	8,348.1	8,324.2
Unitholders							
Total investment funds	**5,923,346**	**5,475,403**	**5,160,888**	**5,422,414**	**5,348,482**	**5,160,888**	**5,158,280**
Fixed income[1]	2,204,652	2,041,487	1,622,664	1,864,776	1,745,366	1,622,664	1,575,523
Balanced fixed income[2]	277,629	290,151	270,341	295,325	280,230	270,341	265,230
Balanced equity[3]	209,782	182,542	171,336	185,118	182,860	171,336	169,221
Euro equity[4]	377,545	299,353	266,395	280,529	280,566	266,395	260,376
International equity[5]	467,691	458,097	501,138	487,813	502,463	501,138	511,086
Fixed income guaranteed	538,799	570,963	790,081	690,600	762,369	790,081	847,655
Equity guaranteed[6]	1,402,948	1,188,304	1,065,426	1,142,072	1,115,180	1,065,426	1,053,235
Global funds	444,300	88,337	105,719	99,163	110,538	105,719	108,756
Passively managed[7]		85,403	90,343	97,949	93,049	90,343	89,026
Absolute return[7]		270,766	277,445	279,069	275,861	277,445	278,172
Return (%)							
Total investment funds	**-4.21**	**5.73**	**0.35**	**-1.83**	**1.64**	**-0.04**	**0.63**
Fixed income[1]	**2.06**	**1.91**	**0.11**	**-0.62**	**0.63**	**-0.35**	**0.18**
Balanced fixed income[2]	-7.14	6.85	-0.54	-2.18	1.82	-0.56	0.68
Balanced equity[3]	-22.21	16.47	-0.98	-6.00	4.67	0.78	2.35
Euro equity[4]	-39.78	32.41	-2.94	-10.66	10.11	1.27	6.47
International equity[5]	-41.71	37.28	14.22	-4.97	5.35	8.01	-0.39
Fixed income guaranteed	3.29	3.81	-0.67	-1.24	0.89	-1.28	0.17
Equity guaranteed[6]	-2.61	3.56	-1.79	-1.91	1.20	-1.45	0.78
Global funds	-8.64	10.90	3.22	-2.82	2.80	1.87	0.54
Passively managed[7]		-	-2.36	-7.28	6.32	0.31	5.01
Absolute return[7]		-	1.53	-1.19	1.17	0.58	-0.03

Source: CNMV.

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

* Data for the first quarter of 2011 correspond to the month of January. Provisional data.

1 Includes: Euro and international fixed income and money market funds.

2 Includes: Balanced euro fixed income and balanced international fixed income.

3 Includes: Balanced euro equity and balanced international equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed and partially guaranteed equity.

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

Total funds in operation are reduced further by mergers, while unitholder numbers fall once more.

The wave of fund mergers continued its advance, most intensely in the second quarter. A total of 256 operations were reported in the full-year period, with a third of this number corresponding to one UCITS management company. The result was a 5% decrease in the number of funds in operation as far as 2,408 at the 2010 close. Unitholder numbers also declined, from almost 5.5 million in 2009 to 5.2 million in 2010. In both cases (funds and unitholders), the fall was steepest in the fixed-income category, in line with the run-down in managed assets.

Exhibit 5: "Changes in UCITS regulations"

Royal Decree (RD) 749/2010 of 7 June made a series of amendments to Royal Decree 1309/2005 implementing Law 35/2003 on Collective Investment Undertakings. The main novelties introduced are described below:

1) Authorisation of special-purpose UCITS or "side pockets" for the spin-off of assets subject to liquidity or valuation constraints, provided they sum over 5% of the original scheme's net assets. Participants will receive units in the new compartment in proportion to their holdings in the original scheme. These special-purpose UCITS are banned from issuing new units or shares. Instead their function is to liquidate their assets at the earliest opportunity, as the exceptional circumstances giving rise to their segregation progressively remit. The proceeds of such sales will be allocated to unitholders in proportion to their share in the special-purpose scheme. While side pocket investments are being realised in this way, the original UCITS goes on functioning as normal.

2) New measures that pursue greater flexibility in fund operation without reducing the level of investor protection. Main changes to this end are:

    a) The RD regulates the possibility of UCITS management companies entering agreements to refund the fees charged to certain unitholders, as provided for in the scheme prospectus.

    b) The brokerage fees paid by investment funds may henceforth include the provision of financial analysis services under certain conditions.

    c) In the case of investment funds being formally wound up, liquidators are empowered, via liquidations on account, to progressively distribute the proceeds from disposal of the fund's assets, once arrangements have been made to settle all accounts payable.

    d) Disclosure requirements are tightened up in respect of the indirect charges borne by UCITS investing in other UCITS.

    e) Financial UCITS are given greater leeway in diversifying their investments, while schemes whose management is geared to a target return are allowed more flexibility to invest in derivative products.

f) Exchange-Traded Funds (ETFs) are free to operate as open-end investment companies as well as just funds.

g) The regime governing real estate collective investment schemes is made more flexible so they can invest, up to certain limits, in real estate investment companies (SOCIMI in their Spanish initials) and other real estate schemes.

3) The regime for delegating functions of UCITS management companies is amended in order to align their treatment with that given to investment firms under RD 217/2008 on the legal regime of investment firms and other entities providing investment services. The main novelty here is that companies will not longer have to seek prior authorisation from the CNMV to delegate administrative and internal control functions: in its place a simple notification will suffice. However prior authorisation must still be sought for the delegation of asset management. The RD also lifts the requirement to inform the CNMV beforehand of the control procedures in place for externalised activities. Instead, management companies will be obliged to furnish the CNMV on request with all details necessary to monitor the performance of such activities.

4) UCITS management companies engaged in the marketing of shares and units in their own and outside schemes are brought under the rules of conduct set out in Chapter III, Title IV of RD 217/2008 on the legal regime of investment firms, and will accordingly be obliged to carry out suitability and appropriateness tests on the products offered to each client.

Recent studies on the liquidity conditions of investment funds show that the volume of less-liquid assets held in private fixed-income portfolios receded from 11.42 billion euros in June 2010 to 10.65 billion euros in December, while their share of total investment fund assets oscillated between 7.1% and 7.4% (see table 15). Funds' exposure to less-liquid assets differed widely from one asset category to the next. Specifically, most of the decrease in exposure had its origin in the declining volume of less-liquid asset-backed securities, from 4.71 billion euros in mid-year 2010 to 3.26 billion at the annual close. Conversely, the volume of less-liquid financial fixed-income assets of high credit quality moved up from 650 million to 4.37 billion in the second-half period. The fact that the share of less-liquid assets in fund portfolios has held flat over several quarters at a time of large-scale redemptions, reflects both the improved liquidity conditions prevailing on private fixed-income markets and the liquidity management policies being applied by management companies.

The proportion of less-liquid assets in investment fund portfolios closed 2010 at a stable 7.4% of industry assets.

Estimated liquidity of investment fund assets

TABLE 15

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	**Jun-10**	**Sep-10**	**Dec-10**	**Jun-10**	**Sep-10**	**Dec-10**
Financial fixed income rated AAA/AA	3,724	4,195	4,374	18.3	22.4	20.4
Financial fixed income rated below AAA/AA	2,740	2,468	2,798	19.6	23.7	17.5
Non financial fixed income	246	225	218	3.5	3.8	3.4
Securitisations	4,711	4,020	3,260	79.9	61.0	66.3
AAA-rated securitisations	2,346	1,867	1,429	79.6	62.8	66.2
Other securitisations	2,366	2,153	1,831	80.2	59.7	66.3
Total	**11,421**	**10,908**	**10,651**	**24.2**	**25.1**	**23.1**
% of investment fund assets	**7.4**	**7.1**	**7.4**			

Source: CNMV.

Exhibit 6: "Review of money market fund regulations in the U.S."

The volume of assets held in U.S. money market funds has been climbing steadily in the past decade, and by end-2009 was around three trillion dollars, equivalent to 20% of American GDP. Money market funds play a key role in the country's short-term funding markets, with particular incidence in commercial paper and repo trading.

The current financial crisis has made plain that certain features of U.S. money market funds can trigger "runs by investors" on these markets, at times when unitholder redemption orders are building up sharply. We can pinpoint two traits that make these instruments especially vulnerable to swift changes in investor expectations and behaviour. Firstly, money market funds are not only exposed to credit and interest-rate risk, but also carry liquidity risk in the shape of a maturity mismatch between assets and liabilities. And secondly, most U.S. money market funds have a stable net asset value (NAV), which is usually equal to one dollar. This heightens the risk of unitholder flights, on fears that the fund may not be able to meet all redemption orders at a preset NAV in adverse market circumstances, when its share price could drop below this level (breaking the buck).

In effect, two kinds of problems have come to light with stable NAV funds. One is that this fund structure encourages a "jump ship" attitude among investors, with each one rushing to be the first to withdraw at the first signs of trouble. The other is that a stable NAV is not a reliable guide to the performance of the fund portfolio, and in some circumstances may engender a false sense of security.

The credit and liquidity risk profile of money market funds was the subject of a review in February 2010, following a series of SEC amendments to the existing legislation (Rule 2a-7 of the Investment Company Act). The changes introduced were of two kinds. Firstly, tougher constraints were imposed regarding the quality of assets funds can hold in their portfolios, along with new measures restricting the collateral acceptable for their repo transactions. And secondly, liquidity requirements have been tightened up to ensure more cash is on hand to cope with large-scale redemption orders. Specifically, funds are now obliged to keep 10% of their portfolio in assets that convert into cash within one day, and 30% in assets that convert into cash within a week. Also, funds will have the option to suspend redemptions if their market value falls below a given threshold, allowing them to move to an orderly process of asset liquidation.

Later on, in October 2010, the SEC published a report (*President's Working Group on Financial Markets, PWG*) with additional reform proposals centring on the controversial issue of whether to retain or scrap the stable NAV requirement. The most simple of the alternatives put forward was directly to do away with stable net asset values and thereby prevent or reduce investor "runs on funds". The problem is that this could prompt an outflow from funds into bank deposits, since investors see a stable NAV as an element of security. The second alternative would be a two-tier system, in which stable NAV funds coexist with others with a floating NAV. Either investors could choose in which kind of fund to invest or stable NAV funds could be reserved exclusively for the retail segment, given that institutional investors pose more risk of capital flight. A third alternative would be to keep stable NAV funds, but force them to turn into special purpose banks subject to bank supervision and regulation. This measure too has been strongly opposed (see Macey, 2011)[1] on the grounds that the activity of a money market fund is in no direct sense comparable to that of a bank.

Money market funds in Europe differ from their U.S. counterparts in tending not to operate with a stable NAV. Some jurisdictions, however, allow short-term instruments to be stated at their amortised cost when this is reasonably aligned with their market price. In Spain, as in many other European countries, all assets held in UCITS portfolios must be stated at their market value, to prevent the investor conflicts of interest generated by amortised cost valuation and their potentially harmful impact on market stability – concerns, precisely, that are coming to dominate the U.S. regulatory debate.

1 Macey (2011), *Reducing Systemic Risk: The role of money market mutual funds as substitutes for federally insured bank deposits,* John M. Olin Center for Studies in Law, Economics, and Public Policy, Research Paper No. 422, January 2011.

Real estate investment schemes

Real estate schemes continue to suffer the effects of the property market downturn and mounting redemption orders.

Real estate schemes continue to operate in a troubled environment, coloured by the prolonged downturn in Spanish real estate and a gathering outflow of investors since 2008. In this situation, some funds have faced problems fulfilling their redemption commitments. Indeed since 2009 the sector has more or less split between funds that remain fully operative and those that have suspended or deferred redemptions.

Fund assets fell by 5.4% in 2010 while unitholder numbers dropped by just under 10%.

Finally, assets under management in real estate funds fell by 5.4% to 6.12 billion euros in the course of 2010, while unitholder numbers dropped by 9.9% to 75,280 (see table 16). The year closed with eight funds on the register, the same number as at end-2009, although one of this group had in fact been liquidated in December[15] and a further three had suspended or deferred redemptions. Aggregate fund returns remained stuck in negative territory (-4.7%), albeit less deeply than one year before (-8.3%).

Three of the real estate funds still going have the backing of their manager's financial group.

The four funds in active operation at the 2010 close accounted for around 28% of real estate fund assets and 41% of unitholders. Also, three of these four enjoyed the backing of their manager's financial groups, which at end-2010 were in possession respectively of 43%, 83% and 84% of their assets.

Funds with redemptions suspended or deferred have experienced mixed fortunes.

The three real estate funds with redemptions suspended or deferred have fared quite differently. One resumed operations in March 2010 and has been granted a two-year liquidity guarantee, part of another has been spun off[16] and the third will in theory renew redemptions starting in April 2011.

Main real estate scheme variables TABLE 16

					2010			
	2007	2008	2009	2010	1Q	2Q	3Q	4Q[1]
FUNDS								
Number	9	9	8	8	8	8	8	8
Unitholders	145,510	97,390	83,583	75,280	81,647	76,772	76,182	75,280
Assets (million euros)	8,608.5	7,406.9	6,465.1	6,115.6	6,363.7	6,279.6	6,201.5	6,115.6
Return (%)	1.3	0.7	-8.3	-4.7	-1.63	-0.99	-1.31	-0.9
COMPANIES								
Number	9	9	8	8	8	8	8	8
Unitholders	843	937	928	943	927	942	934	943
Assets (million euros)	512.9	371.9	308.6	321.9	304.6	327.0	322.7	321.9

Source: CNMV.

1 One of the eight real estate funds on the register at end-2010 was actually liquidated in December.

Hedge funds

Hedge fund categories have coped differently with the crisis. Funds of hedge funds have had a very tough ride.

Hedge funds have performed unevenly throughout the crisis, with funds of hedge funds coming out comparatively worse. These schemes have experienced serious difficulties of asset liquidity and valuation due to restrictions imposed by foreign hedge fund investees, as well as having to cope with a flood of redemption orders. The upshot is that funds of hedge funds have suffered a two-year drain in assets under management which may not be over yet, to judge from the large number in liquidation. Meantime, hedge funds *per se* have seen their figures worsen in the past few quarters after keeping up a reasonable, if not continuous, rate of expansion throughout the crisis.

15 Although it remained on the register during that month.

16 The real estate fund has remained with the management company's financial group, while part of its assets have been transferred to a newly created balanced euro fixed income fund, grouping participants who did not take up the extraordinary exit windows.

Against this backdrop, the number of funds of hedge funds on the register fell from 38 in 2009 to 33 at end-2010.[17] Of this total, thirteen were by that point formally in liquidation or else engaged in an orderly disposal of their assets.[18] Funds of hedge funds finally closed the year with 709 million euros in assets, almost 100 million down on the 2009 figure. Unitholder numbers fell from 5,321 to 4,605 in the same period, while fund returns sagged from 7.8% to 3.4%.

Their main variables continued to worsen over 2010, with numerous schemes forced into liquidation.

After weathering the storm with some success, hedge fund business contracted slightly from the second quarter onwards. True, the number of schemes continued to augment (from 29 to 32), but their year-end assets of 617 million were short of the 652 million of 2009, while the sub-sector's 2010 return of 2.4% compared unfavourably with the previous year's 14.9%.

After negotiating the crisis with some success, hedge funds too suffered a mild contraction in 2010.

Main hedge fund variables

TABLE 17

				2009	2010			
	2007	2008	2009	4Q	1Q	2Q	3Q	4Q [1]
FUNDS OF HEDGE FUNDS								
Number	31	40	38	38	37	34	33	33
Unitholders	3,950	8,151	5,321	5,321	5,311	5,109	4,901	4,605
Assets (million euros)	1,000.6	1,021.3	810.2	810.2	793.9	738.0	726.8	709.2
Return (%)	-0.43	-17.80	7.85	0.83	1.72	-0.61	-0.1	1.59
HEDGE FUNDS								
Number	21	24	29	29	31	31	33	32
Unitholders	1,127	1,589	1,917	1,917	2,137	2,061	1,925	1,873
Assets (million euros)	445.8	539.4	652.0	652.0	722.4	674.1	639.3	617
Return (%)	0.84	-4.82	14.94	1.45	2.38	-3.06	2.97	0.11

Source: CNMV.

1 Available data to November 2010. The 4Q return stated refers to October-November.

Foreign UCITS marketed in Spain

The investment of foreign UCITS marketed in Spain swelled once more to 36.7 billion euros, 46% more than in 2009. Likewise assets under management in these foreign schemes fought back to double the figure for 2008, though this was still far from matching the record levels of mid-2007 (approaching 50 billion euros). Even so, foreign UCITS fared significantly better than their Spanish peers, to the extent that their combined assets stood at 20% of those of Spanish schemes registered with the CNMV compared to just 12% in 2009.

The total investment of foreign UCITS marketed in Spain expanded 41% in 2010.

Among the reasons for this outperformance we can cite an attractive fund offering that competes successfully with the national product, particularly in the equity segment, and, perhaps, the 2010 upswing in perceptions of domestic sovereign risk, which has sent investors casting round for more international exposure and away from nationally-managed to foreign-managed schemes.

These products are mounting a strong challenge to domestic UCITS.

17 November data at the closing date for this report.

18 The scheme's liquidation has not been formally agreed but unitholders have issued a total redemption order.

Outlook

A muddied outlook for the domestic collective investment industry.

The outlook for the domestic collective investment industry remains clouded by uncertainty. On the one hand, preliminary data for the first two months of 2011 point to some tailing-off of unitholder redemptions. And this, together with the gains marked up by equity funds, may have some short-term effect in stemming the outflow of assets. However, stiff competition from alternative products like foreign UCITS, along with the recently observed decline in household savings rates, could put a lid on mid-term recovery prospects. The worst prospects are reserved for real estate investment schemes, which have still not got over the redemption spike of the preceding quarters or the effects of the ongoing adjustment in Spanish real estate.

4.2 Investment firms

Investment firms continue to feel the effects of the crisis, though light is appearing in certain areas.

The crisis continued to take its toll of investment firm business, though rather less intensely than in 2009 or 2008. Also, a performance gap began to open up between entities and business lines. So while the aggregate earnings of broker-dealers and brokers continued to fall, the decline was not only smaller than in 2009 but also different in its origins. Among broker-dealers, the profit slide was mainly in proprietary trading, while investment service business actually picked up in the year. In the case of the brokers, conversely, strong operating cost contention failed to offset the decline extending across all main revenue lines. Sector solvency conditions again held up reasonably well throughout.

Broker-dealer profits slide by 20%, but ordinary revenues show encouraging improvement.

Broker-dealers' aggregate pre-tax profits fell by 20% in the year to 279 million euros (see table 18). This rate of decline, rather less than in 2009, was primarily due to net interest income, down by a hefty 38% to 102 million euros. In contrast, ordinary revenues, that is, those deriving from investment service provision, managed a 2% advance to 798 million euros, breaking with the downward trend of the two previous years. In fact, net fee income on almost all investment services recorded some measure of year-on-year growth, the sole exceptions being issue placement and underwriting, reflecting the slowness of primary markets, and investment advice. Fees from order processing and execution, this segment's largest revenue source, moved up 1.3% to 555 million euros.

Gross income, which includes income from proprietary and customer transactions, closed at 711 million euros, 10% less than in 2009. Net operating income too was down by 19% to 276 million, despite lower net impairment losses and operating cost contention, due to the worse relative result under depreciation and other charges.

Aggregate income statement (2010)

TABLE 18

	Broker-dealers			Brokers			Portfolio managers		
Thousand euros	Dec-09	Dec-10	% var.	Dec-09	Dec-10	% var.	Dec-09	Dec-10	% var.
1. Net interest income	163,272	102,054	-37.5	2,654	1,629	-38.6	341	407	19.5
2. Net fee income	562,082	533,858	-5.0	127,457	109,165	-14.4	10,734	10,097	-5.9
2.1. Fee income	782,214	798,152	2.0	144,351	126,055	-12.7	21,750	20,994	-3.5
2.1.1. Order processing and execution	548,362	555,207	1.3	53,855	38,176	-29.1	–	–	–
2.1.2. Distribution and underwriting	26,326	8,499	-67.7	2,950	2,748	-6.9	–	–	–
2.1.3. Securities custody and administration	16,183	22,367	38.2	509	366	-28.1	–	–	–
2.1.4. Portfolio management	11,768	13,880	18.0	19,584	19,489	-0.5	18,463	18,020	-2.4
2.1.5. Design and advising	57,051	49,433	-13.4	2,750	2,790	1.5	2,698	1,160	-57.0
2.1.6. Search and placement	10	36	258.9	0	304	–	–	–	–
2.1.7. Margin trading	14	9	-31.2	28	27	-4.0	–	–	–
2.1.8. Fund subscriptions and redemptions	63,341	65,487	3.4	23,968	23,946	-0.1	18	34	93.5
2.1.9. Others	59,159	83,233	40.7	40,707	38,209	-6.1	571	1,779	211.8
2.2. Fee expense	220,133	264,294	20.1	16,894	16,890	0.0	11,016	10,897	-1.1
3. Result of financial investments	45,266	48,588	7.3	1,866	456	-75.6	92	51	-44.8
4. Net exchange income	22,582	24,445	8.3	-296	-3	99.1	5	9	54.8
5. Other operating income and expense	-762	1,635	–	-1,042	-1,413	-35.6	-389	13	103.3
GROSS INCOME	**792,440**	**710,580**	**-10.3**	**130,640**	**109,834**	**-15.9**	**10,784**	**10,577**	**-1.9**
6. Operating expenses	412,998	415,433	0.6	119,224	97,582	-18.2	9,144	9,305	1.8
7. Depreciation and other charges	-48,401	6,006	–	2,651	2,817	6.3	208	118	-43.4
8. Impairment losses	88,137	12,888	-85.4	55	-23	–	135	0	–
NET OPERATING INCOME	**339,706**	**276,253**	**-18.7**	**8,709**	**9,457**	**8.6**	**1,296**	**1,154**	**-11.0**
9. Other profit and loss	10,256	2,265	-77.9	1,412	19	-98.7	-15	38	347.6
PROFITS BEFORE TAXES	**349,962**	**278,519**	**-20.4**	**10,121**	**9,476**	**-6.4**	**1,281**	**1,192**	**-6.9**
10. Corporate income tax	98,977	81,685	-17.5	5,747	3,024	-47.4	392	254	-35.4
PROFITS FROM ONGOING ACTIVITIES	**250,984**	**196,834**	**-21.6**	**4,374**	**6,452**	**47.5**	**889**	**939**	**5.6**
11. Profits from discontinued activities	0	0	–	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**250,984**	**196,834**	**-21.6**	**4,374**	**6,452**	**47.5**	**889**	**939**	**5.6**

Source: CNMV.

Broker pre-tax profits fell 6% in 2010, with decline in main revenue lines …

The 6% decline in **broker** pre-tax profits, to an aggregate end-2010 total of 9.5 million, marked a substantial improvement on the 54% slide of the previous year. Fee income from investment services provision, companies' single largest revenue item, dropped back 13% to 126 million euros. Indeed fee income fell across all business lines except investment advisory services, with order transmission and execution faring worst of all in volume terms (-29% to 38 million euros).

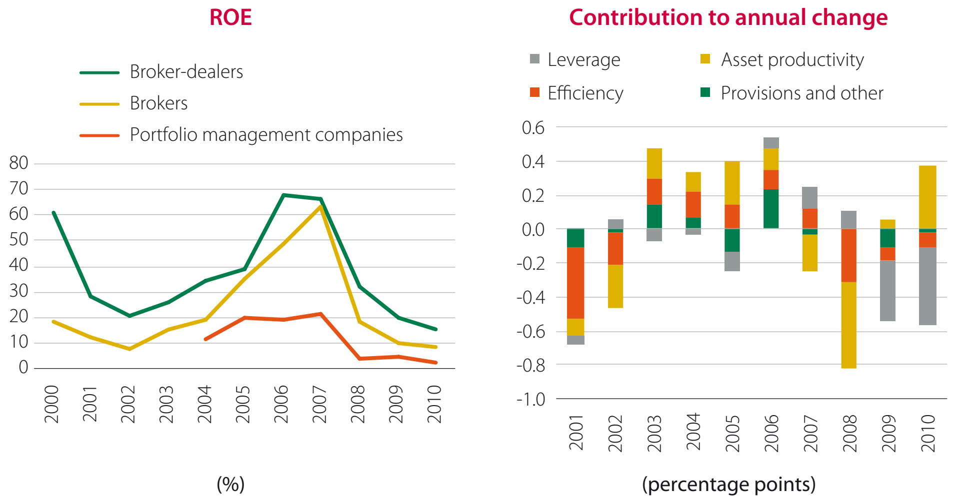
…outstripping the savings achieved in operating expenses.

Falling fee income made further inroads into brokers' gross income, which decreased by 16% to 110 million euros. However, by keeping a firm grip on operating expenses (down 18% to 98 million) firms managed a 9% advance at the net operating income line. Indeed the year-on-year decline in their pre-tax profits traced mainly to the absence of extraordinary income (1.4 million euros in 2009, see table 18).

Portfolio management companies join in the profits slide (-11%).

Finally, **portfolio management companies** were unable to repeat the successes of 2009, when they outperformed their sector peers with 20% growth at the pre-tax profit line. The 11% fall in their 2010 pre-tax profits, to 1.2 million euros, had its origins in a 3.5% decline in fee income and, particularly, a 1.9% increase in operating expenses, contrasting with the -19% of 2009.

Pre-tax ROE of investment firms FIGURE 20



Source: CNMV.

Return on equity falls less than in the two preceding years.

Earnings erosion made further inroads into the **return on equity**[19] (ROE) of the investment firm sector, though on a significantly smaller scale than in 2009 (see figure 20). ROE fell from 19.6% to 15.3% at broker-dealers, from 9.6% to 8.1% at brokers and from 4.5% to 2.2% at portfolio management companies, in this case unwinding the advance of the previous year. A look at the 2009 and 2010 change factors for ROE in broker-dealer and broker contingents shows that the same forces were operating but with a rather different intensity. As we can see from figure 20 (right-hand panel), the factors detracting from investment firm profitability were primarily leverage, a slightly diminishing efficiency (less so in 2010) and negative extraordinaries. Asset productivity contributed positively in both years, although far more strongly in 2010.[20]

19 ROE is calculated as:

$$ROE = \frac{\text{Profit before taxes (annualised)}}{\text{Equity}}$$

In which:

Equity = Capital + Share premium + Reserves – Treasury shares + Retained earnings and prior-year profit/loss - dividends and other entitlements.

20 The following equation allows us to isolate the effects of changes in each factor contributing to investment firm ROE:

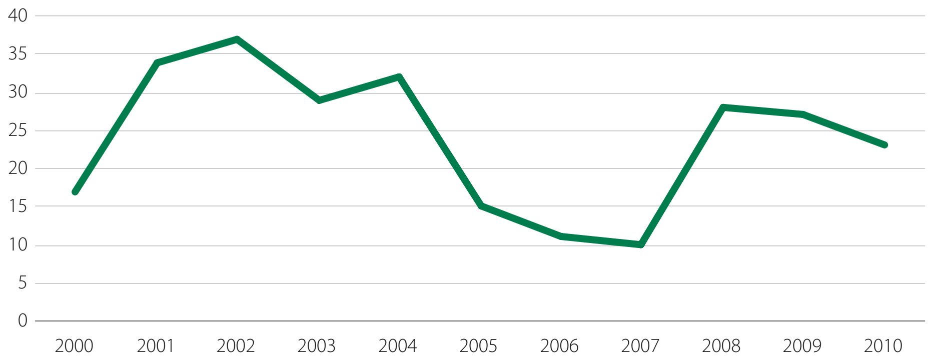
$$ROE = \frac{PBT}{Equity} = \frac{PBT}{\text{Net operating inc.}}(1) \times \frac{\text{Net operating inc.}}{\text{Gross income}}(2) \times \frac{\text{Gross income}}{\text{Assets}}(3) \times \frac{\text{Assets}}{\text{Equity}}(4)$$

in which the numbered elements serve as indicators of: (1) extraordinary items in the income statement, (2) efficiency, (3) asset productivity and (4) leverage. For a fuller description of how to interpret the elements in this equation, see the exhibit "ROE breakdown" in *Securities markets and their agents: situation and outlook* in the CNMV Bulletin for first quarter 2008.

As figure 21 shows, the number of firms reporting (pre-tax) losses was smaller in 2010, prolonging the improvement trend initiated after the 2008 peak. Of the 23 firms in losses at the end of the year (four fewer than in December 2009) from a total of 100 in operation, ten were broker-dealers (the same number as in 2009), twelve were brokers (three fewer than in 2009) and one was a portfolio management company (two in 2009). The aggregate losses of this group were also less severe at 16 million euros compared to 26 million the previous year, and amounted to around 5.5% of the sector's aggregate pre-tax earnings.

The number of loss-making firms reduces, as does the extent of their losses.

Number of investment firms in losses FIGURE 21



Source: CNMV.

Investment firms remained comfortably compliant with capital standards, though note that the stricter capital requirements imposed under 2009 rules has made some inroads into aggregate margin. At the 2010 close, the own funds of broker-dealers stood 3.2 times above the minimum requirement (3.4 times in 2009), while those of brokerage firms were 1.9 times higher (improving on the 1.5 times of the previous year) and those of portfolio management companies 1.2 times higher (1.5 times in 2009). No Spanish firms reported a year-end deficit position, and of the six with an own funds deficit at the 2009 close (five brokers and one broker-dealer), four ceased trading in 2010 and two were restored to compliance after implementing the mandatory viability plan.

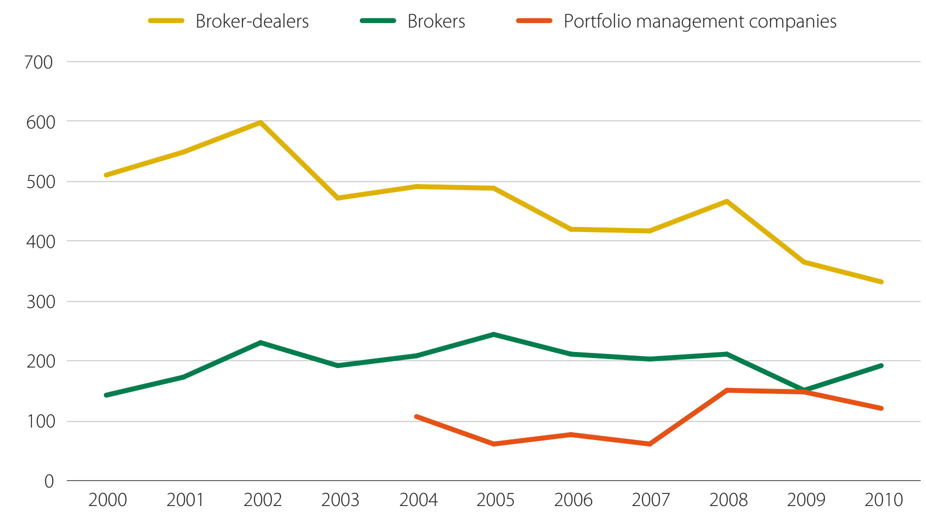
Sector solvency remains robust overall. No one entity reported an own funds deficit at end-2010.

Investment advisory firms had their debut in the Spanish market in 2009 following the transposition of the Directive on Markets in Financial Instruments (MiFID). They are authorised solely to dispense investment advice and guidance, that is, to make bespoke recommendations to clients regarding transactions in financial instruments. At the 2010 close, 52 such enterprises were registered on the CNMV books, none of them belonging to financial groups. Almost all advisory contracts signed has been concluded retail clients (97% of a total of 2,423), though note that this segment accounted for a relatively small share of assets under advice - 15.85 billion euros or just 11% of the 2010 total.

New arrivals investment advisory firms were advising some 16 billion euros in assets by the 2010 close.

Investment firm capital adequacy FIGURE 22

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



Source: CNMV.

The sector outlook is a little more encouraging with improvement coming through in main business lines.

The outlook for investment firms is better than for some time, with a tentative upturn in revenues from main business lines, especially those tied in with financial market turnover and UCITS sales. Further support comes from operating cost contention, which has been particularly strong among the broker group. The (customer) business faring worst is issue placement and underwriting, which continues to betray the effects of primary market slowdown. However, some traditionally lower-earning lines have been gaining in dynamism over the past two years - the case of investment advisory and portfolio management fees. Among broker-dealers, the proprietary trading business that has been weighing on income statements will foreseeably pick up in the coming months. For brokers, however, the outlook is rather less encouraging, in the absence of a clear recovery in their main business lines. Excess capacity and the mergers under way at Spanish savings banks, with ownership stakes in 14 investment firms, could give rise to a degree of restructuring further ahead.

4.3 UCITS management companies

Assets under management in UCITS management companies dropped by 13% in 2010, to 178 billion euros...

Aggregate 2010 figures for UCITS management companies put their assets under management at 178 billion, 13% less than in 2009 in what was the fourth consecutive annual decline. In straight-number terms, the fall in managed assets exceeded 25 billion euros and was the second largest of the past decade (behind only 2008), taking this variable back to the levels of the late 1990s (see table 19).

...despite which these entities grew their profits 24.5% in aggregate terms.

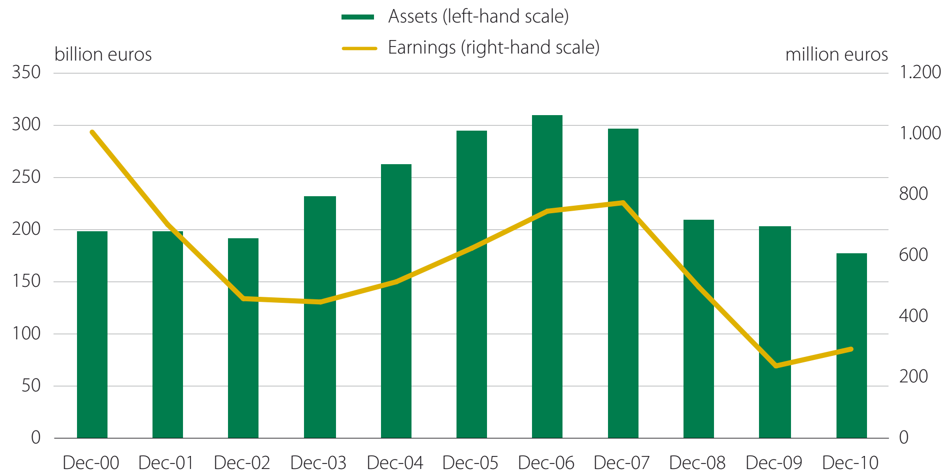
Despite the fall in assets, UCITS managers secured a 24.5% advance in pre-tax profits to 294 million euros (see figure 23), after the negative outcome of the two previous years. Earnings improvement drew on a small annual increase in net fee income[21] (0.9%), operating costs savings (-1.7%) and the practical disappearance of impair-

21 Fees paid fell faster than fees charged (-5.6% vs. -3.4%), translating as a net increase of 0.9%.

ment losses, after a 2009 figure upwards of 24 million euros. Aggregate return on equity climbed from 16% to just under 20% on the strength of the year's higher earnings. And, finally, although the number of loss-making companies rose from 31 to 34, their combined losses dropped to half (from 41.4 million to 20.2 million euros).

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

FIGURE 23



Source: CNMV.

Managers have been working hard to cut costs and rationalise their fund offering, but sector restructuring still looks a likely option.

It has been evident for some time that UCITS managers are working hard to rationalise their investment fund offerings through product mergers and operating cost contention. That said, we would not rule out a process of sector restructuring further ahead, as advised by the excess capacity in the system and in view of the gathering consolidation wave among Spanish banks and savings banks, which will certainly lead to changes of control[22] and, possibly, more than one casualty.

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

TABLE 19

Million euros

	Assets under management	CIS management fee income	Average CIS management fee (%)	Fee ratio (%)[1]
2001	198,115	2,465	1.24	65.8
2002	192,099	2,259	1.18	72.7
2003	231,458	2,304	1.00	73.8
2004	262,132	2,670	1.02	73.6
2005	293,973	2,976	1.01	72.2
2006	308,476	3,281	1.06	71.5
2007	295,922	3,194	1.08	70.5
2008	209,014	2,302	1.10	70.8
2009	203,379	1,702	0.84	68.6
2010	177,676	1,622	0.91	68.1

Source: CNMV.

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

22 Of the 15 changes of control in the UCITS management company sector in 2010, eight were a by-product of savings bank mergers.

Exhibit 7: "Enquiries regarding CNMV Circular 6/2009 on internal controls in UCITS management companies: some reflections"

In December 2010, the CNMV posted a document on its website setting out the regulator's response to the main queries launched by the sector regarding its Circular 6/2009 on the internal controls of UCITS management companies and investment companies,[1] in force as of 22 December 2009. The purpose of its publication was to guide obligated entities in interpreting the Circular's content. As such, the explanations it gives have no legal force, but are intended to help them understand and apply the rules with respect to their own organisational structures and internal control procedures.

The most frequent enquiries turned on the delegation of legal compliance, risk management and internal audit functions which, the Circular states, should be subject to certain restrictions or precautions. The document makes plain that in no case may such functions be delegated to an entity with which some conflict of interest may exist, and that their execution must at all times be governed by the principles of autonomy, separation and independence. With this overriding consideration in mind, and allowing for the constraints imposed by the text *per se*, the following clarifications are offered.

Regarding the possibility that audit and legal compliance functions can be entrusted to the same entity, if the manager's internal audit is taken on by the entity that handles the internal auditing of its group, and that entity or another within its group is simultaneously charged with the legal compliance function, no conflict of interest need be surmised, provided that: (i) the internal audit function is carried out by a separate department, (ii) its position allows it to oversee other internal control functions with sufficient autonomy and authority, and (iii) its remuneration system poses no conflicts of interest with the areas under review.

On the contrary, if the internal audit function is delegated to a service provider outside the manager's group and this provider or some other with which it has common interests attempts to simultaneously take on other internal control functions (legal compliance and/or risk management), this would clearly engender a conflict of interest and a breach of the principle of independence.

It is also specified that the entity conducting the internal audit function may not simultaneously be charged with responsibility for risk management. Indeed the Circular explicitly states that these two functions may not be handled by the same provider.

Further, if the management company and custodian belong to the same group, the audit function may be taken on by the custodian's internal audit unit, assuming this same unit is also responsible for internal auditing on a group-wide basis. In any event, the function should be performed by a department at arm's length from the rest, whose position within the entity assures it sufficient autonomy and authority to oversee other internal control functions.

The document also advises that the global nature of the review, extending to all the entity's systems and procedures, requires that the internal audit should be conducted in a unified, integral manner and should conclude in a single, comprehensive report signed by one entity. It follows that the internal audit function cannot be delegated to two auditors and nor can there be two reports.

When it is administrative functions that are being delegated, responsibility for having the policies and procedures in place that the Circular specifies for administrative and accounting matters, asset valuation and the calculation of net asset value will lie with the contracted entity. In this respect, the delegating management company should verify before any agreement is signed that the contracted entity effectively operates such policies and procedures, and thereafter check that they are being applied as appropriate to the delegated tasks. Such checks should be run on the progress of all delegated activities.

Finally, the document addresses the sector's concerns about how to distinguish between the delegation of functions and the simple provision of services, in order to demarcate the cases where the CNMV must be informed that a function has been delegated (instances of mere service provision need not be notified to the regulator). What separates these two situations is where decision-making power is vested. Hence when a function is delegated, the contracted entity is not only responsible for its execution but also for taking decisions on how such execution should proceed. Conversely, when a third-party service is being provided, the contracting management company retains the final power of decision.

1 www.cnmv.es/Portal/AlDia/Comunicaciones.aspx

4.4 Other intermediaries: venture capital

The number of venture capital entities continues to expand.

The register of venture capital entities (VCEs) recorded 22 new entrants and 17 retirals in 2010. A total of 75 venture capital funds were in operation at the end of the year, one more than in 2009, venture capital companies summed 150, three fewer than in 2009, and VCE managers increase their number by seven to a year-end total of 108 (see table 21). New entrants tended to be specialised in early-stage small and medium-size enterprises, whose sphere of operations is basically national. Among the year's developments was the first appearance of venture capital funds for entrepreneurs, focusing on small technology-based firms, and the return of the leveraged buyout specialists absent from the scene since first-half 2008.

Movements in the VCE register in 2010 TABLE 21

	Situation at 31/12/2009	Entries	Retirals	Situation at 31/12/2010
Entities	**328**	**22**	**17**	**333**
Venture capital funds	74	4	3	75
Venture capital companies	153	8	11	150
Venture capital management companies	101	10	3	108

Source: CNMV.

Investment by venture capital companies climbs to 3.43 billion euros in 2010, led by large-scale leveraged transactions.

According to data furnished by the Asociación Española de Entidades de Capital Riesgo (ASCRI), venture capital companies increased their investment in Spain by 106% to 3.43 billion euros, contrasting with the lean years of 2008 and 2009.[23] Behind this figure was a jump (from one to six) in large leveraged transactions (over 100 million euros), which together accounted for 57% of the sector's annual investment. So though overall transaction numbers fell from 923 to 823, their average size was greater. New funds raised came to 3.07 billion, 161% more than in 2009, with 76% corresponding to pan-European operators. Finally, divestments in the year summed 1.39 billion euros, an increase of 61% with respect to 2009. That said, a number of scheduled disposals had to be called off because the fund could not find the buyers for a public offering.

A good overall outlook for the sector, though difficulties persist with transaction financing and divestment processes.

The upswing in venture capital activity, nationally and across Europe, configures a generally positive outlook for the industry. Reasons for optimism include the presence of top international funds and the resumption of large-scale transactions, denoting the existence of attractive investment opportunities in Spain, and a tentative improvement in the funding conditions for private equity. However, capital market divestments are proving a tough proposition, to the extent that some seller funds had to call off the public offerings scheduled for 2010.

23 Investment fell 32% in 2008 and 47% in 2009.

II Reports and Analyses

Participation shares in the current regulatory regime for savings banks

Óscar Arce, Ricardo Crisóstomo and Cecilia González (*)

(*) Óscar Arce and Ricardo Crisóstomo are members of the CNMV's Research, Statistics and Publications Department and Cecilia González is a member of the CNMV's Primary Markets Department. The authors wish to thank Fernando Restoy and Lucio Sanjuán for their comments.

1 Introduction

The reform recently approved in Royal Decree-Law 11/2010, of 9 July, on Governance Bodies and other aspects of the Legal Regime for Savings Banks significantly strengthens several key elements in the functioning of these credit institutions. On the one hand, this reform introduces new measures to improve the corporate governance of saving banks and professionalise their management and, on the other hand, it aims to help them to raise own funds through the markets in conditions based on those governing banks.

Following the same line, the recently approved Royal Decree-Law 2/2011, of 18 February, for the Reinforcement of the Spanish Financial System, introduces a set of measures aimed at strengthening the solvency of Spanish credit institutions. These measures include making it mandatory for all credit institutions to possess a high level of top-quality capital, expressly including participation shares as one of the instruments which savings banks can use to reach the required level of capital.

In this context of strengthening of the own funds of credit institutions, this article focuses on the new legal regime for participation shares, an instrument to which the legislator has given a significant role as a possible mechanism for recapitalising savings banks in the new legislative environment.

Firstly, this article presents a description of the regulatory framework applicable to participation shares following the latest legislative modification contained in Royal Decree-Law 11/2010. It then goes on to study in certain detail some of the particular characteristics of these instruments which make them different from the ordinary shares of a public limited company. Specifically, this paper analyses the effects resulting from the dilutions of the economic and voting rights of the holders of participation shares, which results from an asymmetrical mechanism for distributing the surplus between this group of investors and the savings bank's equity, as is the case in current legislation. A key conclusion of this analysis is that the level of complexity of the aforementioned particular nature of participation shares may be notably high, especially with regard to their valuation by unsophisticated investors. Finally, the article explores various mechanisms aimed at reducing the inherent complexity of these instruments.

The rest of the article is structured as follows: the second section describes the key elements introduced by the reform in the legal framework for savings banks approved in 2010 with regard to the recapitalisation mechanisms of these institutions, and provides a description of the current legal regime applicable to participation shares. The third section analyses the possible effects of the dilution of the rights of holders of participation shares which may be caused by the mechanism for distributing the surplus of savings banks as provided in current legislation. The fourth section explores two mechanisms for mitigating the complexity of participation shares and the final section contains various final reflections. The article also contains three appendices. The first describes the experience so far relating to issues of participation shares, including some actions carried out recently in the context of the Fund for Orderly Banking Restructuring (Spanish acronym: FROB). The second contains the details of a simple optimal investment model which is used in some of the quantitative exercises presented herein. Finally, the third appendix contains the formal development of one of the mitigating mechanisms analysed in the fourth section.

2 The current legal framework for participation shares

In addition to improving the corporate governance of savings banks, the main aim of Royal Decree-Law 11/2010 is to strengthen the capitalisation mechanisms of these institutions. This section reviews, firstly, the new aspects which in this regard are introduced by the aforementioned Royal Decree-Law and then presents the most noteworthy characteristics of the current legal regime applicable to participation shares.

2.1 The regulation of savings banks' capitalisation and restructuring mechanisms

On the one hand, it is important to highlight that the new regulation opens the possibility for savings banks to engage in indirect financial activity and for them to transform into special nature foundations. On the other hand, it revises the regulation of participation shares and Institutional Protection Systems (Spanish acronym: SIPs).

It should be pointed out, however, that participation shares and SIPs are not strictly-speaking new concepts.[1] The initiatives for the financial sector contained in Royal Decree-Law 6/2010, of 9 April, on Measures to promote Economic Recovery and Employment included the establishment of the new regime applicable to the SIPs which are created among credit institutions with the aim of guaranteeing maximum legal security for this type of operation.[2] The new wording of Royal Decree-Law 11/2010 aims to reinforce the stability and irreversible nature of the SIPs. In particular, the SIPs made up of savings banks must have a bank form (legislation says that

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1 SIPs represent a contractual agreement between various credit institutions whereby they establish a mutual solvency and liquidity commitment through immediately available funds and share a significant part of their results. The system must have a central institution, which will be responsible for meeting the regulatory requirements of the SIP.

2 Royal Decree-Law 6/2010, of 9 April, on Measures to promote Economic Recovery and Employment, gives Institutional Protection Systems (SIPs) a new legal regime through the modification of Section 8 of Act 13/1985, of 25 May, on Equity and Investment Ratios and Reporting Obligations of Financial Intermediaries. This new legal regime for SIPs provides legal security and specific regulation for a key figure in the restructuring of the Spanish financial system which, until the approval of this legislation, lacked substantial regulation, except for the brief related precepts contained in the regulation on the equity of credit institutions.

the central institution will be a public limited company), over which the savings banks forming the SIPs will retain at least 50% of their voting rights.

The possibility to carry out indirect financial activity introduced by Royal Decree-Law 11/2010 offers new alternatives for savings banks in their restructuring process. On the one hand, savings banks may carry out their main objective as credit institutions through a banking entity in which they hold at least 50% of its voting rights, while maintaining their nature as credit institutions and savings banks. Alternatively, savings banks may segregate the financial activity to a bank and the charity-social activity to a special foundation which would be a shareholder of the bank.

With regard to participation shares, the new regulation has not introduced noteworthy new items relating to their nature, to the extent that these instruments continue to be equity assets which are classified as equity of the highest quality with regard to their capacity to absorb losses. These instruments continue to be an option reserved exclusively for credit institutions which maintain the status of savings banks. Nevertheless, on recognising the option to issue shares with voting rights, Royal Decree-Law 11/2010 brings the nature of these instruments closer to that of shares in public limited companies, although there are still notable differences between the two types of assets, as analysed later in the article.

2.2 The legal regime for participation shares

Participation shares were introduced in 1988 through the reform of Section 7 of Act 13/1985, of 25 May, on Equity and Investment Ratios and Reporting Obligations of Financial Intermediates, which was subsequently implemented in Royal Decree 664/1990, of 25 May, on Participation Shares of Savings Banks. Under this legislation, however, there was only one issue of "associative shares", carried out in 1998 by the Spanish Confederation of Savings Banks (Spanish acronym: CECA), which could only be subscribed by the savings banks themselves.

Subsequently, Act 44/2002, on Reform Measures for the Financial System, rewrote Section 7, and a new Royal Decree 302/2004, on Participation Shares of Savings Banks, repealed the previous section. Within that framework, participation shares were conceived as tradable securities representing monetary contributions of a perpetual nature, which could only be issued by savings banks and which must be listed on an organised secondary market.[3]

From the creation of these securities up to the approval of Royal Decree-Law 11/2010, participation shares lacked voting rights. The main effect of this was that participation shares did not grant the right to vote or to attend the savings bank's General Assembly and, therefore, holders did not participate in any decisions which affected them, such as, for example, the financial remuneration policy for holders of participation shares. This key aspect represented one of the major differences with ordi-

3 Appendix 1 describes the details of several recent issues of participation shares, including that of the CAM in 2008 and other actions within the framework of the Fund for Orderly Bank Restructuring (Spanish acronym: FROB).

nary shares of a public limited company in the former regulatory framework, as the return on shares was partially determined by possible discretionary actions which the savings bank could carry out without any control from these investors.

Furthermore, even though the law does not allow voting rights and the volume of participation shares in circulation shall not exceed 50% of the savings bank's equity, it was prohibited for any investor to directly or indirectly control more than 5% of the shares and, if they passed this threshold, their economic rights were suspended. In addition, a syndicate of holders of participation shares, which could act as an instrument for defending their interests and for communication between this group and the savings bank, could only be set up by the entity itself.

With regard to the conditions for issuing new shares, which remain in force following approval of Royal Decree-Law 11/2010, it should be pointed out that the savings bank has to estimate the economic value or market value of the shares to be issued, which will be used to establish the issue premium of the securities.[4] The issue price of the shares is made up of the nominal value plus the issue premium. The latter is spread among the savings bank's general reserves (the savings bank's funds) and the reserve fund of the holders of the participation shares (investors' funds). The following three funds or accounting items will be created in the process of issuing shares:

– The participation fund, which is equal to the sum of the nominal value of the shares.

– The reserve fund of the holders of participation shares, made up of a percentage of the issue premium and, subsequently, with the part of the unrestricted available surplus of the holders of the participation shares which is not paid to them in cash or allocated to the stabilisation fund.

– On a voluntary basis, the savings bank may set up a stabilisation fund which will be allocated with a part of the unrestricted available surplus of the holders of participation shares and whose resources may be distributed among the investors so as to avoid excessive fluctuations in the return on the shares.

The shares grant the following economic rights to their holders:

– To obtain variable and non-cumulative remuneration, participating in the distribution of the savings bank's unrestricted available surplus in proportion to their holding in the equity.[5] Each year, the savings bank's General Assembly will agree the distribution of the profit or unrestricted available surplus among its reserves, the social work and the holders of participation shares. The Assembly will take into account the savings bank's solvency ratio when agreeing the distribution. Act 13/1985 provides that, as a maximum, the savings banks

4 Throughout this article the terms "economic value" and "market value" are used indistinctively in reference to the fundamental values of an entity for its owners, which theoretically corresponds to the net discounted flow of the entity's future profits.

5 The criteria for distributing the part of the surplus corresponding to the shares is analysed in the following section.

may allocate 50% of the part of the unrestricted available surplus which is not attributable to the holders of participation shares to the charity-social work.

– Pre-emption rights for new share issues, unless this right is withdrawn by the savings bank's General Assembly. Unlike ordinary shares, it is not possible to issue paid-up participation shares and therefore they do not have the right of free assignment.

– Right to obtain the net asset value in the event of the savings bank's liquidation, defined as the part which corresponds to each participation share from the three funds, adding or abstracting the part which is attributable to it from the profit or loss of the liquidation balance sheet which has not been previously distributed.

– In the event that the issuing savings bank merges, the right to assign participation shares to the savings bank and obtain the market value, understood as the average price over the last 30 sessions or, if this is not possible, the valuation carried out by an independent accounts auditor.

With regard to obligations, the participation shares are applied to offset the issuing savings bank's losses in the same proportion and order as the founders' fund and reserves. The offset of losses charged to the participation shares may consume up to the full amount of their funds.

The main new element contained in Royal Decree-Law 11/2010 relating to participation shares is the possibility to issue shares with voting rights, specifically:

– The right of representation (with speaking and voting rights) of the holders of participation shares in the savings bank's governance bodies, which will be proportional to the percentage of the shares in the savings bank's equity.

– The right to oppose the resolutions adopted by the General Assembly and by the Board of Directors under the same terms as those for shareholders in a public limited company.

– The right to information regarding issues of their interest for the holders of participation shares which represent at least 5% of the shares in circulation.

In addition, the concept of the syndicate of holders of participation shares is withdrawn, and the obligation to be listed only affects the issues of participation shares aimed at the general public. It also eliminates the limit of 5% of the maximum holding of participation shares by one single holder. On the other hand, although the regime for takeover bids will not be applied, the control regime for significant holdings in credit institutions provided for in Act 26/1988, of 29 June, on Discipline and Intervention of Credit Institutions, will be applied.

Furthermore, the new Royal Decree-Law 11/2010 clearly underlines the principle of the free issue of participation shares. Consequently, issues of these securities will not require prior administrative authorisation. In addition, the annual remuneration of the participation shares and their distribution will not require any administrative authorisation in the area of credit planning, without prejudice to the powers of the Bank of Spain in exercising its functions.

In the event of a merger, the participation shares of the entity which disappears will be swapped for participation shares in the savings bank resulting from the merger, in such a way that the economic value of their rights suffers no alteration. With this modification, and under the new legislative framework, the potential holders of participation shares lose the right to assign their shares to the savings bank at market value, which was provided for in the previous legislation.

The other rules applicable to participation shares remain unchanged, including the condition that the volume of participation shares in circulation may not exceed 50% of the savings bank's equity.

3 The mechanism for distributing the surplus: The "dilution effect" and the "distribution bias"

Article 2 of Royal Decree-Law 11/2010 establishes that participation shares provide their holders with the right to participate in the distribution of the savings bank's unrestricted available surplus in the proportion that the volume of shares in circulation represents in terms of the bank's equity plus the volume of the participation shares in circulation. For this purpose, the savings bank's equity is defined as the sum of the founders' fund, the general cash reserves and the fund for general banking risks, while the volume of participation shares in circulation corresponds to the sum of the participation fund and the reserve fund of the holders of participation shares and the stabilisation fund of the issues of participation shares in circulation. Accordingly, the proportion of the unrestricted available surplus assigned to the holders of participation shares, denoted as s_t, on a generic date *t*, can be expressed as

$$s_t = \frac{CP_t}{CP_t + PAT_t} \qquad (1),$$

where CP_t is the volume of participation shares and PAT_t is the savings bank's equity before paying dividends.

For its part, Article 9 of Royal Decree 302/2004 establishes that the percentage of remuneration each year of participation shares over their part in the unrestricted available surplus may not be lower than the percentage allocated to charity-social work over the part of the unrestricted available surplus which does not correspond to the participation shares, and may not be greater than 50%.[6]

Accordingly, the possibility of granting greater cash remuneration to participation shares than to charity-social work which is implicit in this regulation can be under-

6 Nevertheless, the same article establishes that the Bank of Spain may authorise, at the savings bank's request, remuneration percentages greater than the aforementioned 50% providing that these decisions do not notably weaken the institution's solvency.

stood as the legislator's wish to configure a mechanism aimed at balancing the following two objectives: on the one hand, providing these entities with solid organic capitalisation mechanisms, by means of a general imposition of maximum limits to the total rate of profit distribution and, on the other hand, making participation shares an attractive savings instrument for investors to the extent that this regulation implicitly allows for the part of the surplus to be distributed in cash among the holders of participation shares to be greater than that assigned to charity-social work.

Achieving the above balance may, however, bring some technical problems which should be taken into account when evaluating the possible effects of the surplus distribution system in the recent legislative reform. Specifically, the fact that the profit distribution system described generally allows reinvestment rates for the surplus greater in the case of the savings bank's equity than in that of the participation shares implies that the relative weight of the volume of participation shares with regard to the total equity (s_t) may automatically fall over time. Accordingly, in the absence of any corrective mechanism, this "dilution effect" brings about a relative loss of the economic and voting rights of the holders of participation shares.

The aforementioned dilution effect in fact also tends to lead to bias in the distribution of the savings banks' profits. In fact, given that the economic interest of holders of participation shares is calculated based on the book value (or accounting value) of the volume of shares, and not on their market value, it can be expected that the dilution of the rights of the holders of participation shares leads to inter-temporal distortions in the allocation of the economic profit, as analysed below.

In what is perhaps the most frequent case, in which the increase in the market value of the total stock of participation shares in a given financial year, including the reserves of the holders of participation shares, is greater than the increase in their book value (because of the existence, for example, of unrealised gains in that year), the 'excess' of dilution of the relative weight of the holders of participation shares due to basing the distribution of the surplus on the book value and not on the market value will directly lead to a gradual loss in the surplus to be allocated to these instruments. The following example illustrates how this type of inter-temporal distortion or 'distribution bias' takes place.

Example. Consider that at the start of a determined period *t*, the book value of the savings bank's equity and the volume of participation shares in circulation in both cases stand at 125 euros. That is, according to equation 1, $CP_t = PAT_t$ = 125 euros and, therefore, s_t = 50%. In addition, assume that the mechanism for distributing the profit/loss is such that the remuneration percentage for participation shares over their part of the free available surplus is 50%, while this percentage is only 25% in the case of charity-social work. Finally, assume that the *accounting profit* generated over the reference period is 80 euros while, due to the existence of unrealised gains of 20 euros, the *economic profit* totals 100 euros.

With the above hypotheses, the holders of participation shares will receive a cash remuneration of 20 euros (50% x 50% x 80 euros) and the relative weight of the participation shares in the savings bank's total resources, following distribution of the profit for the year, will amount to 48.3%. This percentage results from updating the formula for calculating the net interest of the holders of participation shares, as shown in equation (1), bearing in mind that the book value of the participation shares in circulation at the end of the period *t*, CP_{t+1}, has increased by 20 euros (i.e. the proportion of the accounting profit attributable to the holders of participation shares which has not been distributed to them), while the book value of the savings bank's equity, PAT_{t+1}, has increased by 30 euros. This loss in the relative interest of the holders of participation shares illustrates the aforementioned 'dilution effect'.

In addition, the fact that a part of the gains generated during the period *t*, in which the participation of the holders of participation shares in the savings bank's total equity amounted to 50%, are only recognised and distributed or allocated to reserves in a subsequent period, in which the previous percentage will necessarily fall below 50%, leads to what was referred to above as 'distribution bias'. In order to have a better idea about how this bias materialises, it is useful to consider, firstly, what the return on investment would be for holders of participation shares in period *t* in the absence of said bias. Consider, for example, that all the gains generated in the period are recognised at the end of the period and, consequently, the economic profit and the accounting profit are the same (for example, in both cases the profit totals 100 euros.) In this case, in accordance with the aforementioned dividends policy, the holders of participation shares would receive a cash remuneration of 25 euros (50% x 50% x 100 euros) and an increase of their reserves also of 25 euros. Therefore, the holders of participation shares would receive a total remuneration of 50 euros.

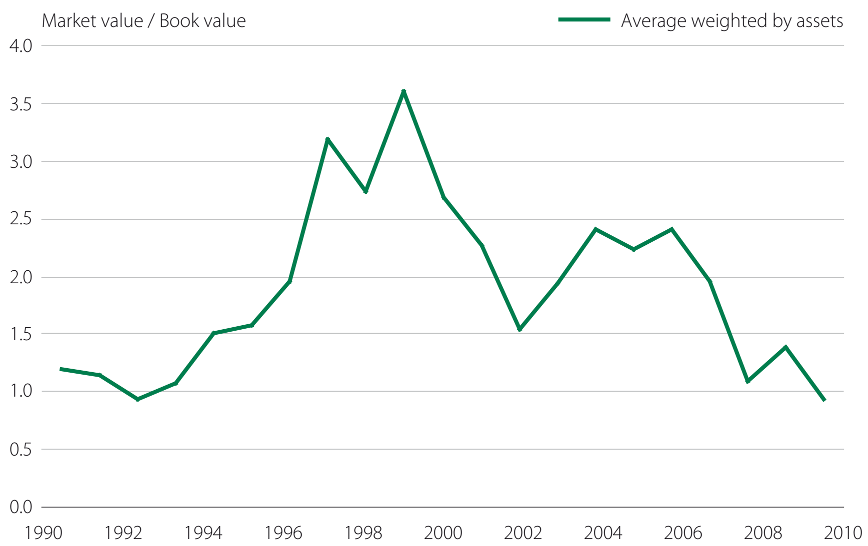
On the other hand, in the case of unrealised gains, assuming, for example, that the gains for the current year are recognised in the following year, the profit originating in the current period and effectively allocated to the holders of participation shares would total 49.6 euros, which corresponds to the sum of the following quantities: 20 euros paid in cash at the end of the current year, 20 euros assigned to reserves of the holders of participation shares and 48.3% of the gains recognising the following period, which in total would amount to 20 euros,[7] with which the total remuneration would fall below the 50 euros which would be obtained if the unrealised gains were assigned in accordance with the relative participation of the holders of participation shares during the year in which said gains were generated (which is 50%).

Furthermore, the fact that the accounting profit is less than the economic profit tends to increase the dilution caused by the asymmetry in the policy for distributing the surplus. Continuing with the above example, if all the gains were recognised in the period in which they are generated, the participation of the holders of participation shares in the savings bank's total equity after distribution of the surplus of the year in question would total 48.4%, compared with 48.3% which is obtained if there is a delay in recognising all the gains as the volume of shares in circulation at the end of the year CP_{t+1}, would have increased by 30 euros, i.e., the proportion of the economic profit, instead of the accounting profit, attributable to the holders of participation shares which has not been paid to them, while the savings bank's equity, PAT_{t+1}, would have increased by 40 euros.

7 For the sake of simplicity, these operations do not take into account the inter-temporal discount factor or, in equivalent terms, they assume that the amount of the unrecognised gains in the current period grow at an equal rate to the discount rate applied by holders of participation shares to future cash flows.

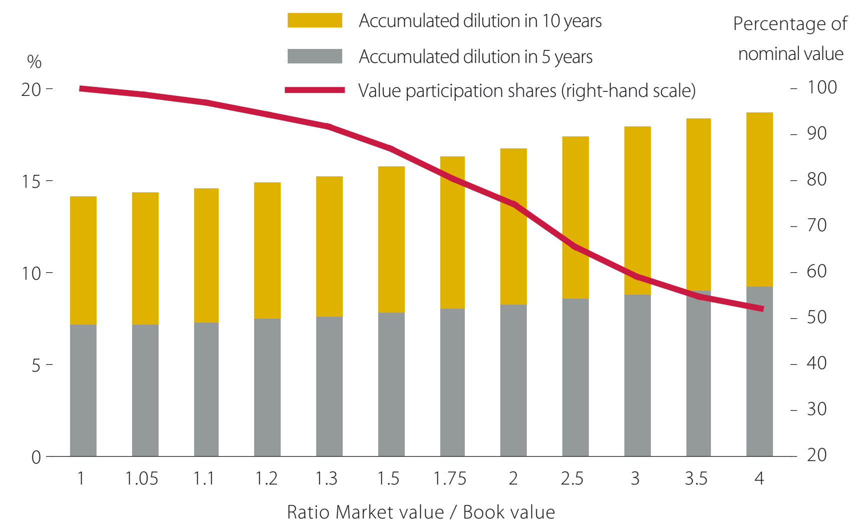
Even though in the above examples the figures relating to the effects of the distribution bias on the loss of absolute value for holders of participation shares and for the level of dilution of their participation are seemingly modest, it is important to underline that these effects are cumulative over time such that their total impact may be substantial, especially, when the unrealised gains or losses of the savings bank are significant. In this regard, the available evidence shows that the differences over time between the book value and the market value may be substantial in the case of financial institutions. Figure 1 contains the historic series for the average ratio between market value and book value of listed Spanish banks. This figure shows two important points. Firstly, the size of the difference in the market value and the book value of a credit institution may be significant and consequently, the volatility of these differences is also very high.

Market value and book value of Spanish banks FIGURE 1



Source: CNMV.

Effect on the dilution and theoretical value of the participation shares FIGURE 2



Source: CNMV.

With the aim of providing an approximate estimate of the impact of the difference between economic value and book value, both in terms of their amplifying effect on the dilution of the interests of the holders of participation shares and as its impact on the value of the participation shares, figure 2 presents the results of several numerical exercises performed with a simple valuation model (Appendix II, at the end of the article, contains the details of this model). Specifically, these exercises show how the additional dilution effect caused by the distribution bias increases as the sustained differences between the savings bank's market value and book value grow. In addition, although this additional dilution does not seem large (at least in moderate time horizons), its effect on the valuation of the participation shares is noteworthy. For example, if the ratio between the economic value and the book value reached a sustained value of 3.5 times (a value which coincides with the historic high of this series of Spanish banks: see figure 1), the value of the participation shares would only reach 54.7% of their nominal value.

Furthermore, the distribution bias introduces a significant element of complexity when valuing participation shares. As highlighted in the above example, the interaction between the dilution effect and the differences between economic and accounting figures means that the proportion of the profit effectively allocated to holders of participation shares depends on the time at which the unrealised profits are recognised and distributed. This last point adds considerable difficulty to the analysis of the risk profile and valuation of the participation shares, whose theoretical price will depend on variables which are difficult to predict, such as the differences between the accounting and economic profit and the moment when the unrealised gains and losses are recognised and distributed. In this regard, it is important to bear in mind that, as indicated above, the empirical evidence relating to Spanish banks shows that the differences between economic and accounting figures are normally very volatile (see figure 1). Furthermore, the fact that the moment in which the unrealised profits are recognised has redistributive effects means that the decision to recognise and distribute profits may be potentially subject to complex conflicts of interest.

The subsequent increase in the complexity of these instruments may have a relatively major impact on the retail investor base, which normally has a limited capacity for analysing complex financial instruments. Furthermore, a greater level of complexity may also represent an obstacle to achieving greater levels of market discipline as the market price of the participation shares will include, as indicated above, a series of factors which are not directly linked to the current expectation about the future institution's results or the quality of the management of each institution.

In addition, the dilution of the voting rights of participation shares reduces their appeal for investors looking for control to the extent that the system for attributing rights involves a reduction in the weight of the holders of participation shares in the savings bank's management bodies. This characteristic, together with the fact that Article 2 of Royal Decree-Law 11/2010 expressly prohibits making takeover bids on savings banks will also tend to reduce the appeal of these instruments even more for investors which do not aim to take control given that the management premium normally incorporated into the value of an ordinary share of a public limited company will be reduced in the case of participation shares.

Faced with the above effects caused by the dilution of the rights of holders of participation shares, the legislator has provided the possibility of applying mechanisms to mitigate said effects. Accordingly, Article 9 of Royal Decree 302/2004 establishes that "savings banks may adopt measures aimed at mitigating the effects of the differences in the percentages of remuneration to holders of participation shares and allocation to social work as a percentage of the unrestricted available surplus which corresponds to the holders of participation shares". Nevertheless, this rule does not provide for any specific instrument which may mitigate these differences. With this objective, the following section explores several mechanisms which may at least partially attenuate the aforementioned complexity and the subsequent loss of appeal of participation shares.

4 Some mechanisms to mitigate the effects of the dilution of the rights of holders of participation shares

This section analyses two mechanisms which may correct the distribution bias analysed above. The first corrects the distribution bias directly by means of adjusting the formula for calculating the economic interests of the holders of participation shares. The second mechanism consists of granting these investors the option to maintain their economic and voting rights in the savings bank by means of a system for distributing the surplus partially based on issuing new participation shares, which reduces the intensity of the dilution effect.

4.1 Value adjustments in surplus distribution

Given that the distribution bias occurs as a consequence of using a rule for distributing the surplus based on accounting figures (book value of the participation shares), and not economic figures (market value of the participation shares), a modification of said rule which allows assignment of the relative economic and voting rights based on market values would eliminate said bias. Accordingly, as shown in the example in the section above, in a situation in which the accounting profit over a period is, for example, lower than the economic profit, as the market value of the participation shares and the savings bank's equity at the end of the period will be higher than their book values, the dilution effect on the participation shares will be lower and their valuation simpler.

Specifically, the following formula for updating the rule for distributing the surplus would achieve the above objective of eliminating distribution bias:

$$s_t = \frac{\begin{pmatrix}\text{market value of}\\ \text{the participation shares}\end{pmatrix}_{t-1} + \begin{pmatrix}\text{Non-distributed economic surplus}\\ \text{of the participation shares}\end{pmatrix}_{t-1}}{\begin{pmatrix}\text{market value of}\\ \text{the participation shares}\end{pmatrix}_{t-1} / s_{t-1} + \begin{pmatrix}\text{total non-distributed}\\ \text{economic surplus}\end{pmatrix}_{t-1}} \qquad (2);$$

The main virtue of this formula is the fact that its application would theoretically allow these instruments to be valued following the same basic principles as those used to value any share of a public limited company. In particular, given that the total flow of profits attributable to the holders of participation shares would no longer depend on the differences between the book values and market values and the moment when the unrealised profits are recognised and distributed, in the absence of any other more general distortion effect, the market value of the participation shares would only reflect the discounted value of its corresponding part of the economic profits generated by the savings bank.

In summary, the adjustment of the rule for distributing the surplus contained in expression (2) would most likely lead to participation shares being more appealing for investors and analysts as it would make the valuation of these instruments similar to that of ordinary shares of a listed company. As shown in detail in Appendix III, this type of adjustment may be implemented by means of a series of simple calculations using information which should in theory be directly available from market data.

4.2 Granting an option to receive profits in the form of new participation shares

The automatic dilution of the rights of the holders of participation shares could be mitigated, and with it the distribution bias, by granting these investors the option of maintaining their rights in the savings bank over time. Following this general idea, the surplus distribution system presented below is based on granting an option which allows the holders of participation shares to receive a part of their dividends in the form of new participation shares.

Specifically, this distribution system means that fully exercising the option would exactly preserve the weight of their economic and voting rights following profit distribution. Therefore, this mechanism provides the holders of participation shares with the possibility of applying, if they so wish, a profit reinvestment rate similar to that carried out by the savings bank, receiving a level of cash dividends which is equivalent, in relative terms, to the surplus assigned to the social work.

A scheme of this type could be implemented using a payment rule for distributing the surplus of the holders of participation shares which combines the two following elements:

– a minimum remuneration tranche in cash, denoted by $DIV_{t,1}^{CP}$, which fulfils the following equation

$$\frac{DIV_{t,1}^{CP}}{CP_t} = \frac{DIV_t^{OBS}}{PAT_t} \qquad (3),$$

in such a way that the proportion which said minimum tranche represents over the volume of participation shares coincides with the proportion represented by the part of the savings bank's equity surplus assigned to charity-social work over the savings bank's equity.

– a remaining tranche, denoted by $DIV_{t,2}^{CP}$, up to the limit of the pay-out target (proportion of the profits distributed over the total profits generated) for the holders of participation shares, which may take the form of cash remuneration (as in the tranche above) or the form of new participation shares valued according to their book value. In formal terms, the joint amount of the two tranches must meet the following equation:

$$x_t^{CP} s_t \pi_t = DIV_{t,1}^{CP} + DIV_{t,2}^{CP} \qquad (4),$$

where x_t^{CP}, is the pay-out ratio applied to the holders of participation shares and π_t is the accounting profit for the period. The above expression thus establishes that the sum of both tranches shall be equal to the total pay-out for the period in question.

With regard to the decision of the holders of participation shares to exercise or not the option of receiving part of the remuneration in the form of participation shares, it is clear that when the market value of the shares is above their book value, the optimal choice will be to receive the second tranche of the remuneration in the form of new participation shares. In this case, the increase in the volume of participation shares (additional to the non-distributed proportion of the surplus of the holders of participation shares, $1-x_t^{CP}$), denoted by ΔCP_{t+1}^{Option}, will be equal to $DIV_{t,2}^{CP}$. Accordingly, the surplus assigned to the holders of participation shares distributed in cash will simply be $DIV_{t,1}^{CP}$, which coincides with the corresponding proportion for social work. Therefore, the reinvestment rate of the savings bank's profits carried out by these investors will be identical to that applied by the savings bank's equity. Accordingly, there will be no dilution in the rights of the holders of participation shares.

If, on the hand, at the time of distributing the surplus, the book value of the participation shares is higher than the market value, which according to the evidence shown in figure 1 occurs less often, the decision of the holders of participation shares is somewhat more complex. Specifically, if the difference between the book value and the market value is not too high or is not expected to persist over a long period, it may still be optimal for these investors to receive the second tranche of the remuneration in the form of new participation shares. Intuitively, the fact that the decision not to exercise the option has long-lasting effects, to the extent that the dilution it causes may be permanent, implies that the expectation to return in the future to a situation where the market value of the participation shares is above its book value may also make optimal the exercise of the option at the present time.

The main appeal of this mechanism is that it provides holders of participation shares with the possibility to maintain the weight of their participation in the savings bank over time and, therefore, directly mitigate the automatic dilution of their interests, and indirectly the size of the distribution bias. Specifically, to the extent that the probability of not exercising the remuneration option in the form of participation shares is low, the problem of valuing these instruments is very similar to that for the shares of a listed company. This is because, as indicated above, aspects such as the differences between book values and market values or the time for recognising and distributing the unrealised profits will then be less important.[8]

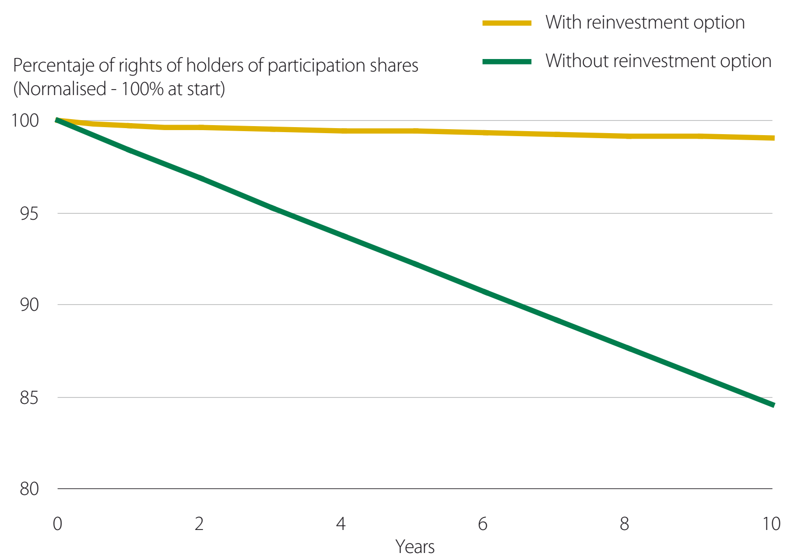
8 However, the valuation of the option on which this mechanism is based would be subject to considerations relating to the difference between the accounting profit and the economic profit and, in addition, to the uncertainty with regard to the time at which the unrealised gains or losses are recognised.

Furthermore, it should be pointed out that implementation of this mechanism is based on transactions and assets which are common in financial markets (such as the payment of dividends through shares and transactions with options). Consequently, practical application should not lead to any additional complexity.

Quantitative analysis

In order to illustrate the possible quantitative impact of the mechanism analysed herein, we have performed several numerical simulations using the optimal investment model developed in Appendix II, appropriately calibrated in accordance with the most relevant available historical evidence. Figure 3 shows how the introduction of the option of receiving part of the dividend in the form of participation shares substantially alters the pace and size of the dilution effect. Specifically, assuming that the savings bank grants this option to the holders of participation shares, the dilution would only reach a value of 0.9% of the initial investment at the end of 10 years, compared with 15.21% in the absence of said option.

Cumulative dilution of rights with reinvestment option FIGURE 3



Source: CNMV.

Furthermore, the existence of this option, given that it makes it possible to eliminate the distribution bias effects, increases the theoretical value of participation shares and, consequently, the amount of funds which the institutions can raise when issuing these financial instruments

5 Conclusions

In the context of the current legal framework for savings banks, which has recently seen the amendment of several of its basic elements, and in the current economic and financial environment, which has revealed the need to strengthen the solvency of some of these institutions, this article analyses several aspects relating to participation shares which can be issued by savings banks.

It has a twofold aim. Firstly, it analyses the consequences of the dilution effect which the system of distributing the surplus of savings banks provided in the current legislation may have on the economic and voting rights of the holders of participation shares and, specifically, it indicates the high level of complexity inherent to the participation shares of savings bank. To the extent that this dilution may lead to distortions in the distribution of the savings bank's profits which make it difficult to value the participation shares, and which may affect the investment appeal of these instruments, it seems necessary to reflect on possible measures to mitigate these distortions and temper their most negative consequences.

Accordingly, the second aim of this article is to explore several mechanisms which may mitigate the particular complexity of participation shares, including i) considering a surplus distribution system based on the market value of the participation shares, instead of their book value, and ii) granting an option to the holders of participation shares which allows them to receive a part of the distributed profit in the form of new shares. Following different strategies, both mechanisms are viable alternatives in terms of their practical application. Specifically, these mechanisms have the potential to reduce the differences which, in terms of the complexity inherent in valuing them, may exist between the participation shares of the savings bank and the ordinary shares of a public limited company.

Appendix I. Recent issues of participation shares and actions within the framework of the FROB

Caja de Ahorros del Mediterráneo (CAM) was the first institution to make a public rights offering of participation shares. In July 2008, it issued 50 million worth of participation shares, representing 7.5% of the savings bank's equity. The issue price of the shares was 5.84 euros, of which two euros corresponded to the participation fund, 1.56 euros to the reserve fund of holders of participation shares and 2.28 euros to the company's general reserves. 69% of this offer was placed among retail investors.

The remuneration policy agreed by this company for the participation shares means that the dividend remuneration (cash remuneration) for the holders of participation shares accounts for a greater percentage (calculated on the unrestricted available surplus corresponding to the participation shares) than that allocated to charity-social work. Accordingly, the percentage of the holdings of the holders of participation shares in CAM's equity, following distribution of the 2009 profit, fell to 6.94%, as a result of the dilution effect analysed in sections three and four herein.

Subsequently, in the framework of the current crisis, the Government approved the creation of the Fund for Orderly Banking Restructuring (FROB) through Royal Decree-Law 9/2009, of 26 June, on Bank Restructuring and Reinforcement of the Equity of Credit Institutions (modified by Royal Decree-Law 6/2010 and Royal Decree-Law 11/2010, and recently by Royal Decree-Law 2/2011).

The creation of the FROB meant modifying Section 7 of Act 13/1985 which regulates participation shares so as to allow the FROB to provide savings banks with equity in the restructuring process similar to a share acquisition in the case of a bank. For these purposes, the 5% limit for one investor holding participation shares is withdrawn and the participation shares that the FROB may acquire are granted voting rights and are not transferable to third parties (they will have the right to representation in the General Assembly based on the percentage of the issuing savings bank's equity represented by the acquired participation shares). In addition, some procedures are simplified for participation shares issued for exclusive acquisition by the FROB (for example, the pre-emption right is cancelled) and it is no longer mandatory for the participation shares to be listed on an organised secondary market when held by the FROB. This modification in the regulation of participation shares also includes that, in exceptionally serious cases for the issuing entity, the limit of 50% of participation shares in circulation with regard to the entity's equity may be exceeded.

The FROB may also acquire preferred shares convertible into participation shares to strengthen the equity of savings banks involved in integration processes and which do not have viability problems. In the event of converting the preferred shares into participation shares, the latter will be subject to the same characteristics as referred to in the paragraph above. The initial conversion period is five years which may be extended by two further years, although the FROB may request their conversion at any time if the Bank of Spain considers that, in light of the issuer's financial situation, it is not likely that the buyback of preferred shares could be carried out at the end of the five year period.

Following the Bank of Spain's intervention in Cajasur in May 2010, in June the FROB subscribed participation shares in that entity for €800 million, as the savings bank had insufficient equity. The participation shares were issued at par, that is, at their nominal value, as there was no issue premium since the savings bank had negative economic value and equity. The participation of the FROB as a holder of participation shares in the unrestricted available surplus of the savings bank is 100%, the same representation percentage which will correspond to the FROB in the General Assembly. The securities are not listed on any organised secondary market.

Other support from the FROB for integration processes includes a subscription of unlisted preferred shares convertible into participation shares. To date, preferred shares convertible into participation shares of the following savings banks established as a result of the merger had been included in the CNMV's book-entry registry:

– Caixa d'Estalvis de Catalunya, Tarragona i Manresa in July 2010, for 1.25 billion euros.

– Caixa D'Estalvis Unió de Caixes de Manlleu, Sabadell i Terrassa (UNNIM), in July 2010, for 380 million euros.

– Caixa de Aforros de Galicia, Vigo, Ourense e Pontevedra, in December 2010, for 1.162 billion euros.

In total, up to the middle of March 2011 the FROB has agreed to provide funds to the Spanish banking system amounting to 11.559 billion euros.

Appendix II. A simple optimal investment model

The main hypotheses of the model used in the quantitative exercises presented in section 4 herein are as follows:

1. The holders of participation shares take their investment decisions based on the discount value of the profit flows distributed by the savings bank. In particular, it is assumed that

   – The planning horizon of the holders of participation shares is infinite,

   – The average discount factor applied by these investors coincides with the average expected return on the participation shares,[9]

2. It is assumed that the voting rights do not affect the investment decision.

3. With regard to the policy for distributing the surplus followed by the savings bank, it is assumed that

   – All the economic benefits obtained in a certain year are distributed, provided they are positive, with a maximum term of *n* years. Specifically, it is assumed that in the year the economic profit originates, a fraction of said profit is distributed in the form of dividends, while *n* years later the remaining part is distributed. Meanwhile, this part would be recorded either in the form of reserves (undistributed recognised profits), or in the form of gains or losses which have not been recognised in the accounts. At any event, it is assumed that the profit reinvestment rate is not greater than the discount factor used by the holders of participation shares, which means that the net current value of the undistributed economic profits over the long-term is zero.

   – Once the savings bank selects a surplus distribution policy, this is maintained unchanged over time, i.e., the fraction of the surplus not attributable to the holders of participation shares is divided between social work and equity following a constant distribution pattern and the same principle applies to the part corresponding to the holders of participation shares: the percentage of the allocation of funds between reserves and distribution of dividends, irrespective of the composition of the latter

9 This hypothesis is consistent with an environment commonly used in financial literature in which i) for an individual investor the average return on investment is equal to the marginal return and ii) the investor forms its portfolio by equalling the marginal returns on all their investments in such a way that the opportunity cost on the margin is the same in all its investments.

(cash versus new participation shares in the cases in which this possibility is explored) is constant over time.

4. Based on available historical information, the following numerical values have been assigned to the model's main parameters:

   – The average value of return on equity has been set at 12.3% per year, which corresponds to the average observed for Spanish savings banks as a whole over the period from 1992 to 2009. The volatility of this variable has been estimated, in accordance with its typical range over the same period, at 65.6%. In addition, it is assumed that the disturbances which affect this variable are white noise and follow a normal distribution.

   – The average value of the difference between the economic profit and the accounting profit has been calibrated based on information corresponding to the sample of banks listed on the General Index of the Madrid Stock Exchange (Spanish acronym: IGBM) over the period from 1992 to 2009, with this figure reaching a difference of 13.7% of the economic profit.[10] The volatility of this value has been estimated based on its typical deviation (according to quarterly data) over the period from 1992 to 2009, and stands at 93.4%. However, in order to be able to incorporate a higher number of observations in which the economic profit falls below the accounting profit (something which is more feasible in a period of recession, such as the current one) which would arise from the hypothesis of normality with white noise in the disturbances (as is maintained herein), it has been considered appropriate to increase said volatility up to 120%.

   – The average percentage of profits allocated to social work has been set at 25%, in accordance with the average percentage of the main savings banks between 2003 and 2009.

   – The percentage of the surplus attributable to the holders of participation shares distributed in the form of dividends is set at 50%, bearing in mind the average payout ratio over the period from 1992 to 2009 of the distributions of dividends charged to the results of the banks listed on the IGBM, weighted by their capitalisation, was 51.4% while Article 9 of Royal Decree 302/2004 establishes that the maximum value applicable to participation shares is 50%.

These last two variables, in accordance with the above hypotheses of an unchanging policy for distributing the surplus, have been modelled as constant parameters. Finally, it has been set that $n = 5$.[11]

10 The average economic profit (which includes the unrealised profit/loss not included in the accounting profit/loss for the year) in this period is estimated based on the average of the market capitalisation of the banks listed on the IGBM multiplied by the average of a return adjusted for risk in said period (8.2%). This last variable has been approximated by means of the inverse of the PER of the listed banks.

11 This parameter does not have a clear reflection in reality and therefore its calibration is arbitrary.

Appendix III. Elimination of the distribution bias by means of adjustments in the rule for distributing the surplus

The following two steps procedure illustrates how an adjustment to the rule for distributing the surplus contained in expression (2) could be implemented using market information and simple calculations:

Step 1: Calculate the market value of the participation shares and the savings bank's equity

The market value of the participation shares, including the reserves of the holders of participation shares at the start of the period *t* (before generating and distributing the profit for that period), denoted by CP^m_t, can be written as

$$CP_t^m = CP_{t-1}^m + \left(1 - x_{t-1}^{CP}\right) s_{t-1} \pi_{t-1}^e \quad (5),$$

where p^e_{t-1} is the economic profit (which also includes the unrealised results) obtained during the period *t*-1 and x_{t-1}^{CP} is the pay-out ratio applied to the holders of participation shares over that period. Accordingly, the above equation (5) establishes that the increase in the *market value* of the participation shares between any two dates, *t-1* and *t*, can be expressed as the part of the economic profit obtained in that period attributable to the holders of participation shares based on their economic interest in the savings bank at the start of the period, and not distributed at the end of the period, which corresponds to the term $\left(1-x_{t-1}^{CP}\right)s_{t-1}\pi_{t-1}^e$ in equation (5). Similarly, the development of the fundamental value or market value of the savings bank's equity, PAT_t^m, can be expressed according to the following equation,

$$PAT_t^m = PAT_{t-1}^m + \left(1 - x_{t-1}^{PAT}\right)\left(1 - s_{t-1}\right) \pi_{t-1}^e \quad (6),$$

where x_{t-1}^{PAT} is the part of the surplus attributable to the savings bank's equity which is used for charity-social work in period *t*-1.

Finally, the savings bank's total market value, denoted by VT_t^m, which is defined as the sum of CP_t^m and PAT_t^m of the economic value of the participation shares and the savings bank's equity, can be obtained by summing the above expressions (5) and (6):

$$VT_t^m = VT_{t-1}^m + [\left(1 - x_{t-1}^{CP}\right) s_{t-1} + \left(1 - x_{t-1}^{PAT}\right)\left(1 - s_{t-1}\right)]\pi_{t-1}^e \quad (7).$$

Step 2: Adjustments in the rules for determining the interests of the holders of participation shares

Combining expressions (5)-(7), we can directly obtain the following version of the rule for setting the proportion of the unrestricted available surplus assigned to the holders of participation shares, contained in expression (1), based on market values, instead of accounting values,

$$s_t = \frac{CP_t^m}{VT_t^m} = \frac{CP_{t-1}^m + \left(1 - x_{t-1}^{CP}\right) s_{t-1} \pi_{t-1}^e}{VT_{t-1}^m + [\left(1 - x_{t-1}^{CP}\right) s_{t-1} + \left(1 - x_{t-1}^{PAT}\right)\left(1 - s_{t-1}\right)] \pi_{t-1}^e} \quad (8).$$

This expression is simply a formalised development of expression (2). Implementation of this modified rule, however, is not direct, as it depends on the economic profits obtained in the preceding period, π_{t-1}^e, which is not a variable that can always be directly and simply identified. In order to counteract this problem, it is useful to express the economic profit as a function of other variables which are more easily observable. In particular, bearing in mind that the economic profit of a company over a certain period is equal to the sum of the increase in the market value of that company over the period plus the distributed dividends, π_{t-1}^e can be expressed as

$$\pi_{t-1}^e = VT_t^m - VT_{t-1}^m + DIVT_{t-1} \quad (9).,$$

where $DIVT_{t-1}$ are the total dividends distributed by the savings bank, including the cash remuneration to the holders of participation shares and the allocation to charity-social work. Next, using the definition $s_t = {CP_t^m}/{VT_t^m}$ in expression (9), it is possible to express the economic profit for the previous period as

$$\pi_{t-1}^e = s_t CP_t^m - s_{t-1} CP_{t-1}^m + DIVT_{t-1} \quad (10).$$

This last expression has the advantage of showing π_{t-1}^e as a function of information which is theoretically directly accessible by the savings bank's managers as well as by external investors. On the one hand, both the dividends and the weight of the participation shares in the distribution of the surplus in the last period, $DIVT_{t-1}$ and s_{t-1}, respectively, are historic public information and, therefore, are available at the time of calculating s_t. The other important factor is the market value of the total stock of participation shares at the start of the two last periods (before distributing dividends for the corresponding period), CP_t^m and CP_{t-1}^m, which should be directly observable.

Accordingly, combining equations (8) and (10) we can obtain the value of the proportion s_t which corrects the distribution bias by making calculations based on market economic values using a relatively simple calculation methodology which only uses information that will normally be available when determining said proportion.

Competition between regulated markets and multilateral trading systems within the framework of the MiFID

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1 Introduction

Directive 2004/39/EC, known as the MiFID Directive (Markets in Financial Instruments Directive), established a new framework for competition between the different European trading systems by including within its scope not only traditional markets, now referred to as regulated markets, but also other trading platforms such as multilateral trading facilities (MTFs) and systematic internalisers. Similarly, in accordance with the wide range of trading systems considered, the MiFID obliges intermediaries to apply the principle of best execution, according to which orders must be executed under the most favourable conditions for the investor. This double pronouncement (recognition of a range of trading infrastructures and the principle of best execution) is the cornerstone on which the current regulatory framework for European trading infrastructures lies.

Since the MiFID entered into force on 1 November 2007, several MTFs have been established in Europe, achieving a significant market share. Specifically, at the end of 2010 there were 138 MTFs registered in the database of the Committee of European Securities Regulators (CESR), which from January 2011 was substituted by the European Securities and Markets Authority (ESMA), and their volume of trading accounts for around 20% of total trading in Europe.

In this context, this article has a two-fold aim. Firstly, we analyse the situation in Europe of the different spot share trading platforms following the entry into force of the MiFID, comparing their importance in terms of traded volume. Secondly, after highlighting the many reactions of the regulated markets and the corporate movements which have occurred between said platforms, we analyse the perspective for the future of these infrastructures, which may be partly determined by the review of the MiFID, which is due to begin in the first half of 2011 and which will possibly incorporate new measures aimed at improving transparency and at creating more standardised rules of play for all platforms.

The second section of this article shows the most important aspects of the MiFID with regard to spot share trading processes. The third section describes the current situation; firstly detailing the main MTFs established in Europe and the activity which they carry on and, secondly, the impact on regulated markets and the reactions of related markets to growing competition. The fourth section analyses the latest recommendations which CESR published about the review of the MiFID with regard to securities markets. Finally, the fifth section presents some brief conclusions.

2 The regulatory framework: the MiFID

Implementation both of the MiFID and the level 2 directive which implements it (Directive 2006/73/EC, implementing Directive 2004/39) has introduced a substantial change in the processes for trading financial instruments in Europe.

One of the main changes of the MiFID, which entered into force on 1 November 2007, is the abolition of the "order concentration rule", which still inspired its predecessor, the Investment Services Directive (ISD).[1] Article 14.3 of the ISD conferred on Member States the right to require that trade orders be processed through a regulated market. The principle was based on the idea of concentrating all orders on a security in a single market so as to ensure a fair transaction for all investors operating at the same time, with one single price. However, it should be pointed out that the ISD provided certain flexibility to the concentration rule given that Article 14.4 indicates that the States must grant investors that are resident or established in that Member State the right not to comply with it. This flexibility led to different approaches in national legislations when transposing the Directive. Accordingly, while the concentration rule was imposed under Spanish, Italian and French legislation, Germany and the United Kingdom allowed certain competition in the different trading services. Until the entry into force of the MiFID, most regulated markets in practice continued to hold clear dominance in collecting orders, with limited competition from alternative trading systems.

The main aim of the MiFID was to create a single efficient financial market in Europe by establishing a new competition environment and equal conditions for the different secondary trading markets. Accordingly, the Directive aims to eliminate any type of exclusivity or privilege in trading, recognising the existence of a range of order execution venues. In particular, the Spanish legislation which transposes the MiFID (Act 47/2007, of 19 December, amending Act 24/1988, of 28 July, on the Securities Market) indicates that the final aim of this Directive is to increase options for investors, encourage innovation, lower transaction costs and improve the efficiency of the price formation process throughout Europe.

The MiFID regulates three types of trading system for financial instruments: regulated markets, multilateral trading facilities and systematic internalisers. The Directive defines these trading infrastructures as follows:

– **Regulated market:** multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions in a regular manner.

– **Multilateral trading facility**: multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments - in the system and in accordance with non-discretionary rules - in a way that results in a contract.

1 Directive 93/22/EEC of the Council, of 10 May 1993, on investment services in the securities field.

– **Systematic internaliser**: investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside a regulated market or an MTF.

At any event, regulated markets continue, in practice, to be the benchmark for other trading systems as they have greater transparency and a more verified price setting process. Accordingly, for example, practically only regulated markets perform opening and closing auctions, while other trading systems use the prices and volumes set in regulated markets as a reference. Similarly, when a security is suspended or excluded from an official market, in accordance with the MiFID, it is automatically suspended or excluded from any MTF or systematic internaliser.

The application of the best execution requirement, contained in the MiFID for investment funds which execute orders on the account of their clients, also encourages greater competition between the different trading systems throughout Europe. In accordance with the aforementioned requirement, the Directive establishes that orders must be executed in the most favourable terms for clients, bearing in mind, in addition to the execution price, other factors such as costs (including clearing and settlement costs), speed and the likelihood of execution and settlement. This multi-dimensional approach with regard to the factors guiding the execution policy of European investment firms encourages regulated markets to compete among themselves and with the MTF and systematic internalisers through the different elements which determine the quality of their service. However, it should be pointed out that this approach differs substantially from that adopted in the United States, where the results to be taken into account when applying the best execution requirement are only based on price and the obligation to ensure it is complied with corresponds to the trading systems themselves (for further details on regulation, see SEC, 2005).[2]

In order to comply with the best execution requirement, European investment firms need to be truly connected to multiple platforms with detailed information on both price and volume and on other market factors (trading and clearing fees and even the different taxes existing under each legislation). This smart order routing ensures efficiency in executing the order despite the existence of fragmented markets.

In order to counteract the negative effects of liquidity fragmentation, which may affect the efficiency of price formation, in addition to the requirement for best execution policies from investment firms, the Directive provides other corrective mechanisms with regard to information, such as establishing transparency requirements (pre-trade and post-trade), setting transaction reporting requirements and the need to consolidate information.

It is important to bear in mind that the entry into force of the MiFID has not only led to decentralisation in the field of trading, so as to eliminate the monopolies of traditional markets in this area, but also the decentralisation of the information associated with trading, which was previously concentrated in said markets. Accord-

2 Securities and Exchange Commission (2005), "Regulation National Market System, Reg NMS", release No. 34-51808, April 2005.

ingly, since the implementation of the MiFID, investment firms which trade on an OTC market decide where they publish both pre-trade and post-trade information. In this regard, in February 2007, CESR issued a set of guidelines and recommendations aimed at information consolidation (CESR, 2007).[3] Basically, these guidelines and recommendations aim to ensure that the information provided by the different resources is reliable and comparable with formats which allow consolidation and which are accessible at a reasonable cost. This document also details pre-trade and post-trade transparency.

3 The current situation

3.1 The growth of MTFs

Since the entry into force of the MiFID, numerous MTFs have been established in Europe. Initially, the MTFs were promoted by large investment banks so as to compete with regulated markets. However, as indicated later on, these same markets are currently creating their own alternative platforms to strengthen their competitive position.

The MTFs which have achieved greatest trading volume include the following three, which are characterised by the Europewide scope of their activity and the volume achieved:

– **Chi-X**: Created in March 2007 by Instinet, a subsidiary of Nomura Holdings. It currently belongs to a consortium of financial institutions, which include BNP Paribas, Citadel, Citigroup and Crédit Suisse. Instinet is also the parent company of Chi-X Global, a holding company of platforms which compete with different stock markets worldwide: Chi-X Canada, Chi-X Japan, Chi-Tech and Chi-East. It also aims to launch Chi-X Australia in 2011.

  In August 2010, Chi-X announced the possibility of selling all or a part of its business after receiving an offer from a third party, although to date no agreement has been closed regarding its possible acquisition.

– **BATS Europe**: Began to trade on 31 October 2008 and belongs to the BATS Global Markets group, which is one of the main securities markets in the United States.

– **Turquoise**: Started up on 18 August 2008 and owned by the investment banks Citigroup, Bank of America, Merril Lynch, Goldman Sachs and Morgan Stanley, among others. In February 2010, the London Stock Exchange Group (LSEG) acquired a majority share in Turquoise through the merger with Baikal, a Europewide MTF belonging to LSEG which specialises in dark pools.

3 CESR (2007), *Publication and consolidation of MiFID market transparency data. Level 3 CESR's guidelines and recommendations for the consistent implementation of the Directive 2004/39/EC and the European Commission's Regulation No 1287/2006*, ref. CESR/07-043, February 2007. Available at: http://www.esma.europa.eu/popup2.php?id=4228

Unlike these three platforms, which compete Europewide, other MTFs have aimed to establish themselves within a regional framework. The following two are especially noteworthy: Burgundy and Tradegate. The former was created in the middle of 2009 by several investment banks and other financial institutions from Scandinavian countries, and operates basically in this area. Tradegate was created in Germany in 1999 to operate on the Berlin and Frankfurt stock markets. It became an MTF in 2007 following the entry into force of the MiFID Directive. In December 2009, Deutsche Börse acquired 75% of its capital and a few months later modified the platform's status, converting it into a regulated market, as defined in the Directive, under the name Tradegate Exchange.

Finally, and as detailed below, another two MTFs were created by regulated markets which already existed in Europe, although they have developed differently. NYSE Euronext launched the NYSE Arca Europe MTF in March 2009 so as to extend Euronext's activity to more liquid securities Europewide. NASDAQ OMX created NASDAQ OMX Europe (NEURO) in September 2008 to provide a trading platform for the most active securities on European stock markets. However, this platform was closed in the middle of 2010 as it did not reach a sufficiently high trading volume.

Due to the current importance of the location of the IT systems of trading platforms, the most important MTFs, including Chi-X, BATS Europe and Turquoise, are located in London and surrounding areas as the city houses the most important financial centre in Europe.[4] However, NYSE Arca Europe and Burgundy, whose focus is more regional, as indicated above, are located in Paris and Stockholm.

Figure 1 shows the distribution of total trading in Europe between regulated markets and MTFs. In both cases, trading is broken down into the part included in the order book (RM-Book[5] and MTF-Book) and trading outside the order book (RM-Off- Book and MTF-Off-Book).[6] The figure shows that MTFs have undergone significant growth in their share of total European trading, from practically nothing at the beginning of 2008 to around 20% in 2010. With regard to the type of trad-

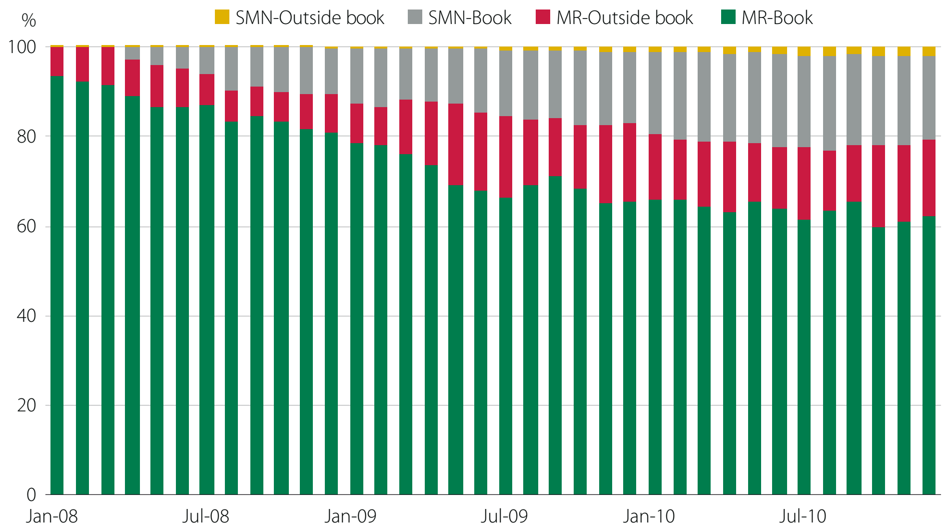
4 As indicated in González Pueyo (2010, *Proceso de consolidación de las infraestructuras de mercado* [Consolidation process of marketing structures], CNMV, Working Paper No 39), a significant proportion of trading on platforms comes from high frequency trading (HFT). The strategy of this trading is to generate trades automatically according to market prices and orders, searching for market opportunities. These operations require stock markets to have a trading system which makes it possible to cross borders quickly to the point of influencing the location of the stock market itself. A paper published by Aite Group suggests that in 2009, 25% of trading in the United Kingdom came from high frequency trading and estimates that, in 2012, this activity will account for 45% of the total. High frequency trading is also significant in the Spanish market. This is shown by the BME in response to a consultation from the CESR regarding this issue (CESR 10-142), which indicates that this activity accounts for between 25% and 30% of the volume traded on BME. In the USA, where high frequency trading has taken place for a longer time than in Europe, this activity accounts for 50% of total trading according to calculations by the SEC.

5 RM-Book includes opening and closing auctions, which in practice are only carried out by regulated markets. The weight of these auctions in the trading of regulated markets is significant. According to data from Bloomberg, in January 2011, trading from opening or closing auctions as an average percentage of total daily trading on regulated markets accounted for 20% for the British FTSE and the French ICAC, 16% for the German DAX and 24% for the Spanish Ibex.

6 Trades outside the book include OTC trades reported under the rules of a regulated market or an MTF and trades generated by a dark pool which functions as an MTF.

ing, we can highlight the growing importance of trading outside the order book,[7] especially in regulated markets, where it accounted for 17% of the total at year-end 2010.

Distribution of European trading according to platform type and type of trading order FIGURE 1



Source: Reuters.

By market, most trading of European MTFs is concentrated in Chi-X, Turquoise and BATS. Specifically, at the end of 2010 these three MTFs accounted for 19.4% of the total traded in Europe, compared with 20.8% for MTFs as a whole. As indicated above, these three platforms trade with shares admitted to trading on the regulated markets of various European countries. As shown in Table 1, around one third of the trading by these MTFs in December 2010 corresponded to shares whose main market was in the United Kingdom. With regard to the other three MTFs shown in Table 1, trading of NYSE Arca Europe is fairly evenly spread between shares of the United Kingdom, Germany and Switzerland, while Burgundy and Tradegate concentrate their activity in Sweden and in Germany respectively.

In Spain, however, the impact of MTFs has been very low to date mainly because of the particular nature of the Spanish settlement and registration system (see, for example, González Pueyo, *op. cit.*). However, the modification of Iberclear's Regulation through Order EHA/2054/2010, of 26 May, involves a significant change in some of the system's idiosyncratic aspects. On the one hand, the new regulation allows direct settlement for security transactions without the need to formalise them as a trade on stock markets and, on the other hand, it allows Iberclear to extend the activities performed through links with other central securities depositories. In addition, the pending reform project of the Spanish securities, clearing,

7 The rise in high frequency trading has led to a considerable fall in the average cash per transaction executed (according to data from Sociedad de Bolsas, in the Spanish market this figure fell by 47.6% between 2006 and 2010). This fall has in part led to the move to trading outside the order book by investors which want to trade a high volume, as the impact on the market is lower.

settlement and registration system provides the establishment, as a minimum, of a central counterparty (CC) and the management of its risks, and also introduces significant amendments to transaction finality and registration. The changes of this reform are expected to be put into practice no later than the entry into operation of Target2-Securities (T2S), which is expected to be completed in September 2015. It is expected that with these changes, the amendment of the Regulation and the reform project, the volume traded on MTFs in Spain will grow over the coming years.

Breakdown of the trading of the main MTFs by country. December 2010 TABLE 1

%	Chi-X	BATS Europe	Turquoise	NYSE Arca Europe	Burgundy	Tradegate
UK	30.8	33.3	34.3	35.6	4.8	2.7
France	18.6	11.4	19.5	–	–	6.0
Germany	17.2	16.0	14.9	26.9	–	84.3
Switzerland	9.1	12.5	9.0	23.9	5.8	1.0
Italy	5.8	8.5	5.3	3.4	–	0.2
Sweden	4.8	5.3	4.3	5.1	76.1	0.1
Other	13.7	13.1	12.7	5.0	13.3	5.8
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

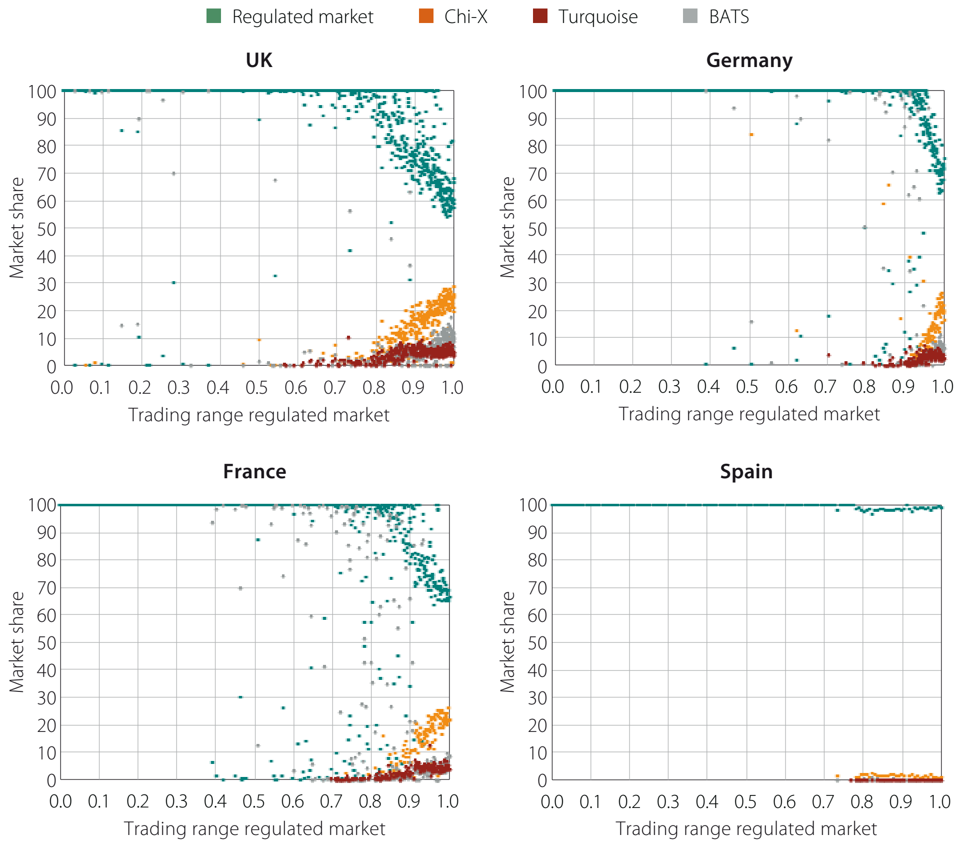
Source: CNMV with data from Reuters.
NB: Includes all types of MTF operations.

Figure 2 shows that the trading activities of the main European MTFs in securities admitted to trading on regulated markets is specifically concentrated on those which generate the greatest trading volume within regulated markets. Specifically, the different panels of the figure make it possible to compare the shares of trading of the three main European MTFs and the regulated markets in the United Kingdom, Germany, France and Spain for the different securities admitted to trading on the benchmark regulated market at the end of 2010. These values have been ordered based on their importance within total trading of the regulated market, from lesser to greater, taking as a reference the average trading of the four quarters of 2010. As can be seen, the shares of trading of the three MTFs considered in the last quarter of 2010 tended to increase with the position of the securities in the trading ranking, with this gain in share accelerating considerably for securities located in the highest positions of the ranking, where the shares of trading already reach clearly significant levels.

If the preference of the MTFs for securities with greatest trading in the benchmark regulated market is clear, we have recently seen a certain increase in the trading activity of these platforms in other listed securities. As shown in figure 2, at the end of 2010, the MTFs traded securities positioned within the 70% with the lowest trading in the corresponding regulated market for several European countries, while in the second quarter of 2010, MTFs hardly traded these securities at all.

Distribution of the share of trading of platforms according to the importance of each security in the trading of the regulated market[1]

FIGURE 2



Source: CNMV with data from Bloomberg.

1 Share of trading (vertical axis): for each platform including regulated market, percentage of total trading (regulated market + Chi-X + Turquoise + BATS) corresponding to the platform during the last quarter of 2010 for a specific security.
Trading range in the regulated market (horizontal axis): for each security, position in a set formed by the securities traded on the regulated market and ordered from lower to higher based on the trading volume (for example, zero corresponds to the security with lowest trading, 0.25 corresponds to the security positioned at the first quarter, 0.5 to the median value and 1 to the security with greatest trading volume). In order to determine the position of the securities, the average trading of the four quarters of 2010 is taken as a reference. It only takes into account listed securities on the regulated market at the close of 2010.

3.2 The reaction of regulated markets

Since the entry into force of the MiFID at the end of 2007, the governing bodies of the regulated markets have undergone a contraction of income from equity trading (see Table 2). This fall is partly due to the reduction in activity as a result of the crisis, and partly due to the reduction in the market share and the tightening of margins as a result of competition from MTFs.

Breakdown of the income of governing bodies of the main European markets

TABLE 2

% of total	2006	2007	2008	2009
LSEG[1]				
Capital markets	67.6	63.3	50.9	45.7
Primary	18.1	15.1	10.3	11.0
Secondary	46.9	48.4	35.1	29.0
of which, equity	n.a.	n.a.	27.4	21.2
of which, of the United Kingdom	n.a.	n.a.	23.3	16.2
of which, of Italy	n.a.	n.a.	4.2	5.0
Post-trade	0.0	8.4	16.7	18.5
Information and technology	30.3	26.7	30.9	34.5
Other	2.1	1.6	1.5	1.3
Total	**100.0**	**100.0**	**100.0**	**100.0**
Total (million pounds)	**349.6**	**546.4**	**671.4**	**628.3**
Deutsche Börse				
Xetra Platform	15.7	18.0	14.8	11.6
of which, equity trading	10.2	10.5	8.2	6.1
Derivatives (Eurex, which includes trading and clearing)	29.8	29.5	37.5	37.2
Post-trade (Clearstream)	34.9	31.8	28.6	33.4
Information and technology	12.1	11.1	10.3	13.2
Other	7.5	9.6	8.8	4.5
Total	**100.0**	**100.0**	**100.0**	**100.0**
Total (million euros)	**2,004.9**	**2,416.0**	**2,691.9**	**2,159.1**
NYSE Euronext[2]				
Equity trading		40.0	50.8	47.0
of which, of Europe (through Euronext)		10.4	13.4	7.4
Derivatives (trading and clearing)		16.8	19.5	18.4
Admission to trading		9.8	8.4	8.7
Information and technology		11.9	12.5	12.9
Other		21.5	8.8	13.1
Total		**100.0**	**100.0**	**100.0**
Total (million dollars)		**3,938.0**	**4,703.0**	**4,687.0**
BME				
Equity	45.5	46.0	42.9	41.0
Fixed-income	2.2	2.0	1.8	2.0
Derivatives	8.3	7.0	8.2	8.0
Admission to trading	8.9	8.0	8.1	9.0
Post-trade	21.5	24.0	23.6	23.0
Information	9.3	9.0	10.8	11.0
Consulting & IT	4.2	4.0	4.6	6.0
Total	**100.0**	**100.0**	**100.0**	**100.0**
Total (million euros)	**287.7**	**383.1**	**352.9**	**316.7**

Source: FESE (Federation of European Securities Exchanges).

n.a.: Not available.

1. Annual data from April of the reference year to March of the following year. From 2007, the group includes both the London Stock exchange and the Borsa Italiana.
2. No data is given for 2006 as this was prior to the merger between NYSE and Euronext. 2007 income includes that of NYSE for the whole year and that of Euronext from 4 April 2007 following the merger of the two governing bodies.

The contraction in income for equity trading has been unevenly spread over the different regulated markets. Accordingly, the LSEG group saw a 27.5% fall in income between March 2008 and March 2009, mainly due to the 34.8% fall in income for trading in the United Kingdom. The governing body of the German market, Deutsche Börse recorded 40.2% less income in 2009 compared with the previous year, a similar fall to that seen for income from trading in the European market of the NYSE Euronext in the same year, 44.6%. Income for the BME group from equity trading suffered a smaller fall: 14.2% between 2008 in 2009, and 26.3% between 2008 and 2010. BME, compared with the aforementioned regulated markets, has seen very little competition from MTFs over recent years and, therefore, the fall in its income basically reflects the fall in stock market activity.

It is important to bear in mind, however, that income for equity trading has an unequal weight among the different regulated markets. Accordingly, although Deutsche Börse and the European business of NYSE Euronext suffered the most significant fall in said income, the governing bodies of these markets are also those which least depend on this activity. As shown in Table 2, their income is well diversified among different services and, in the case of NYSE Euronext, also among geographical areas.[8] In 2009, income for equity trading in Europe accounted for around 7% of total income both for Deutsche Börse and for NYSE Euronext. For its part, income for trading of financial assets (not only equity) for the LSEG group accounted for 47% of the total in 2006, just before the merger with Borsa Italiana. This percentage fell in the following years to stand at 29% in 2009, with a specific contribution of equity traded in the United Kingdom of 16.2%. Compared with the aforementioned groups, the income of BME is more closely linked to equity trading, as it accounts for a little over 40% of the group's total income.

The governing bodies of the regulated markets have reacted in different ways to the growing competition in the area of trading infrastructures. The most important initiatives adopted by these bodies are given below.

Mergers between regulated markets

Over recent months there has been a significant intensification of contacts and negotiations aimed at possible mergers between regulated markets. These movements have been largely caused by the increase in competition with MTFs. By means of mergers, regulated markets aim to achieve an appropriate size to successfully compete both with MTFs and other regulated markets.

At the start of February 2011, the negotiations aimed at the merger between LSEG and the Toronto stock exchange (grupo TMX) were made public, and the negotiations between NYSE Euronext and Deutsche Börse were at a very advanced stage. If these mergers were to take place, we would see greater pressure for other regulated markets to also undergo merger processes.

The two possible aforementioned mergers have three clear characteristics in common. Firstly, their main actors (LSEG, NYSE Euronext and Deutsche Börse) are

8 It should be pointed out that in the case of NYSE Euronext, income for equity trading from the USA accounted for 40% of the group's total income in 2009, compared with 30% in 2007.

groups with a great weight in trading equity and other financial instruments worldwide. Therefore these mergers, if they were to take place, would give them a significant lead in the share of trading compared with other markets. Secondly, in both cases the mergers extend beyond Europe, confirming the trend towards global concentration. Thirdly, the possible advantages of the merger (the economies of scale and scope and income diversification) do not come exclusively from equity trading, but also from other areas which include trading in derivatives and other financial products, post-trade processes, information and technology.

Acquisition of competitor MTFs

In addition to the obvious purpose of reducing the number of competitors, this type of operation can also have other aims, such as accessing more sophisticated technology, used by the MTF, and extending the type of assets traded and the markets reached, as well as recovering the trading which the investment banks owning the MTF in question channel through it.

There are two relatively recent operations, which are mentioned above, which serve as examples of this strategy in Europe. In February 2010, LSEG acquired the majority of shares in Turquoise to create a new Europewide trading platform through the merger of the businesses of Turquoise and Baikal Global Limited, a subsidiary of LSEG which operated a dark pool. The new platform, which keeps the name of Turquoise, aims to expand LSEG's services throughout Europe, both in the segment of trading with a pre-trade transparency and in the field of dark pools. The second operation took place in 2009, when Deutsche Börse acquired the capital of the Tradegate multilateral trading facility, which it transformed into a regulated market at the start of 2010. This acquisition was carried out in order to strengthen and expand, throughout Europe, Deutsche Börse's offer of services in trading for retail investors in shares, bonds and mutual funds, a segment in which Tradegate specialised.

In December 2010, it was made public that Chi-X may be totally or partially acquired by a regulated market. Both Nasdaq OMX Group, which had just closed its own MTF, and NYSE Euronext, had shown their interest in this MTF. However, in February 2011, the media declared that the likely buyer was BATS, another MTF.

Creation of their own MTF

Several regulated markets have decided to establish an MTF with a two-fold aim: (i) to compete directly with the other MTFs and with other regulated markets, especially in foreign shares listed on other markets throughout Europe, and (ii) to use their own MTF to experiment with new trading technology.

As indicated above, this is the type of strategy followed by Nasdaq OMX following the failure of its NEURO platform in the middle of 2010. This platform had been established to compete in the trading of the most liquid securities in Europe, but it failed because, unlike the main MTFs, NEURO did not have any fixed agreement with liquidity suppliers. Another example of this type of strategy was the creation by Deutsche Börse of the Xetra International MTF in November 2009, in which the most liquid assets in Europe are traded.

Improvement in technology used

To counteract the advantages of technology-based MTFs, some regulated markets have made substantial investments to improve their own trading systems or they have bought companies specialised in such technology.

Specifically, LSEG focused its interest on improving its technology in June 2007 by implementing a new trading system (TradElect). The new technology made it possible to drastically reduce latency, i.e. the time from when an order is launched into the market until its trading system receives it on its trading platform. According to LSEG's 2010 Annual Report, between March 2007 and March 2008, latency fell from 120 ms to 60 ms, and in March 2010 down to 1.4 ms. Despite this improvement, in 2009 LSEG decided to acquire a technology solution provider (MillenniumIT) to substitute TradElect and to sell the new technology to other stock markets. In the middle of 2010, LSEG decided to channel share trading in Turquoise through the new MillenniumIT trading system in order to test the new technology. At the start of 2011, some tests were carried out with the electronic order book of the London Stock Exchange, SETS, and the definitive transfer of this trading took place in the middle of February of this year.

In addition, Nasdaq OMX Group has improved the trading technology which is used by incorporating all its financial products (equity, fixed income, derivatives, commodities and energy contracts) in a single trading system (called Genium INET). For its part, BME has just announced a project to renew the SIBE equity trading system, unifying the trading of shares, ETFs, warrants, certificates and other products in one single system. It is expected to begin operating in the last quarter of 2011.

Searching for new market segments or extending the range of products

Over the last decade, regulated markets have been very active in developing new business strategies, above all focusing on extending their range of products and acquiring other infrastructures within the trading value chain.[9] Since the entry into force of the MiFID, the search has intensified for new initiatives to offset the fall in income from equity trading. The strategies which markets have carried out as a result include the search for new market segments and diversification of income sources.

With regard to the search for new market segments, the major regulated markets have tried to recover part of the market share lost in recent years in equity due to the rise of dark pools. It is usually institutional investors which operate in this type of infrastructure, which trade large on scale orders and want to operate anonymously so as not to cause an adverse market impact on their positions. Regulated markets have used several methods to recover this type of investor.

Accordingly, some regulated markets have acquired or created companies specialised in these trading systems based on dark pools, a strategy which has also been followed by the main MTFs (for example, Chi-X, Turquoise and BATS have their

9 For further details, see González Pueyo (op. cit.).

own dark pools). In particular, LSEG acquired Baikal Global Limited in the middle of 2009, and subsequently merged it with Turquoise, as already indicated above. For its part, in October 2009, Nasdaq OMX Group created NEURO Dark, with the aim of providing access to dark pool trading for shares available on its NEURO MTF (both were subsequently closed, as indicated above).

Following a different line, at the beginning of 2009, NYSE established an MTF which operates and is regulated independently (SmartPool). This platform focuses on executing orders from institutional investors in a manner consistent with the waivers of the MiFID, crossing orders at the midpoint between the best purchase price and the best sales price at that moment.

A third method has been used both by Deutsche Börse and Swiss Exchange, which introduced modifications in their own regulated markets (Xetra MidPoint and Swiss Block, respectively) with the aim of crossing large orders without pre-trade transparency (applying the MiFID waivers), at the midpoint between the best purchase price and the best current sales price in the order book. Both markets started to accept this type of order at the end of 2009. However, while Deutsche Börse allows all the shares listed on its own market to be traded, Swiss Exchange only allows the most important shares. At the end of 2009, Swiss Block began to be operated by SmartPool, although it is still owned by Swiss Exchange.

With regard to diversification strategies, regulated markets have focused on incorporating new financial products and acquiring new investors for existing products (many products are targeted at institutional investors which are also traded among retail investors). This type of initiative has been adopted by markets including BME, which in 2010 announced its intention to extend its range of products so as to considerably diversify its income sources. These changes announced by BME include: (i) The creation of a new electronic fixed income trading system for retail investors (called SEND, which began to operate on 10 May 2010), (ii) the intention to create a platform for subscription and redemption of all types of stock market mutual funds, (iii) the aim to create together with Clearstream (the post-trade infrastructure of Deutsche Börse Group) the first European Central depository for OTC derivative transactions (REGIS-TR) and (iv) the launch of new energy derivative contracts and the establishment of a central counterparty for these products in February 2011.

Modification of fees applied

Faced with growing competition from MTFs, regulated markets have modified the fees applied to investors, not only reducing them but also on some occasions adopting the maker-taker model used by several MTFs.

As the MTFs were applying significantly lower fees than those of regulated markets, the latter have on several occasions reduced the tariffs on equity trading and, in some cases, on post-trading.

As indicated above, several regulated markets have considered changing the system of fees which they apply to investors so as to attract liquidity to the system. Some

MTFs, such as Chi-X, BATS and Turquoise have set up in Europe applying a fee system which is new here but very widespread in the United States. These MTFs use an asymmetrical system in such a way that they charge investors which withdraw liquidity from the system and reimburse those which provide liquidity (maker-taker model). With this system, liquidity increases significantly as many investors decide to send limited orders to the system, acting to some extent as market-makers which provide "artificial" liquidity continuously and in many cases achieving reductions in fees for trading.

Although the main MTFs have applied this fee system, few regulated markets have been able to establish it because of legal problems. Specifically, the competition authorities do not always allow those markets with a dominant position in the market to offer discounts to investors which provide liquidity to the system, thus creating imbalances between the fees applied by the MTFs and those applied by regulated markets. LSE offered this fee system between September 2008 and September 2009, but only to those investors which offered liquidity with a high level of trading. However, LSE decided to abandon the asymmetrical fee system as, according to the institution itself, this system led to the application of higher fees for its most traditional and important clients. SWX Europe also changed from a symmetrical to an asymmetrical price system in April 2008, which is currently in force.

4 Perspectives: The MiFID review

The future of trading systems will be affected both by how the operators of regulated markets and MTFs respond to the challenges of developments in the market and by their adaptation to the changes in the regulatory framework that will be brought about by the MiFID review in 2011.

The factors which may influence the development of the market and condition the future of trading systems include the duration of the current trading period, which is relatively low, and the growing weight of high-frequency trading. With regard to the former, the financial crisis has led to a sharp fall in trading levels compared with the previous period. The long duration of this period of reduced activity is significantly affecting MTFs, as their survival is linked to the need to reach a critical trading level. With regard to high-frequency trading, as mentioned above, this type of activity accounts for around one third of current trading on various European markets and is expected to grow significantly in the coming years.

The reform of the MiFID may significantly affect the future of trading systems. Since it was implemented, this Directive has been subject to some criticism both by the industry and by regulators. CESR assessed the impact of the MiFID for the first time in the first half of 2009 (its conclusions were published in a report in June 2009)[10] and since then it has worked on its review, provided for in the Directive itself. Consequently, in October 2010, CESR published its latest recommendations to

10 CESR/09-355, *Impact of MiFID on equity secondary markets functioning*, June 2009, available at: http://www.esma.europa.eu/popup2.php?id=5771

the European Commission with regard to said review relating to securities markets,[11] based on the comments received following a public consultation carried out in the middle of 2010. For its part, at the end of 2010, the European Commission started up its own public consultation on the modification of the MiFID, which ended at the start of February 2011[12] and which will probably lead to the formal processing of the Directive in spring 2011.

The main proposals in the document presented for consultation by the Commission are as follows:

1. **Pre-trade transparency regime for regulated markets and MTFs.** The Commission document proposes maintaining the pre-trade transparency requirements for regulated markets and MTFs with regard to securities admitted to trading in the former. In addition, it considers that the existence of a regime of waivers to pre-trade transparency, such as the current one, is justified and proposes maintaining the thresholds which are currently used to define 'large in scale' orders, unless the studies being performed conclude that they should be modified. However, the Commission believes that practical implementation of waivers should be clarified so as to allow their reasonable and consistent use. Similarly, the Commission proposes granting powers to ESMA to carry out regular reviews of the use of waivers, as well as to publish binding technical standards with regard to this practice. Furthermore, in line with other measures to achieve greater alignment of the regulation applied to regulated markets and MTFs, the Commission document presents for consideration the possibility of extending the pre-trade transparency regime to the securities admitted to trading exclusively on the latter.

2. **Post-trade transparency regime.** The Commission suggests that new measures should be introduced to improve the quality of the information, shorten delays in reporting and reduce the complexity of the current regime, in line with the proposal specified in a joint paper by CESR and the industry, published in October 2010.[13] In particular, the Commission presents for consideration several proposals with regard to the deadline for reporting for the different types of transactions, which in any case should be lower than the current time.

3. **Regulatory framework for post-trade transparency consolidation.** The Commission considers that in order to achieve efficient price formation and facilitate compliance with best execution, the information on the transactions published in the different sources must be reliable and that investors must be able to compare the prices of the different platforms easily and at a reasonable cost. In accordance with this point of view, the Commission con-

11 CESR/10-975, *CESR Technical Advice to the European Commission in the Context of the MiFID Review: Equity Markets*, October 2010. Available at: http://www.esma.europa.eu/popup2.php?id=7284

12 European Commission, Public Consultation. *Review of the Markets in Financial Instruments Directive (MiFID)*, December 2010. Available at: http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf

13 CESR/10-882, *CESR Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets: Post-trade transparency standards*, October 2010. Available at: http://www.esma.europa.eu/popup2.php?id=7282.

sults on several options with regard to improving the quality and consistency of post-trade transparency reporting, possible ways to improve investor access to information and to reduce its cost, and the possibility of establishing a consolidated tape. With regard to the consolidated tape, the Commission puts forward three options: a system operated by a non-profit-seeking entity, established and appointed by a legal act (similar to the model used in the United States), a system operated by a single entity appointed following a public tender on the merit of its bid, or a system with multiple authorised entities which meets a series of conditions which will have to be incorporated in the MiFID.

4. **Alignment of the regulation of regulated markets and MTFs.** Several regulated markets have expressed their concern that the competition with MTFs is not fair as the former are subject to stricter and more costly regulatory requirements than MTFs.[14] In its consultation document, the European Commission reflects this concern and recognises the existence of some inconsistencies in the MiFID, requesting the opinion of the market with regard to possible changes which would lead to an alignment of the organisational requirements applicable to regulated markets and MTFs and the strengthening of oversight requirements for the managers of both types of platforms.

5. **Regime for systematic internalisers.** This article makes scant reference to the role of systematic internalisers following implementation of the MiFID because of their limited number and weight in traded volumes compared with regulated markets and MTFs. However, it should be pointed out that the Commission presents for consultation the possibility of modifying their regime. Accordingly, with regard to the definition of this type of platform, it recommends clarifying the criteria which define as internalisers investment firms which trade "on an organised, frequent and systematic basis". Similarly, it presents for consideration the possibility of softening some obligations for systematic internalisers and improving the value of the information which they provide to the market.

6. **Extension of the MiFID to other trading platforms.** The Commission requests opinions on extending the regulatory scope of the MiFID to a new type of trading platform (organised trading facility), which will be added to the three which currently exist (regulated markets, MTFs and systematic internalisers). Specifically, this new type of platform would include any system operated by an investment firm or by a market operator that on an organised basis brings together buying and selling interests or orders relating to financial instruments, irrespective of whether the trade is bilateral/multilateral or discretionary/non-discretionary. Examples of organised trading facilities would include crossing systems within investment firms, as well as any type of dark pool.

14 An example of the inequalities would be the greater capital requirements for regulated markets compared with those for investment firms which operate the MTFs. Another example is the fact that, while a regulated market has to wait 18 months from the admission of a share in another regulated market so as to trade it on its own market, MTFs may trade it immediately. Another example of the uneven treatment is the fact that some Member States impose additional requirements on regulated markets to those established in the MiFID, which the Directive itself allows.

5 Conclusions

The MiFID has substantially modified the competitive environment of the spot market for shares. Furthermore, the recent changes in this market have intensified with the technological advances of recent years. Specifically, the rise of high-frequency trading has been a challenge for trading platforms, as the speed of order execution has become a highly competitive element in the equity market.

Two noteworthy trends can be seen in stock markets coinciding with the entry into force of the MiFID. Firstly, trading outside the order book (both OTC trades and dark pools) has grown over recent years, especially within regulated markets. Secondly, MTFs are significantly and constantly attracting a greater trading volume throughout Europe. This volume has grown from practically zero at the beginning of 2008 to over 20% of total trading at the end of 2010, almost all of which is concentrated in three of the registered MTFs: Chi-X, BATS and Turquoise. The expansion of MTFs is taking place in several countries and is focused on shares with a high trading volume, although in the last few months of 2010, the main MTFs started to trade shares with a lower average trading volume.

As a consequence of this greater competition, regulated markets have reacted in several ways. These include the various mergers carried out both with other regulated markets and with competing MTFs, improvements in the technology used in the trading system so as to complete with other platforms under better conditions, the search for new market segments or the extension of the product range so as to diversify their income sources, and the modification of their fee policies. In the area of mergers and acquisitions, the most recent movements of regulated markets, and even of MTFs, tend towards global, not only European, consolidation processes. Although the processes announced mainly involve European and North American institutions, it is likely that they will extend to other areas, such as Asia and Latin America.

The future of equity trading infrastructures over the coming years will depend on the response of the operators of regulated markets and MTFs both to the challenges of developments in the market and to regulatory changes. With regard to the former, it is especially important to point out the trend in activity levels, i.e. trading volumes, which are now significantly lower than in the period prior to the crisis, as well as the growth in high-frequency trading, which has a considerable impact on the way of competing for trading volumes.

Finally, with regard to the changes in the regulatory framework, significant amendments to the current regulation are expected as a result of the first review of the MiFID, which is expected to start formally in spring 2011. In December 2010, the European Commission published a consultation document in which it requested the market's opinion about possible amendments to the Directive.

In general terms, the Commission document formulates questions which can be grouped into two major blocks. Firstly, it considers possible amendments to the Directive aimed at improving market transparency. In this regard, the Commission reflects the existing concern among investors, regulators and other agents about the negative effects of excessive fragmentation of the market on information availability (both pre-trade and post-trade transparency), its quality, comparability between different sources and the cost for investors of accessing information. The second block of questions reflects the concern about the existence of asymmetries in the regulatory treatment of the different types of trading platform.

We can infer from the document presented for consultation by the Commission that it is considering the possibility of undertaking major reforms, which include establishing a registration system, consolidated throughout Europe, for post-trade transparency information and extending the Directive's coverage to other systems which are not currently covered.

Securitisation in Europe during the crisis

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1 Introduction

Over the last decade, securitisation has attracted a great deal of attention from experts, both in the market and in the academic world. In general, up to 2007 securitisation was considered to be essentially beneficial because of its potential to stimulate credit activity and, in turn, the economy, and for its effect on credit risk management as it allowed risk to be spread among those investors who were best prepared or willing to take it on. Consequently, the rapid growth in this activity was not generally seen as a threat to financial stability.

However, the outbreak of the crisis exposed, in some cases, significant deficiencies in credit management by institutions with regard to securitisation practices, credit rating services, investor behaviour and, in addition, the actions of some supervisors. Indeed, we can state that the current point of view about securitisation in general has changed, and that this activity is charged with a certain stigma which overshadows its more positive aspects.

Both the financial industry and regulators have implemented various initiatives affecting securitisation over the last three years. The regulatory measures are aimed at re-establishing confidence in these products and markets and ensuring a stable framework which in the future will prevent the excesses and errors exposed during the crisis, which will contribute to reactivating credit and to growth in the economy. Originators, fund managers and other economic agents have called for the reactivation of securitisation markets as a viable financial practice which is able to generate positive synergies for the real economy. For their part, banks consider that securitisation is an alternative source of funding which allows them to expand their activity in credit markets for sectors such as the housing sector, the consumer sector and the business sector.

The current weakness in investor and credit activity and the stigma which still falls to a large extent on securitisation, together with some of the measures which have recently been adopted or which are currently being debated mean that, at the moment, the industry fears an increase in the costs of securitisation transactions and, at the same time, the disappearance of a part of their investor base.

Within this context, this article focuses on European securitisation markets in the period from 2007 to 2010 with the aim of compiling the initiatives affecting securitisation in the context of the financial reform currently in progress. In particular, most of the initiatives analysed are presented together with the identification of some of the main problems in the functioning of securitisation markets and in the behaviour of the agents in these markets before the crisis.

The document is structured as follows. The second section describes the European securitisation market since 2007. Section two contains a review of the main problems which affect securitisation, as well as the initiatives implemented to correct them. The fourth section presents other measures which affect securitisation, in particular, the new prudential requirements resulting from Basel III and the new European legislation applicable to insurance companies, as well as the initiatives in the area of international accounting. The final section contains a series of conclusions.

2 The securitisation market in Europe in the period 2007-2010

The financial crisis which began in 2007 put a drastic brake on the securitisation market worldwide, practically paralysing placements among private investors. However, the impact on issues was smaller as the originators, basically credit institutions, were able to use securitisations of their own assets as collateral to obtain liquidity from central banks.

European issues of securitised products between 2007 and 2010 TABLE 1

Amounts in billions of euros	First quarter	Second quarter	Third quarter	Fourth quarter	Total
2007	128.74	152.00	98.26	74.71	453.71
2008	40.00	169.60	134.07	367.61	711.28
2009	123.23	81.20	114.73	94.92	414.08
2010	75.50	31.60	111.6	160.6	379.9

Source: AFME, Securitisation Data Reports.

As shown in table 1, in the first half of 2007, European issues still showed considerable growth, in line with the performance of the market up to that time. However, the trend changed from July of that year, and from then on the securitisation market fell sharply, which continued during the first half of 2008. However, 2008 ended with a record number of issues of securitised products, surpassing the amount of 2006, which had set the record to date with 481 billion euros issued. The reason for this major increase in issues, mainly in the fourth quarter of 2008, was the implementation of emergency economic measures by European governments with the aim, *inter alia*, of injecting liquidity into the financial system so as to restore confidence and prevent the strangling of credit. In this regard, it is important to mention initiatives such as the Financial Asset Acquisition Fund implemented by the Spanish government, the Special Liquidity Scheme of the United Kingdom and the purchases of impaired assets made by Germany, Netherlands and Belgium. In this context, we should point out that the aims of the bailout operations and, in general, the support given to the financial system, do not include the recovery of the securitisation market. However, the manner in which the support was designed meant that in some cases, and in some countries, securitisation was a useful instrument for accessing said support. In particular, securitisations took on special importance in this environment in the implementation of measures aimed at reducing the weight of impaired assets in banks' balance sheets and in the liquidity injection schemes.

Although its actions cannot strictly be framed within any rescue plan, it is true that the Eurosystem has also played an important role in providing liquidity to the European financial system over the last three years. Specifically, the European Central Bank (ECB) publishes and updates the individual assets which may be used in its operations for providing liquidity and the securitised products which the ECB will accept providing they meet a series of conditions. The average amount of securitised products deposited as collateral in the ECB in 2008 was 1.1 billion euros, 9% of the total. In 2009, the amount increased to 1.3 billion euros, 10% of the total.

The Government initiatives for providing liquidity to the financial system and the activity of the ECB have had a significant impact on securitisation during the crisis. Indeed, over this period the issues of securitised products have mainly been designed so that the originators can benefit from one of these facilities. We can therefore expect that the progressive withdrawal of these schemes, which has already begun, will have a negative effect on issues in the short term, as happened in the United States in the middle of 2010 when its securitisation support scheme, the Term Asset-Backed Securities Loan Facility (TALF), ended.[1]

In contrast with the dynamism of issues, without bearing in mind the withholdings carried out by the originators themselves, acquisitions by other investors in the primary market accounted for a low percentage of the total.[2] However, this percentage has grown somewhat over the last year. In 2010, 23% of the securities issued were acquired by investors unrelated to the issuer, compared with 6% in 2009. In general, over this period investors have focused their interest on securitised products with low levels of associated risk, such as the Dutch mortgage market or the automobile market in Germany. Most securitisations placed in the market originated in the United Kingdom, with 50.7%, followed by the Netherlands with 27% and Germany with 11.3%.

European securitisations are still closely linked to the housing market. In 2007, residential mortgage backed securities (RMBS) accounted for 57% of the total, which increased to 82% in 2008. In 2009 and 2010, this percentage stood at 58% and 71% respectively. There are no changes in the list of the most active countries in this market: The United Kingdom, Spain, the Netherlands, Italy and Germany continue to account for over 70% issues of securitised products.

3 Problems which affect securitisation and corrective measures

The first initiatives aimed at the recovery of securitisation markets came from within the industry itself. Accordingly, in July 2008 nine financial sector associations presented ten measures to increase transparency in the area of securitisa-

1 This special scheme ended on 30 June 2010. Issues of consumer loan securitisations (credit cards, vehicle purchase and student loans) were particularly affected by the withdrawal of the scheme and underwent a 39% fall over the second half of the year.

2 See the data published by AFME: Association for Financial Markets in Europe.

tion.[3] In general, the first proposals from the private sector consisted of recommendations aimed at the different participants in securitisation transactions: originators, investors, rating agencies, providers of financial services etc. However, the persistence of the financial crisis, and subsequent stagnation in securitisation markets, led to an increasingly determined intervention from regulatory bodies.

Throughout this section, we present the details of the main measures which are being put forward or, in some cases, being carried out to combat the problems detected. These are basically as follows: (1) conflict-of-interest between originators and investors, (2) lack of transparency, (3) complexity of securitisation structures, (4) deficiencies in due diligence by investors, (5) the role of rating agencies and (6) illiquidity in the secondary market for securitised products.

3.1 Conflict-of-interest between originators and investors

Encouraging the formation of quality loan portfolios is one of the primary requirements not only for relaunching securitisation, but also for good functioning of the financial system as a whole. Investors in securitised products do not normally have the same level of information on the assigned assets as the originating entities.

One possible solution for dealing with this problem, which has received a great deal of attention as a result of the crisis, consists of involving originators more directly in their own securitisation transactions, obliging them to retain a part of the risk from these transactions. In the context of the European Union, this idea has been put into practice through an amendment of the Capital Requirements Directive applicable to credit institutions, CRD II, which entered into force on 1 January 2011.[4]

Specifically, this amendment provides that no bank may have securitisation positions unless the originator retains, on an ongoing basis, a "material net economic interest" in the corresponding securitisation of at least 5%. For the purposes of calculating this minimum withholding percentage, the originator may choose between the following alternatives: i) withholding of no less than 5% of the nominal value of each of the tranches sold, ii) withholding of no less than 5% of the total nominal value of the securitised exposures, iii) withholding of randomly selected exposures, or iv) withholding of the first loss tranche or other tranches with the same risk profile as those tranches sold.

It should be pointed out that this obligation does not only affect banks as investors in securitised products, but also in the cases in which the banks assume exposure from securitisations in compliance with their obligations as providers of liquidity facilities, subordinated loans or as counterparties in swap transactions. For their part, the originators must maintain the aforementioned withholding on their books,

3 See the document *Ten Industry Initiatives to increase Transparency in the Securitisation Market*, prepared by the Commercial Mortgage Securities Association (CMSA Europe), the European Association of Co-operative Banks, the European Association of Public Banks (EAPB), the European Banking Federation (EBF), the European Savings Banks Group (ESBG), the European Securitisation Forum, the International Capital Market Association (ICMA), the London Investment Banking Association (LIBA) and the Securities Industry and Financial Markets Association (SIFMA).

4 See Article 122a of Directive 2009/111/EC of 16 September 2009.

in any of its forms, without the possibility of selling it or reducing the risk assumed through hedging.

Accordingly, the European regulators have considered that the implementation of prudential legislation may be a suitable tool for aligning the interests of originators and investors in securitised products, thus contributing to improving the quality of securitised portfolios. Non-compliance with the 5% withholding will lead to a penalty in the risk weight of the securitised positions held by the institution in question, and therefore in the requirements regarding the capital which it must register on its balance sheet. With the aim of harmonising the interpretation by competent authorities of the provisions in the new legislation, in December 2010 the Committee of European Banking Supervisors (CEBS)[5] published a series of guidelines for practical application of Article 122a of the Capital Requirements Directive (CRD).[6]

Similar measures to those introduced in the Capital Requirements Directive for credit institutions were recently included in other legislative implementation, such as Directive 2009/138 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II) and the Directive on alternative investment fund managers. The aim is thus to create a homogenous regulatory framework for the whole range of potential investors in this type of product and to prevent the possibility of regulatory arbitrage.

3.2 Lack of transparency

The specific needs of the different participants in the securitisation industry with regard to information on these products vary according to the type of asset considered. In a survey carried out by several associations of members of the financial industry at the end of 2008,[7] investors mostly showed their agreement with the information available in the case of consumer loans or commercial mortgage-backed securities (CMBS). However, they felt that it was necessary to improve the information which originators normally provide on RMBS. In the case of collateralised debt obligations (CDO), they felt there was insufficient information available and that it was also difficult to understand, which hindered its practical use. Accordingly, the combination of the high level of complexity of many of these products with the limited amount of usable information regarding them led to investors systematically resorting to the analyses carried out by rating agencies.

In order to address the lack of information on the portfolios to be securitised and to improve the understanding of the functioning of the new securitisation structures, the CRD II has also introduced new requirements on information availability for originators or sponsors of securitisations which are banks. According to this new regulation, banks must: i) disclose to investors the level of “material net economic interest” which they plan to hold in each securitisation, ii) ensure that prospective investors have readily available access to all materially relevant data on the credit

5 In January 2011, CEBS was substituted by the new European Banking Authority (EBA).

6 See the document *Guidelines to Article 122a of the Capital Requirements Directive* of the EBA.

7 Included in the report *Restoring Confidence in Securitization Markets* prepared by the American Securitization Forum, the Securities Industry and Financial Markets Association (SIFMA), the Australian Securitisation Forum and the European Securitisation Forum, published on 3 December 2008.

quality and performance of the individual underlying exposures as well as on the cash flows and collateral supporting the securitisation exposure, and iii) ensure the availability of such information as is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values.

Furthermore, uncertainty about the possible impairment of securitised loan portfolios and its impact on the performance of the securitisation structures was one of the factors which led to the securitisation market practically stagnating as from 2007. In many cases, only after a considerable time period, data started to become available on the real quality of the securitised loan portfolios and the strength of the vehicles.

An analysis of the information on the performance of these products reveals that defaults have in general been unevenly distributed among the different segments of the securitisation market and that, as a whole, their weight in the European market has been relatively small compared with the US market. In fact, between the middle of 2007 and the end of 2009, only 0.3% of all European issues of structured finance products rated AAA suffered defaults. Specifically, the defaults within this rating level did not affect the RMBS segment, and were concentrated in the CDO and CMBS segments. The highest volume of defaults during the indicated period corresponded to securities with ratings lower than BBB, mainly CMBS, and accounted for 4.2% of the total volume issued with speculative grade. As a whole, over this period the European market suffered defaults in securities which accounted for 0.4% of the total volume issued, compared with 4% for US issues.[8]

With the aim of preventing periods of practical paralysis of the market, such as those which have taken place since the start of the current crisis, and to enable investors to carry out realistic assessments of the risks included in their portfolios, the industry initially issued a series of recommendations on best practices regarding information disclosure. Subsequently, regulation has taken over as the route for channelling this type of initiative (see table 2). The main regulatory measures in this area are described below.

Measures for increasing information on securitised portfolios TABLE 2

Measure	Authority responsible
– Loan-by-loan information for asset-backed securities to be used as collateral in the Eurosystem.	– European Central Bank. – This requirement is expected to be fully operational within 18 months as of 16 December 2010.
– Loan-by-loan information for asset-backed securities to be used as collateral with the Bank of England.	– Bank Of England. – This requirement is expected to be fully operational within 12 months as of the publication of the corresponding forms for each asset type.
– Requirements for information availability on securitised portfolios for securitisation originators or sponsors which are banks.	– Capital Requirements Directive, CRD II. – Entered into force on 1 January 2011.
– Specific legislation on periodic public information on vehicles issuing asset-backed securities admitted to trading on organised markets.	– Spain: CNMV Circular 2/2009. – United Kingdom: FSA CP 10/17: 'Strengthening Capital Standards 3 - feedback to CP 09/29, final rules for CRD 2 and further consultation', July 2010.

8 Data available on the AFME website: http://www.afme.eu/document.aspx?id=4452

With the aim of ensuring that asset-backed securities as collateral for Eurosystem transactions are of a suitable quality, in December 2010 the European Central Bank published its decision to require loan-by-loan information linked to the assets presented in said transactions. These requirements are expected to enter into force in the next 18 months, starting with residential mortgage-backed securities and gradually extending to other securitised products.

For its part, in July 2010 the Bank of England published that it will also require loan-by-loan information on asset-backed securities for them to continue to be eligible in the transactions carried out with the Bank of England. The information must be available at least quarterly. Investors will be provided with a monthly report which includes the development of the underlying assets, the assignment of the resources and details on credit enhancements contracted. Investors will also be provided with a form with the cash flow table. In November 2010, the Bank of England published a market notice establishing the requirements for RMBS transactions and the institutions which must have implemented the procedure within 12 months.

As indicated above, the amendment of the Capital Requirements Directive (CRD II) obliges originators of securitisations to provide investors with sufficient information so that they may make a full analysis before carrying out their investments. Due to the nature of this type of transaction, the European Commission, also through the CRD II, has considered it necessary for this information to be provided to the market on an ongoing basis. Although the Directive does not specify how often the originators must publish the information, and given that it transfers to credit institutions which are investors the obligation to have, at all times, a valuation of their securitised exposures and to provide evidence for this valuation, we can deduce that the information must be permanently available so as to meet requests from investors.

In Spain, given the importance acquired by the securitisation market within the financial system over the last decade, it was considered appropriate to increase the requirements on the information that funds were providing to the market. Accordingly, in March 2009 Circular 2/2009 was published. This was subsequently amended by CNMV Circular 4/2010 which, *inter alia*, establishes a framework of obligations applicable to the preparation of periodic information for securitisation funds. According to this new regulation, the funds must publish, by means of a standardised form and electronic reporting of data every six months, their balance sheet, their profit and loss account, their cash flow statement, detailed information on the situation of the assets assigned to the fund (nature of the assets, outstanding amounts, delinquency rates, amounts declared as defaults, residual life, early redemption's, etc.) and the liabilities issued (interest rates, redemptions carried out, average life, current ratings, etc.), as well as the situation of the credit enhancements incorporated in the fund.

In the United Kingdom, the Financial Services Authority (FSA) - the supervisory body for financial markets - has approved,[9] within the procedure for transposing the new requirements of the CRD II, new measures which involve increasing the

9 See FSA, *Strengthening Capital Standards 3 - feedback to CP 09/29, final rules for CRD 2 and further consultation* (CP 10/17, published in July 2010).

frequency for reporting data on securitisations, from half-yearly to quarterly. It has also amended the information form which must be sent to the regulator on the securitisations originated or maintained in the trading books. These new rules entered into force on 31 December 2010.

3.3 Complexity of securitisation structures

Given their nature, even the simplest securitised instruments are usually more complex than many other financial instruments. The level of complexity depends on the design of each securitisation and of each type of securitised asset. The difficulty in understanding the functioning of the structures, together with the fact that certain types of securitisation have been associated with the outbreak of a financial crisis, have stigmatised this type of financial operation.

Both the industry and regulators believe it is necessary to return to the origins and give priority to simple structures, which are easily understood by the market, so to once again generate investor confidence. In this context, we can highlight two initiatives which are likely to have a considerable impact on how securitisation is carried out in the coming years: the tightening of the capital requirements for the investments of credit institutions in complex securitisations and initiatives relating to over-the-counter (OTC) derivatives promoted by the G-20 (see table 3).

Measures to discourage excessively complex structures TABLE 3

Measures	Authority responsible
– Tightening of capital requirements for banks which hold complex securitisations on their books.	– Capital Requirements Directive, amendments CRD III and IV. – Applicable from 31 December 2011 and pending publication by the European Commission of any definitive proposal respectively.
– Regulation of OTC derivatives markets.	– Proposed by the G-20 in its Leaders' Summits of April and September 2009. – The European Union has published a draft with its proposal for the creation of an OTC derivatives market. It is expected to be operational at year-end 2012.

The European Commission believes that the risk weight of re-securitisations should be different from that of a normal securitisation due to the greater complexity of the former. Following this line, another of the recent amendments to the Capital Requirements Directive, known as CRD III, raises the weight range for re-securitisations,[10] for the purposes of calculating the capital requirements which must be held by banking institutions which invest in these products, to levels of

10 According to the definition given by the Basel Committee on Banking Supervision, a re-securitisation is a securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position. Similarly, an exposure to one or more re-securitisations is, in turn, a re-securitisation.

between 40% and 650% if following the standardised approach (while a securitisation valued according to this same method has a weight of between 20% and 350%). Similarly, the weight ranges for re-securitisations valued using other approaches are set at levels higher than those for normal securitisations.

Furthermore, following the trend for increasingly restrictive treatment of synthetic securitisations, CRD IV proposes specific supervision for repo transactions which incorporate securitised assets as collateral and prohibiting the use of re-securitisations in this type of transaction as collateral for the purposes of calculating the regulatory capital.

The intensive use of derivatives in securitisation structures generates complexity for investors when valuing and understanding the instruments. With regard to securitisation, derivatives are not only present in synthetic securitisations, backed by credit derivatives, but the simplest securitisations also usually include an OTC derivative within the credit enhancements.

OTC derivatives are represented by a contractual structure adapted at each moment to the conditions agreed between the parties (Nystedt, 2004).[11] The lack of transparency of the transaction has often made it difficult to know the precise final exposure to risk taken on both by the counterparty and the final investor. As shown in the first stages of the current financial crisis, the lack of transparency in these markets increases uncertainty among financial agents, which may have a very negative impact on the prices and liquidity of these products.

Following the guidelines set by the G-20,[12] the European Commission has recently drawn up a document with its main proposals for creating a European OTC derivatives market,[13] with the aim of increasing transparency and reducing counterparty risk and the operational risks associated with this type of product. Specifically, the document presented by the Commission includes the following requirements: i) requirement for European financial and non-financial companies to report detailed information on the OTC derivative contracts they have entered into to trade repositories, making it available to regulatory bodies, ii) trade repositories must publish aggregate positions by class of derivative in a manner which is easily accessible by all market participants, iii) For central counterparties, it sets the minimum capital requirements, the internal organisational model and the standards under which they must carry on their activity, iv) obligation to clear and settle standardised OTC contracts through central counterparties, v) it sets measures to mitigate the risk of those contracts which, because of their nature, do not need to be cleared through a central counterparty, and vi) the terms of the contracts entered into must be confirmed by electronic means. These proposals from the European Commission must be ratified by the European Council and the European Parliament and are expected to be fully operational at year-end 2012.

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11 Nystedt J. (2004), *Derivative Market Competition: OTC Markets versus Organized Derivative Exchanges* (IMF Working Paper, WP/04/61).

12 The G-20, in its Leaders' Summit of April 2009, proposed as a priority task fostering the creation of central counterparties for derivatives which would be subject to regulation and supervision with the aim of achieving a standard and stable credit derivatives market.

13 *Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories.*

Accordingly, in a regulatory framework in which those transactions which use non-standardised derivatives are penalised with higher capital requirements, financial agents will be encouraged to use those derivatives, and to design securitisation structures, which bring the greatest possible savings in terms of capital. It is therefore likely that some types of securitisation will no longer be economically viable. At the same time, it is reasonable to expect that these measures will lead to a greater level of standardisation in securitisations by reducing the range of derivatives to be used to make a transaction viable. Encouraging standardisation in the field of derivatives may, in turn, lead to simplification of the securitisation structures which use them.

3.4 Deficiencies in due diligence by investors

The securitisation market is essentially a wholesale market i.e. a market aimed at professional investors. Despite the qualifications which professional investors are supposed to have, there is certain evidence that in the years prior to the start of the crisis, these investors trusted almost exclusively in the analyses performed by rating agencies, without carrying out due valuations and their own verifications. This is shown, for example, by a survey[14] on investors sponsored by the industry and carried out in 2008, which recognises that the information on the value of the underlying assets might be insufficient but that, on the other hand, the little information that was available was not taken into account. Specifically, those surveyed indicated that the nature of the system did not facilitate the performance of internal analyses as the demand for these products was very high and the time in which investors had to confirm their requests was limited.

As shown in table 4, the effort of regulators to correct this problem have taken the form of two measures which essentially establish analysis obligations with regard to investments in asset-backed securities and obligations with regard to disclosures to the market relating to the exposure of the entity to those securities.

Measures to encourage investors to carry out their own valuations TABLE 4

Measures	Authority responsible
– Evidence that credit institutions have carried out a full analysis prior to investing in securitised products.	– Capital Requirements Directive, CRD II. – Entered into force on 1 January 2011.
– Disclosure to the market on securitised exposures in the books of credit institutions.	– Capital Requirements Directive, Pillar 3, amendment CRD III. – Will enter into force on 31 December 2011.

In accordance with the new aspects introduced in the Capital Requirements Directive (CRD II), credit institutions will have to demonstrate to the competent authori-

14 Included in the document *Restoring Confidence in Securitisation Markets* prepared at the initiative of a set of representative associations of the securitisation market: the American Securitization Forum, the Securities Industry and Financial Markets Association (SIFMA), the Australian Securitisation Forum and the European Securitisation Forum.

ties that they have implemented the appropriate policies and procedures to allow them to make an extensive analysis of their investments in securitised positions, both before investing and with regard to each of the positions maintained subsequently, commensurate with the institution's risk profile. In addition, they must perform continuous stress tests for their securitised exposures. Furthermore, this Directive establishes that credit institutions may rely on financial models developed by an external rating agency providing they can demonstrate that they understand the methodology, the assumptions and the results of the model and that they took due care, prior to investing, to validate the model.

With regard to the information which credit institutions must disclose about their securitised exposures, Annex XII of the Directive on Capital Requirements of Credit Institutions has been amended so as, on the one hand, to adapt it to certain new regulation in the field of securitisation, such as the withholding of 5% of the material economic interest of each securitisation originated by that institution and, on the other hand, to increase the information relating to the risk assumed by each institution in each one of the securitisation positions included on its balance sheet. In particular, the European regulator has placed special importance on disclosing the type of vehicle used for the securitisation, identifying the on and off-balance sheet exposures, on continuous valuation of said exposures and on studying their sensitivity in different scenarios.

3.5 Role of rating agencies in securitisation

The legal framework and practices of the market have formed a system which is exclusively dependent on rating agencies, which was made clear following the outbreak of the financial crisis.

The need to regulate the activities of rating agencies is one of the milestones of the international financial reform in progress, promoted by the G-20. There are various reasons for this reform, but in the area of securitisation some of the clearest deficiencies relate to agencies undervaluing the risks present in the real estate market and the lack of transparency in their valuation techniques and in the information used to perform the analyses.

In the context of the EU, regulation EC No 1060/2009 has established the legislative framework applicable to rating agencies since October 2009. It establishes obligations for agencies, such as registering in the corresponding State and being subject to ongoing supervision by the competent body. It also introduces rules regarding the manner in which this activity should be carried on, the most important of which are as follows: i) agencies should disclose information to the public on the methodologies, models and key rating assumptions which they use in their credit rating activities, ii) the regimes should be subject to review at least annually and whenever material changes occur that could have an impact on a credit rating, iii) credit agencies should make their credit ratings public, as well as the decision to suspend a rating, iv) agencies should distinguish the ratings for structured finance instruments, such as securitisations, by means of an additional symbol, v) agencies should ensure that the issuing of their ratings is not affected by any actual or potential conflict of interest or commercial relationship, and vi) the employers of the agencies should have appropriate knowledge and experience to carry out their functions, and their remuneration must not be linked to the income the agency obtains from the ratings given.

Although this legislation is in the first stages of implementation, the fast changes taking place in the financial world have led to the publication of a first draft for amending this Regulation. The changes in the new regulation include the centralisation of registration and supervision of rating agencies in the new European Securities and Markets Authority (ESMA). This new legislative framework is expected to enter into force during 2011.

It is also expected that in 2012 the European Commission will present a report[15] with its proposals for dealing with other important problems, such as the excessive reliance on credit ratings by investors and regulators, the conflict of interest inherent to the current model based on issuers contracting rating agencies, and the limited competition among the companies belonging to this sector.

3.6. Illiquidity in secondary markets

Most asset-backed securities are listed on regulated markets. However, in real terms their trading has been historically low. The reason for the limited activity in these securities on secondary markets is that many investors acquire these products with the intention of holding them in their portfolios until maturity. Another reason is that in many cases these financial instruments are individually designed for a client, which, in practice, may make it difficult to find other possible buyers after they have been issued.

The analyses performed both by market agents[16] and by regulators[17] agree that one measure to activate this market would be to increase the transparency of the conditions in which transactions with asset-backed securities are closed. The first working document drafted by the European Commission for the review of the MiFID[18] envisages a review of the pre-trade and post-trade transparency regimes for structured products with prospectuses or listed on any organised market. However, it does not include any specific proposal on how to do it and only mentions that the new requirements will be different depending on the asset type. At any event, this is only the beginning of a process whose final aim is to achieve a harmonised framework for the information available to markets which will allow more efficient price formation for these products and a permanently available market valuation.

15 In accordance with article 39(1) of Regulation 1060/2009.

16 See the report *Restoring Confidence in Securitisation Markets*, published in 2008 by the Joint Global Initiative.

17 See *Transparency of Structured Finance Product*', published by IOSCO in July 2010, and *Transparency of corporate bond, structured finance product and credit derivatives markets*, published by CESR in July 2009.

18 On 8 December 2010, the European Commission presented for consultation the working document *Review of the Markets in Financial Instruments Directive (MIFID)*. The consultation period ended on 2 February 2010.

4 Other regulatory initiatives that will affect the securitisation market

The countries belonging to the G-20, in the summit held in Toronto on June 2010, recognised the work carried out by the Bank for International Settlements, through the Committee on Banking Supervision, to strengthen the banking system and highlight the importance, within this context, of establishing a single set of international accounting standards.[19]

As described below, the new rules introduced in these two areas, and also in the financial regulation of insurance companies, will have a considerable impact on financial markets in general, and on the securitisation industry in particular.

4.1 Reforms in the prudential framework of the banking and insurance sectors

Over the last two years, The Basel Committee on Banking Supervision has published a set of documents and guidelines, known together as Basel III, which tackle the problems exposed during the financial crisis in the banking sector and which aim to strengthen the regulation, supervision and management of risk in that sector. The European Union has already adopted the Basel III rules in the latest amendments to the Capital Requirements Directive (CRD III and CRD IV).

One of the revised aspects in this context has been the capital requirements of securitisations. As indicated above, holding re-securitisations in books will have a risk weight range higher than for traditional securitisations. In addition, CRD III introduces the obligation of applying the same treatment to securitisation positions in the trading book, in terms of capital, as to those included in the investment portfolio.

Another new aspect introduced by Basel III, already incorporated into legislative implementations which are being processed, refers to compliance with a set of ratios: i) short-term liquidity coverage ratio, ii) long-term liquidity coverage ratio and iii) leverage ratio.

In accordance with the latest proposal from the Basel Committee on Banking Supervision, asset-backed securities are not considered as high-quality liquid assets or sources of stable funding when credit institutions calculate these ratios. Similarly, asset-backed securities, credit enhancements granted to securitisation positions and securitised assets not removed from the balance sheet are classified as an extra risk exposure in a financial institution's books.

The securitisation industry has expressed its concern about the impact that both the higher capital requirements and compliance with the aforementioned ratios may have on the securitisation market. The better consideration given by the European Commission to other products such as covered bonds (a category which includes

19 The importance of achieving a single international accounting framework had already been made clear in the G-20 summits in London, in April 2009, and Pittsburgh, in September 2009.

mortgage-covered bonds), which are included, for example, within the group of liquid assets, could lead financial institutions to intensify the issues of this type of security, to the detriment of securitisation.

In parallel with the financial sector, a new framework of rules is currently being adopted for calculating the capital requirements applicable to insurance companies, included in Directive 2009/138 on the taking-up and pursuit of the business of Insurance and Reinsurance (known as Solvency II). Solvency II establishes a new legislative scenario based on calculating capital based on the risk assumed by insurance companies. Although it is still not clear what the final impact of this legislation will be on securitisation, some studies[20] have indicated that the exposures held in the tranches with the worst ratings (mezzanine and junior tranches), will have substantially increased capital requirements.

4.2 Accounting initiatives

The possibility of removing asset-backed securities from the balance sheet, with the corresponding saving in regulatory capital, is one of the potential appeals of securitisation. However, because of the variety of ways in which these operations may be implemented, institutions have found it difficult to apply the control tests for removing assets from the balance sheet. There has also been debate on how to partially recognise an asset which has been assigned but with which the assignor maintains continued involvement or whether a securitisation vehicle should be included or not in the consolidation scope of an originator. With the aim of achieving consistent and homogenous application of accounting standards, both originators and auditors have requested the IASB[21] to provide improvements and clarifications in the application of the accounting framework corresponding to securitisation.

The IASB is currently working on amending two important aspects: accounting consolidation and removing assets from the balance sheet. With regard to the former, it is expected to publish its final conclusions on the work in progress in the first quarter of 2011. With regard to the latter, a draft of a first proposal was published in March 2009, but in May 2010 the IASB decided to redirect the work so as to focus on increasing transparency and improving the information provided to investors, which has given rise to the proposal for an amendment to IFRS 7 (Financial Instruments: Disclosures), presented in October 2010. According to this proposal, institutions must increase the information on the links they maintain with assets which have been assigned but not removed from the balance sheets or on the risks maintained relating to assets partially removed.

The work performed by the IASB over recent years is set within the framework of the convergence process between generally accepted accounting principles in the United States (US GAAP) and International Financial Reporting Standards (IFRS) which the FASB[22] and the IASB agreed in October 2007. This process has been sup-

20 Deutsche Bank (2010), *Solvency II and European ABS*, Special Report, November.

21 International Accounting Standards Board. This is the body responsible for developing international accounting standards, IFRS/IAS, and their interpretations, IFRIC/ SIC.

22 Financial Accounting Standards Board.

ported by the repeated requests from the G-20 to international accounting institutions for them to increase their efforts towards achieving a single set of accounting standards applicable worldwide. The estimated date for concluding this convergence process is June 2011, although the consultations presented to market agents, also following the recommendation of the G-20, could mean that it is delayed until the second half of 2011.

5 Conclusions

Since the start of the crisis, securitisation has been subject to widespread criticism because of its possible role as a cause of the financial crisis. However, at the same time, both the industry and some authorities have underlined the benefits of a recovery in the activity of this segment on a solid and stable foundation, and its advantages as an attractive funding alternative for credit institutions.

At a European level, the interest shown by markets in these products has improved slightly in 2010, but activity continues to be very limited. The characteristics of the latest securitisations placed with private investors still reflect a significant lack of confidence, with relatively low issue volumes, short maturities and highly restructured portfolios or some type of State guarantee.

A quick recovery in the securitisation market does not seem feasible at this time. The current macro-financial environment in most countries is characterised by a lack of willingness on the part of investors to assume new risks, and the stigma which still weighs over these products keeps private demand for them at extremely low levels.

This article provides a review of the main legislative developments implemented recently in the European Union. Some of these developments, which aim to correct the errors and excesses committed in the past, may substantially affect securitisation. Specifically, we cannot rule out that the new regulatory framework which will enter into force in the coming years will reduce the interest of banks and other investors in this type of product, as they will be subject to stricter legislative requirements, such as the increase in capital requirements caused by the new prudential rules for banks and insurance companies, and the establishment of new liquidity requirements associated with the securitisation positions of credit institutions. Similarly, the progressive tightening of the conditions established by the European Central Bank for using its funds will affect the incentives of originators to securitise assets in order to identify them as collateral in the Bank's funding operations.

At the same time, the need to progress in the standardisation of the channels of funding for European credit institutions based on market mechanisms accentuates the role of securitisation as a stable funding source which is able to contribute to reactivating credit. Therefore, in this context it seems appropriate to keep open and encourage the debate among economic authorities, regulators and the financial industry on how to promote a sustainable, efficient and responsible recovery of securitisation markets in Europe.

III Regulatory Novelties

The Directive on alternative investment fund managers[1]

Joan Rius Riu (*)

1 The paper, pending official publication of the Directive in the Official Journal of the European Union, refers to the text agreed by the Council and the Parliament of the European Union published by the Council on 27 October 2010.

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1 Introduction

It is expected that within a few months the text containing the definitive version of the Alternative Investment Fund Managers Directive (hereinafter, AIFMD) will be published in the Official Journal of the European Union. This publication will include the regulation finally agreed by the Council and the Parliament of the EU in November 2010, thus closing a long legislative process formally initiated with the directive proposal presented by the European Commission at the end of April 2009.

This regulation must be understood within the new regulatory context resulting from the financial crisis, taking its inspiration from a firm conviction with regard to the need for more and better regulation on all agents intervening in financial markets, irrespective of their level of sophistication.

Within the area of alternative investment, this concept is materialised in the preparation and coming enactment of the AIFMD, a Directive which aims to establish a common regulatory framework for all Member States with regard to the authorisation and supervision of alternative investment fund managers (AIFMs). This framework must allow greater and better control of the risks which the activities of these managers may represent for investors, counterparties, other participants in financial markets, and in general, the stability in said markets.

Although there is a wide consensus in not considering alternative investment – or the entities which operate in this field - as responsible for the current financial crisis, the European legislator considers that the crisis has clearly shown, on the one hand, the systemic effects that certain strategies of this type of investment can trigger and, on the other hand, the deficiencies resulting from a fragmented response to this situation by Member States. In this context, the Directive aims to harmonise both the conditions for authorising said institutions (Chapter II), as well as the operational and organisational requirements that these institutions must observe in carrying on their activity (Chapter III). It will also lead to harmonisation of the transparency requirements for these institutions (Chapter IV) and, following on from work prior to the directive proposal presented by the European Commission,[2] one chapter is devoted to regulating specific aspects and characteristics of certain types of investment vehicles, such as those which use leverage on a substantial basis to carry out their investment strategies and policies and those which base their investment on acquiring control of other companies (Chapter V). As a consequence of this harmonisation, the Directive envisages the right of AIFMs to provide their services and/or market their products to professional investors in the different Member

2 For an overview of the work performed prior to the publication of the AIFMD, refer to the website which the European Commission devotes to alternative investment: http://ec.europa.eu/internal_market/investment/alternative_investments_en.htm .

States under one single authorisation, which will be granted by the competent authority of their home Member State (Chapter VI).

Finally, and although granting a "passport" to operate on a cross-border basis within the EU is not unknown in the area of financial services in general, and that of collective investment in particular, this Directive includes a series of provisions which regulate, for the first time in European financial legislation, the possibility of extending that right to institutions established outside the territory of the EU (Chapter VII). Accordingly, and following the transitional periods provided in the regulation, a non-EU AIFM will be able to provide its services and/or market its products in the EU without the need to be authorised in each one of the Member States.

This paper does not aim to provide a thorough study of each and every aspect of the Directive, which would greatly exceed the space limits of this article. On the contrary, the paper first provides an overview of the purpose and scope of this new regulation, highlighting the most important aspects of this new regulatory framework for AIFMs. The second section will cover the provisions which outline the scope of application of the regulation so that, once the institutions and activities which the Directive refers to have been determined, the third section examines the requirements established for AIFMs and their activity. Only the AIFMs which observe that regulation may enjoy the passport which allows them to market their products and/or provide their services in the EU on a cross-border basis, as laid out in the article's fourth section. The paper concludes with a series of final considerations about the scenario which can reasonably be expected following the coming entry into force of the AIFMD.

2 Scope of application

The first section of Article 2 of the Directive establishes that it will be applied, on the one hand, to all European managers of alternative investment funds (EU AIFMs) which manage one or more alternative investment fund (AIF) and, on the other hand, to all non-EU AIFMs which manage European AIFs (EU AIFs) and/or market AIFs in the European Union. Accordingly, the European Union is clearly established as the territorial connection which activates application of the Directive, whether it is because the AIFM or the AIF are established in its territory or because of the intention to market an AIF in the EU, irrespective of where said AIF is established.

However, the definitive outline of the entities which this regulation is aimed at is only fully defined if we refer to the different definitions contained in Article 3 of the Directive. These definitions are the subject of the analysis in the first point of this section, with the second point examining the exclusions of certain entities and institutions from the Directive's scope of application. Finally, the paper will analyse the simplified regime provided for AIFMs whose aggregate volume of assets under management does not exceed the thresholds established in the Directive.

2.1 Definition of AIFM

Article 3 of the Directive considers AIFM as any legal person whose regular business is to manage one or several AIFs, defining AIF as any collective investment undertaking, including compartments thereof, which (I) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors and (II) is not within the scope of application of the UCITS Directive. Therefore, an AIFM is defined by the type of collective investment undertaking managed. However, the Directive does not explicitly define what should be understood by collective investment undertaking. In fact, the preamble admits the difficulty in regulating each one of the investment vehicles which does not meet the requirements established in the scope of the UCITS, and therefore opts for regulating the entities which manage any type of collective investment undertaking which cannot be considered a UCITS, irrespective of its investment policy, its legal nature, or whether it is an open-ended or a closed-ended vehicle.

Secondly, and given that the entity which manages one of several AIF can be considered as an AIFM, the Directive defines what should be understood by "managing AIFs". Annex I of the Directive lists the activities which comprise the management of an AIF, which are divided into investment management services (portfolio management and risk management) and other functions that an AIFM may additionally provide in the course of the collective management of an AIF (administration, marketing and other activities relating to the assets of the AIF). Following this scheme, the Directive establishes that an AIFM will be considered as any entity which, at least, provides investment management services to its AIF, adding that each AIF must have one single AIFM, which will be responsible for ensuring compliance with the requirements established by the Directive. Said AIFM may be an entity external to the AIF or it may be the AIF itself, providing the legal form of the AIF allows internal management and that the governing body of the AIF has decided not to appoint an external AIFM.[3]

Finally, we should point out what is understood as an AIFM and an AIF established or not in the European Union, as in certain cases this will determine the application of some provisions rather than others. In the case of AIFMs, the place it is established corresponds to the State in which it is domiciled, while in the case of AIFs, the place it is established corresponds firstly to the State where it is registered or has been authorised or, failing that, the place where it is domiciled.

The Directive, however, does not only define its scope of application through a positive definition of the entities and activities which the regulation is aimed at, but it also completes the definition by means of a series of exclusions, which we shall analyse below.

2.2 Exclusions

Firstly, and even at the risk of stating the obvious, it is important to remember that the first exclusion is that of any entity which does not fall within the definition of

3 Article 5 of the AIFMD.

AIFM offered by the Directive. In this regard, and as mentioned above, the European legislator has not defined certain elements used to define AIFs and, therefore, AIFMs, which seems to indicate that the national legislator will need to interpret the regulation as a whole when transposing the Directive so as to discern which investment vehicle is covered by the AIF definition - and, therefore, its manager in the Directive's scope of application - and which vehicle is not covered.

However, the Directive is explicit in excluding certain entities and institutions from its scope of application. Accordingly, the second section of Article 2 establishes that this regulation will not be applicable to holding companies;[4] to institutions which are covered by Directive 2003/41/EC, on the activities and supervision of institutions for occupational retirement provision (IORP Directive); to supranational institutions, such as the World Bank, the IMF, the ECB, etc; to national central banks; to government bodies which manage funds supporting Social Security and pension systems; to employee participation schemes or employee saving schemes; or to securitisation special purpose entities.

The above list, however, does not cover all the entities which fall outside the scope of application. On the one hand, the list given does not fully coincide with the entities mentioned in the section of the preamble which aims to explain the exclusions, with the latter mentioning family offices, insurance contracts and joint ventures, all of which are considered outside the scope of application of the Directive. It is unclear whether these last exceptions are not expressly mentioned in the articles of the Directive because, as mentioned above, their characteristics do not correspond to the definition given for AIFM and, in that case, it is unclear why the European legislator has expressly mentioned those listed in Article 2.2 and not the others. Furthermore, the first section of Article 3 of the Directive - entitled "Exemptions", which contains a simplified regime which we will examine below - establishes another exclusion for the AIFMs which manage AIFs whose only investors are companies from the same group that it belongs to, and providing none of these investors can in turn be considered an AIF.

Finally, the transitional provision contained in Article 59 of the Directive establishes another exception to its application. In particular, the authorisation provided for in this Directive will not be required for AIFMs which manage closed-ended AIFs which have already been established: (i) which do not make any additional investments after the final transposition date of the Directive, or (ii) whose subscription period has closed prior to its entry into force and whose investment period expires at the latest three years after the final transposition date.

Following this reference to the entities which fall outside the scope of application of the Directive, below is an analysis of the simplified regime provided for certain AIFMs which, because of the volume of assets under management, are allowed to carry on their activity following a lighter set of obligations than that provided for in the general regime.

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4 Article 4.1 (r) defines a holding company as a company with shareholdings in one or more other companies the commercial purpose of which is to carry out a business strategy which contributes to their long-term value, and which is either: (i) a listed company operating for its own account or (ii) not established for the main purpose of generating returns for its investors by means of divestments of its subsidiaries or associated companies.

2.3 Simplified regime

The Directive establishes that the AIFMs defined according to the parameters examined in the first point of this section must comply with all the provisions which will be analysed in the following sections. However, the Directive provides a specific regime for AIFMs with assets under management which do not exceed the following thresholds: (i) 100 million euros when the assets making up the portfolios of one or more of its AIFs include assets acquired through use of leverage or (ii) 500 million euros when the assets making up the portfolios of its AIFs do not include assets acquired through leverage and which have no redemption rights exercisable during the period of five years following the date of initial investment.

These AIFMs must only comply with the following disclosure obligations to the competent authority, without prejudice to the fact that the Member States may establish additional requirements: (i) they must register with the competent authority of their home Member State, (ii) at the time of registration they must identify the AIFs that they manage and inform about their investment strategies, (iii) they must regularly inform about their principal exposures and risk concentrations, and (iv) they must notify when they exceed the thresholds and, therefore, that they may no longer remain under the simplified regime.

AIFMs which are subject to the simplified regime may not request the passport which allows AIFMs from the general regime to provide their services and/or market AIFs throughout the EU under one single authorisation. However, the Directive provides the possibility that the AIFM of the simplified regime may request to be authorised in accordance with the general regime and, consequently, then have access to the passport. The content of the general regime is covered in the following sections.

3 Regulation of AIFM and their activity[5]

As indicated above, the regulation contained in the AIFMD mainly aims to establish a series of conditions and requirements which are common to all AIFMs which intend to operate in the EU so that the activity which they carry on meets certain homogenous quality standards in all Member States. Some of the provisions contained in this Directive are not unknown, showing the European legislator has taken inspiration both in the set of laws for UCITS and in the MiFID to design a regulatory environment for AIFMs which adapts to the specific nature of alternative investment. Chapters II, III, IV and V of the Directive detail most of the requirements that every AIFM must observe, both in its operations and in its internal organisation, as well as in its relationship with investors and the competent authorities.

5 This section does not include the explicit analysis of the administrative procedure for authorisation of AIFM, which is contained in detail in Chapter II (article 6 to 11) of the AIFMD.

3.1 Operating requirements

With regard to initial capital and the own funds required of AIFMs, the Directive establishes that the initial capital must be at least 125,000 euros, or 300,000 euros for an internally-managed AIF. The AIFM must provide an additional amount of own funds when the value of the portfolios managed by the AIFM exceeds 250 million euros, equal to 0.02% of the amount by which the value of the portfolios exceeds 250 million euros. At any event, the requirement for own funds shall not exceed 10 million euros, but may not be below one quarter of its preceding year's fixed overheads.[6] Finally, it is important to point out two provisions which represent the desire of the European legislator, on the one hand, to adapt the rules to the different types of entities they are aimed at and, on the other hand, to introduce measures which may be useful in future difficult situations such as those caused by the current financial crisis. In the first case, the new regulation introduces the power of Member States to allow AIFM not to provide up to 50% of the additional amount mentioned above, providing they benefit from a guarantee of the same amount given by a credit institution or an insurance undertaking. In the second case, however, the European legislator aims for AIFMs to anticipate and expressly cover potential professional liability risks, for which they are required to take out the corresponding insurance, or to have additional own funds specifically for this purpose.

Beyond the initial capital and own funds requirements, the other operating requirements relate to a series of general principles and to a set of specific provisions about the policies of the AIFM with regard to remuneration of their staff and the management of conflicts of interest, as well as on risk management and liquidity management.[7] With regard to the first of these requirements, the Directive refers to the general duties of diligence and fairness which compel the AIFM to employ effectively the resources and procedures that are necessary for the proper performance of its business activities, as well as to operate fairly in the best interests of the AIF it manages and the integrity of the market. The second set of requirements - the obligation to have internal remuneration policies - responds to the desire of European institutions to introduce this issue in all legislative measures for the financial sector.[8] The treatment of conflicts of interest includes the duty to avoid them and, when this is not possible, the duty to identify them, prevent them and manage them so as to mitigate the negative effects which they cause to the AIF and its investors. Said duties affect both the standards of conduct of the AIFM in performing its activity and the manner in which it is internally organised. Finally, the provisions on risk management and liquidity management establish that, in the first case, said management maintains certain functional and hierarchical independence from the other functions of the AIFM providing this is proportional to the nature and size of the AIFM, and that, in the second case, liquidity management includes stress tests which corroborate the consistency between the established redemption profile for each AIF and the management carried out of said liquidity.

6 Article 9.5 of the AIFMD.

7 Articles 12 to 16 of the AIFMD.

8 See Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector.

3.2 Organisational requirements

Similarly, the Directive imposes certain conditions on the AIFMs both for internal organisation and relating to the way in which they interact with other agents intervening in the management of an AIF. AIFMs must have, as a general obligation, adequate human and technical resources and a good administrative and accounting organisation, including control and safeguard arrangements for electronic data handling and adequate internal control mechanisms. Specifically, they must have rules which regulate personal transactions by their employees or for the holding or management of investments in financial instruments in order to invest on their own account. These rules aim to guarantee, at least, that each transaction involving the AIF may be reconstructed according to its origin, the parties hereto, its nature, and the time and place at which it was effective and that the assets of the AIF managed by the AIFM are invested according to the fund rules or the instruments of incorporation and the legal provisions in force. However, the Directive devotes three provisions to organisational aspects which deserve a more detailed examination: The function of valuation, the delegation of functions and the legal regime for the depository.[9]

With regard to valuation, the Directive is based on the principle that this function should be independent from any other function of the AIFM. According to the Directive, this independence is ensured by entrusting this function (i) to an external valuer independent from the AIF, the AIFM or from any other persons with close links to the AIF or the AIFM, or (ii) to the AIFM, provided that the valuation task is functionally independent from the portfolio management and the remuneration policy and any other aspect which may enter into conflict. The depository appointed for an AIF cannot be appointed as an external valuer of that AIF unless the independence of the different tasks can be guaranteed and the possible conflicts of interest properly identified, managed and disclosed to investors, as well as the measures adopted for their treatment and prevention.

The external valuer must carry on its activity within the framework of some type of regulation recognised by law or to legal or regulatory provisions for rules of professional conduct, and must offer sufficient guarantees to be able to effectively perform the relevant valuation function. The appointment of the external valuer must comply with the procedure established in the Directive for the delegation of functions,[10] and may be questioned by the competent authority up to the point of proposing the appointment of another valuer. Under no circumstances may the external valuer delegate the valuation function to a third party. Evaluation must be carried out according to the regulations applicable in the home Member State of the AIF, taking into account the nature of the assets of the AIF as well as its redemption policy. The AIFM shall be ultimately liable for correct performance of this function even if it has appointed an external valuer. When the valuation function is not performed by an independent external valuer, the Member States may require the AIFM to have its valuation procedures verified by an external valuer or an auditor.

9 See articles 18 to 21 of the AIFMD.

10 See Article 20 of the AIFMD.

With regard to the delegation of functions, the Directive establishes a strict procedure according to which the AIFM must, firstly, explain the reasons which justify the delegation. It must also ensure that the delegatee or delegatees not only dispose of sufficient resources to perform the respective tasks, but also that the delegation does not prevent the corresponding supervision of the delegated activity by the AIFM, or the proper supervision of the AIFM by the competent authority. The competent authority must be notified of the delegation prior to its entry into force, and in no case shall the AIFM's liability towards the AIF and its investors be affected, not even in cases of subdelegation, which is permitted providing all the requirements for the delegation are followed, *mutatis mutandis*, even in the special cases of the delegation of portfolio and risk management, which are analysed next.

If these functions are delegated, the Directive requires that the delegatee be an entity which is authorised or registered for said purpose and which is subject to supervision for said activity. Where this condition cannot be satisfied, the AIFM may delegate to the entity in question on the condition of prior authority by the competent authority. No delegation of these functions may be given to the depository or to a delegatee of the depository, with this restriction extending to any other entity whose designation as delegatee may lead to conflicts of interest unless these may be identified, managed and disclosed to the investors of the AIF.

Finally, it is important to point out the extensive regime which the Directive dedicates to the depository, which covers multiple issues including the type of entities which are eligible for carrying out the task of depository, what functions make up said task and what liability regime will be applied to the depository for breach of, or defective compliance with, the established obligations.

Firstly, it should be pointed out that the Directive starts from the premise that each AIF must have one single depository, which must be established in the Member States of the EU where, in turn, the AIF is established. There are, however, two exceptions. The first is included in section 5 of Article 59, which establishes that the competent authorities of the home Member State of an AIF - or, failing that, the AIFM - may authorise the designation of a depository[11] established in another Member State of the EU other than that where the AIF is established for a maximum period of four years after the date of transposition of the Directive. The second refers to non-EU AIF, which may have a depository[12] established in one of the three following options: (i) the country of origin of the AIF; (ii) the home Member State of the AIFM, or (III) the Member State of reference of the non-EU AIFM. In the event that the depository is established in the country of origin of the non-EU AIF, it must also comply with the following conditions: (i) there must be a cooperation arrangement and a tax agreement between the competent authorities of the country of origin of the AIF and the Member State where the AIF will be marketed and, if different, of the AIFM; (ii) that the depository is, in its country, subject to prudential supervision equivalent to the regulation established in the EU; (iii) that the country of origin of the depository is not listed as a non-cooperative country and territory

11 In this case, the only type of entity eligible for carrying out depository functions is a credit institution.

12 In the case of depositories established outside the EU, the regulation restricts the type of eligible entities to (i) credit institutions and (ii) institutions similar to credit institutions or investment firms.

with regard to money laundering and terrorist financing; and (iv) that the depository is contractually liable to the AIF or its investors for correct performance of its functions.

We can now examine the type of entities which the European legislator has in mind for carrying out depository functions. Section 3 of Article 21 refers to the following: (i) credit institutions established in the EU and authorised in accordance with Directive 2006/48/EC; (ii) investment firms established in the EU and authorised in accordance with Directive 2004/39/EC which also comply with the capital adequacy requirements provided in Directive 2006/49/EC; and (iii) any other institution subject to prudential regulation and ongoing supervision which at the date of entry into force of this Directive belongs to the type of entities determined by the Member States as eligible for carrying out depository functions relating to UCITS. In addition to these three types of institutions, the Directive allows Member States to envisage another type of entities for certain cases. Specifically, it provides that the depository of certain AIFs may be an entity which carries out depository functions as part of its professional activity for which it is subject to some type of regulation recognised by law or to legal or regulatory provisions for rules of professional conduct, providing it offers sufficient guarantees for adequate performance of its tasks. This possibility is aimed at AIFs which (i) have no redemption rights exercisable during the period of five years from the date of the initial investment, and which (ii) generally do not invest in assets that must be held in custody as established in the AIFMD for the custody of financial instruments,[13] or generally invest in issuers or non-listed companies in order to acquire their control. The depository of an AIF may not be an AIFM or the prime broker acting as counterparty to the AIF, unless it has functionally and hierarchically separated the performance of its depository functions from its tasks as prime broker and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors.

With regard to the functions attributed to the depository, the Directive regulates both the function of custody of the securities and cash of the AIF and the functions of oversight and supervision of the management carried out by the AIFM. With regard to the first functions, apart from establishing a specific treatment for the custody of cash, the Directive distinguishes between custody in a strict sense for assets - financial instruments - which may be registered in a financial instruments account or which may be physically held by the depository, and custody in a wide sense for any other type of asset. With regard to oversight and supervision, the Directive refers to the typical controls on regulatory compliance and the use of adequate systems and mechanisms to ensure compliance with the management provided for a specific AIF.

Only the function of financial instruments custody - and not cash custody - may be delegated. For this, the depository must demonstrate that there are objective reasons which justify delegation and that they are not delegated with the intention of avoiding the established regulation. In addition, the delegatee must comply with the following conditions: (i) it must have adequate capacity to carry out the tasks entrusted to it; (ii) it must be subject to prudential regulation and supervision, as well

13 Article 21.7 of the AIFMD.

as to an external audit with regard to custody tasks; (iii) it must segregate the assets of the depository's clients so that these may, at all times, be identified as belonging to the AIF in question; and (iv) it may not make use of the assets without the consent of the AIF. The depository must also ensure that the delegatee is not subject to any of the cases of prohibition established in the Directive for the depository, and that it complies with the other established conditions. These conditions do not need to be fulfilled in the specific case in which the national law of the country requires custody by a local entity and there are no local entities that satisfy the requirements. In this case, the depository may delegate to such an entity if, after informing the AIF - or its investors - the AIF instructs it to carry on with the delegation. The delegation of functions does not affect the liability of the depository, except in certain cases which we will now examine together with the general regime of depositaries' liability provided by the Directive.

Section 11 *in fine* of Article 21 establishes that the depository is liable for the losses suffered by the AIF as a result of the depository's negligent or intentional failure to perform its obligations. Therefore, the Directive establishes a contractual liability regime based on the traditional elements of damage, breach and compensation. However, this regime has an exception in the case of failure to perform the obligation of custody in the strictest sense. Specifically, the Directive stipulates that in the event that the depository loses a financial instrument held in custody, the depository shall return a financial instrument of an identical type, or its value, without undue delay. This return may be avoided if, and only if, the depository proves that the loss has arisen as a result of an external event beyond its control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

As has been mentioned above, the general principle is that the delegation of functions does not affect the depository's liability. However, the text provides two cases in which said liability may be transferred to the delegatee. The first establishes that the depository shall not be liable if: (i) there is a written contract which expressly allows and explains the reasons for transferring liability; (ii) the depository substantiates that it has complied with all the obligations for the delegation of its tasks; and (iii) the contract makes it possible for the AIF - or its investors - to make a claim against the third party. The second case refers to the situation in which the depository has delegated to an entity which does not meet the delegation requirements and, even so, it has been instructed to delegate custody of financial instruments. In this case, (i) the rules or instruments of incorporation of the AIF must expressly allow for a discharge; (ii) the investors of the AIF must have been duly informed; and (iii) there is a written contract which makes it possible for the AIF, or its investors, to make a claim against the delegatee.

3.3 Transparency requirements

This last point covers the transparency requirements contained in Chapter IV of the Directive, as well as a set of specific obligations aimed at AIFMs which manage AIFs which use leverage on a substantial basis to carry out their investment strategies and policies or those which base their investment on acquiring control of other companies. As we shall see, this set of specific obligations, contained in Chapter V of the Directive, includes duties whose objective goes beyond strict transparency requirements.

The first block covers, on the one hand, the obligation to prepare an annual report for each one of the AIFs managed by an AIFM[14] and, on the other hand, the reporting duties of the AIFM to investors of each one of the AIFs, as well as the relationship with the competent authorities. The report must be prepared within the six months following the end of the financial year and must be available both for investors and for the relevant competent authorities. The annual report includes the balance sheet, the income and expenditure account, a report on the activities and any material changes in the information available to investors and a breakdown of the remuneration paid by the AIFM to its staff members. The accounting information included in the annual report must be previously audited.

With regard to disclosure, Article 23 establishes that investors, before investing, must have information relating to the following items: (i) the investment objectives and strategies, including the type of assets, any restrictions and the possibility of using leverage; (ii) the procedures established for changing the investment strategy; (iii) the main legal implications of the contractual relationship to be entered into; (iv) the identity of the entities participating in said relationship, including references to the possible delegations of functions, the valuation processes and the organisation of risk and liquidity management; (v) fees and other charges; (vi) the processes for subscription and redemption; (vii) the latest annual report; (viii) the latest net asset value; and (ix) the historical performance, where available. The article makes special reference to the duty to disclose possible liability transfer arrangements made by the depository and establishes, in addition to the initial disclosure requirements, an obligation for periodic disclosures which include the percentage of assets which may be illiquid and the update of the risk profile of the AIF, as well as an update on the level of leverage of the AIF. With regard to the competent authorities,[15] AIFMs must disclose the markets in which they operate and the instruments in which they invest, breaking down their main exposures and concentrations. They must also provide information about their liquidity management, including any illiquid assets and the results of the stress tests carried out, as well as on the management of any other type of risk in which they incur. At the request of the competent authorities, they must present the annual reports and a quarterly list of the AIFs which they manage.

The second block covers the provisions aimed at AIFMs which manage certain types of AIFs. AIFMs managing AIFs employing leverage on a substantial basis must firstly set limits for the use of these techniques, which must always be respected. In addition, they shall make available information about the overall level of leverage including a breakdown of the different types of leverage - borrowing of cash, of securities or the use of derivative instruments -, the five largest sources of leverage, or by any other of these variants with regard to a specific AIF. As we shall see in more detail in the last section of this paper, obtaining and publishing this information must enable one of the objectives of the Directive - the control of systemic risk - to be achieved. Accordingly, and in the case of the use of leverage, the Directive pro-

14 Article 22 of the AIFMD.

15 Article 24 of the AIFMD.

vides stronger cooperation mechanisms between the different supervisory authorities, both nationally and at a European level.

Finally, with regard to the AIFs intending to acquire control of other companies, the Directive creates a specific regime of duties and obligations which exceeds simple transparency requirements. For this purpose, the text defines "control" as follows: holding more than 50% of the voting rights of non-listed companies and, for listed companies, it refers to Directive 2004/25/EC on takeover bids, which in turn refers to the regulations of the Member State in which the listed company is domiciled. This specific regime will not be applied, however, when the non-listed companies (i) are included in the definition of small- and medium-sized companies incorporated in Recommendation 2003/361/EC of the European Commission, of 6 May 2003;[16] or when (ii) they are special purpose vehicles with the purpose of purchasing, holding or administrating real estate.

Given that the acquisition of control of a listed company will be subject to the regulatory framework established by the directives on takeover bids and transparency,[17] the AIFMD is aimed mainly at non-listed companies. In this regard, Article 27.2 establishes that the AIFM of an AIF which acquires said control in a non-listed company must notify the company in question, its shareholders and the competent authority of the AIFM. The notification will include the final distribution of voting rights, as well as the conditions and date on which control was reached. In its notification to the non-listed company, the AIFM shall request the board of directors to inform the representatives of employees or, when there are no such representatives, the employees themselves of the acquisition of control. The Directive establishes a maximum period of 10 working days between acquisition of control and notification. Following the legislation on transparency of issuers of securities admitted to trading on a regulated market, the first section of Article 27 requires that the AIFM notify the competent authority when, through its AIF, it acquires or has holdings which reach, exceed or fall below 10%, 20%, 30%, 50% or 75% of the voting rights of a non-listed company.

Once the AIFM has notified that it has acquired control, the Directive requires, both in the case of listed and non-listed companies, the AIFM to disclose to the company, the shareholders and the competent authority the policy for managing potential conflicts of interest and the policy for external and internal communication. In the case of non-listed companies, the Directive adds that the company and its shareholders must be provided with the plans for the future of the company, as well as the potential impact on employment and employment conditions. Finally, and in addition to certain specifications established in Article 29 on the content of the annual reports which must be made by the controlled non-listed companies, this specific regime includes a provision aimed at avoiding asset stripping of controlled companies. Within the period of 24 months following acquisition of control, the AIFM may not carry out or support any type of distribution which brings the company's net worth below its

16 A medium-sized company is defined as a company which employs fewer than 250 people and whose annual turnover does not exceed 50 million euros or whose annual balance sheet does not exceed 43 million euros.

17 Directive 2004/19/EC of the European Parliament and of the Council, of 15 December 2004, on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

capital, or which exceeds the amount of the profits obtained at the end of the last year, less any losses brought forward and sums placed to mandatory reserves.

The whole raft of provisions relating to the acquisition of other companies are perceived by the European legislator as a necessary regulation to protect social interests which go beyond the correct functioning of financial markets and, perhaps for this reason, the preamble of the Directive invites the European Commission to study a possible extension of these types of provisions to all types of investors and not only to those belonging to alternative investment.

4 Management and marketing of AIFs in the UE

This section examines the different regimes for providing services and marketing AIFs which the AIFMs may be subject to. Some of the requirements and procedures contained in chapters VI and VII of the Directive - which are examined below - have turned out to be the most debated aspects of this regulatory framework over its long negotiation process.[18]

Indeed, the objective was not simple. On the one hand, the different institutions which make up the legislative arm of the EU have at all times shown the firm desire to respect the principle according to which all operators acting in the EU in accordance with the established standards must have the possibility to access the same rights granted by the regulatory framework. This meant, however, that institutions from outside the EU must be able to benefit from the passport provided in the AIFMD if they comply with the regulation established therein. On the other hand, and as already indicated at the start of this paper, said extension of the passport is not only a new element in the European *acquis* for collective investment, but it also poses several challenges in the area of the effective supervision of financial institutions located outside the jurisdiction of the EU. In all, the Directive has managed to design a system through which, after a period of adaptation to the regulatory and supervisory needs put forward, all the AIFMs which comply with the regulation contained in the AIFMD will be able to benefit from the passport provided therein. The conditions and requirements making up this system will be analysed in the first point of this section. The second point is for the different situations in which an AIFM can provide its services or market AIFs under the different non-harmonised national regimes. It will not examine, however, two cases which, although subject to the general regime of the Directive, do not involve application for the passport and which, furthermore, are considered sufficiently detailed in the text of the Directive. These are (i) the authorisation of EU AIFMs to market EU AIFs in their home Member State[19] and (ii) the management of non-EU AIFs by EU AIFMs which, however, do not market them in the European Union.[20]

18 In this regard, see the detailed collection of documentation made by the Alternative Investment Management Association (AIMA) on the legislative process of the AIFMD, available at http://www.aima.org/en/directive-centre/index.cfm.

19 This is the case of non-cross-border marketing within the EU, contained in Article 31 of the AIFMD, and whose authorisation requires the documentation included in Annex III A.

20 This case, included in Article 24 of the AIFMD, is characterised by demanding full compliance with the Directive, given that the AIFM is established in the EU, except the provisions for investor transparency, as non-EU AIFs are not marketed within the European Union.

4.1 Operating with a passport

Firstly, below is an analysis of the situation which is closest to the UCITS regulatory framework, especially following its latest amendment and recasting.[21] This case corresponds to the possibility that an EU AIFM markets or manages EU AIF in a Member State other than the home Member State of the EU AIFM.[22] In this case, the Directive has opted for a procedure of notification between competent authorities so that the EU AIFM informs the competent authority of its home Member State of its intention to market or manage EU AIFs in Member States other than its own, and it will be its competent authority which notifies said intention to the competent authorities of the host Member States, sending the documentation previously presented to it by the EU AIMF.

In the case of marketing EU AIFs, the documentation which the EU AIFM must attach to its communication is that included in Annex III B of the Directive, which must be notified between competent authorities in the period of 20 days following full receipt of said documentation. Said notification will be communicated, in turn, to the EU AIFM and it will be from the date of this communication that the EU AIFM may begin cross-border marketing of the EU AIFs. In the case of management of EU AIFs, the information which must be included in the communication of the EU AIFM is that contained in Article 33 and the time periods for notification between competent authorities is established at between one and two months following full receipt of the aforementioned information. Similarly, the EU AIFM may begin to provide its services in the host Member States once it has been informed of the notification made between competent authorities. This procedure must be included in national legislation within the two years provided for transposition of the AIFMD from its entry into force, which is currently planned for the 20 days following its publication in the Official Journal of the European Union.[23]

The following scenario of interest is that of the marketing of non-EU AIFs in the EU by an EU AIFM.[24] In this case, the EU AIFM must comply with the Directive in full[25] and must also comply with the following conditions: (i) there must be cooperation arrangements between the competent authority of the home Member State of the AIFM and the competent authorities of the countries where the non-EU AIFs are established; (ii) these countries must not be listed as non-cooperative countries with regard to money laundering and terrorist financing; and (iii) there must be tax agreements between all the countries involved: EU AIFM, non-EU AIFs and other Member States of the EU where said non-EU AIFs are to be marketed. Once the competent authority of the home Member State has examined all the requirements, the process of marketing in other Member States will follow a similar procedure to that explained above for EU AIFs, i.e., a notification procedure between competent authorities. However, the Directive provides specific time periods for implementa-

21 Council Directive 2009/65/EC, of the European Parliament and the Council, of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS Directive).

22 Articles 31 to 33 of the AIFMD.

23 Articles 63 to 65 of the AIFMD.

24 Article 35 of the AIFMD.

25 With the exception of Chapter VI, as this chapter deals with marketing EU AIFs.

tion of this extension of the passport to non-EU AIFs. Article 63bis establishes that two years following the deadline for the transposition - which, in turn, is two years following the entry into force of the Directive - ESMA shall issue a report evaluating the functioning of the passport for EU AIFs and advising the European Commission on the suitability of extending it to non-EU AIFs under the conditions which we have examined.[26] If its opinion is positive, the Commission shall adopt, within three months, the necessary measures to make the passport effective for non-EU AIFs.

Finally, it is important to point out the case in which a non-EU AIFM intends to market AIFs or manage EU AIFs in the EU.[27] The system provided for this case is based on the assimilation of the non-EU AIFM to the EU AIFM, so that the system designed for the latter may be applied to the former. This assimilation process begins by requiring that the non-EU AIFM fully complies with the provisions of the AIFMD, for which it is asked to be authorised by the competent authority of a Member State of the EU, which will become the "Member State of reference" and in which the non-EU AIFM must have a legal representative, which will be considered as the principal contact point for all purposes both for investors and the competent authorities.[28] The European legislator has provided a set of criteria to determine the Member State of reference with the intention of avoiding the arbitrary nature of a free choice of said Member State by the non-EU AIFM. The Directive also envisages the possibility that compliance by the non-EU AIFM with its home regulation be incompatible with compliance with the regulation contained in the AIFMD. In this situation, the Directive exempts the non-EU AIFM from compliance with the provisions in question of the AIFMD providing the non-EU AIFM can prove that under its home regulation it is subject to a rule whose purpose and effect are equivalent to that of the provision it has been exempted from. Finally, and as occurs in the case of non-EU AIFs, the non-EU AIFM must demonstrate that (i) there are cooperation agreements between the competent authority of the Member State of reference and the competent authorities of the countries where the AIF and the non-EU AIFM are established; (ii) this country must not be listed as a non-cooperative country and territory with regard to money-laundering and terrorist financing; (iii) there must be a tax agreement between the Member State of reference and the country where the non-EU AIFM is established; and, as an additional requirement, (iv) there must be no legal impediment for effective supervision of the non-EU AIFM by the competent authorities designated under the AIFMD.

Once assimilated, the non-EU AIFM will be authorised to carry out cross-border operations in the EU as if it was an EU AIFM, so any non-EU AIF that it markets must in turn comply with the requirements indicated in the previous paragraph. However, this mechanism is dependent on a process of legislative consultation and action similar to that mentioned for the passport of non-EU AIFs, which will not be activated until two years have passed from the date provided for the transposition. Therefore, it is necessary to explore which other regimes will be in force while operations with a passport are not fully deployed.

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26 That same article contains a series of criteria which ESMA must bear in mind when preparing its report and issuing its opinion.

27 Articles 37 to 39.

28 Article 37.3 of AIFMD refers to this legal representative in terms that remind us of the "designated entity" of our rules on foreign collective investment undertakings, CNMV Circular 2/2006, of 27 June.

4.2 Operating without a passport

The first case in which an AIFM may operate without the need to be subject to the general legal regime established by the AIFM - and therefore, without being able to access the passport provided therein - is that which has already been explained in the second section relating to the AIFM which do not exceed the thresholds of assets managed established in Article 3 of the Directive. The second case is that provided in Article 41, which regulates the marketing of AIFs to retail investors. This article establishes that the power to authorise the marketing lies with the Member States, and that these States may impose more severe requirements than those established in the Directive both to AIFs and to AIFMs for carrying out said marketing. Consequently, no type of AIFM may market AIFs to retail investors in the EU under one single authorisation granted by the competent authority of its home Member State or Member State of reference.

However, as indicated in the previous point, it is recommendable to analyse what the situation will be in the period of time between the transposition of the Directive and up to the possible entry into force of the passport for AIFs and AIFMs not established in the EU. This is dealt with in articles 36 and 40, which establish the conditions for which, respectively, an EU AIFM may market non-EU AIFs, and a non-EU AIFM may market any type of AIF, in the Member States of the EU and without a passport. Firstly, it should be pointed out that, in both cases, the Directive presents these situations as an option of each Member State, which may reject authorisation in these cases. However, in the event that they allow authorisation, the Directive establishes a minimum regulation which must be observed in all cases and which may be strengthened as considered appropriate by each Member State.

For the case of EU AIFMs which intend to market non-EU AIFs, the Directive establishes that the EU AIFM must comply with all the provisions except Article 21, which is substituted by the requirement to designate one or more entities which comply with the depository functions provided by the AIFMD and which must not be carried out by the AIFM. It also requires that (i) there are cooperation arrangements between the competent authority of the home Member State and the competent authorities of the countries where the non-EU AIFs are established; and that (ii) these countries are not listed as non-cooperative countries and territories with regard to money laundering and terrorist financing. For the case of non-EU AIFM, the Directive establishes that they may market AIF in the Member States of the EU without a passport providing they meet the transparency requirements[29] that the AIFMD establishes with regard to each one of the AIFs which they intend to market. In addition to this requirement, there must be cooperation arrangements between the competent authorities of all the countries involved, although this time the Directive states that the specific purpose of such arrangements must be to facilitate the exchange of information so as to oversee systemic risk.

The possibility of operating under these national regimes is not, however, conceived by the Directive as a definitive and permanent scenario. On the contrary, Article 63ter establishes a procedure by which these options of the Member States may be

29 The Directive specifically mentions articles 22 to 24 and the second section of Chapter V.

eliminated. Specifically, the Directive provides that within three years following the possible entry into force of the passport for AIFs and AIFMs established outside the EU, the European Securities and Markets Authority (ESMA) shall prepare a report evaluating the functioning of the passport for non-EU AIFs and non-EU AIFMs and shall advise the European Commission on the appropriateness of eliminating the non-harmonised national regimes which allow operations without passports.[30] If the opinion is positive, the Commission must adopt, within the three following months, the measures necessary to effect the elimination and submit all AIFMs to the general regime established by the Directive, irrespective of the country where they are established.

5 Final considerations

This article offers an idea of the complexity faced by the European legislator for implementing, for the first time, a harmonised legal regime for all types of AIFMs; entities which manage investments of very different types which include hedge funds, venture capital, commodities and real estate investment amongst others. Faced with the concentration of changes and new items which will follow the imminent publication of the Directive on alternative investment fund managers (AIFMD), this final section brings together several considerations about the foreseeable future scenario in which alternative investment will operate in the European Union.

Firstly, it should be pointed out that this Directive will regulate the management and marketing of AIFs by AIFMs, defining marketing as any direct or indirect offering or placement at the initiative of the AIFM, or on its behalf, of units or shares in an AIF to investors domiciled in the EU. Therefore, what is known as "passive marketing", that is, any investment made at the initiative of the investor in AIFs managed by AIFMs which, according to the provisions of the Directive, are not within its scope of application,[31] do not undergo any change and may continue to be carried out as they have been to date.

The second consideration should be focused on the regulatory consequences of the different types of harmonisation provided in the Directive. As has been corroborated by the European Commission,[32] the AIFMD is, essentially, a maximum harmonisation directive. However, several of the provisions of the Directive state that the contents therein are a minimum regarding which the Member States may exercise their regulatory authority.[33] In a similar sense, it is important to remember that all those matters not regulated by the Directive remain outside any harmonisation

30 As with the implementation of the passport for non-EU AIFMs and non-EU AIFs, this provision also provides a series of criteria which ESMA must consider when preparing its report and issuing its opinion.

31 An example could be a non-EU AIFs managed by a non-EU AIFM which is not marketed in the EU. A European investor which, however, knew of its existence, could invest in it subject to the rules which its legal regime as investor e.g. as pension fund, impose on it.

32 This is how it is expressed in its provisional request for technical advice on level 2 measures required by the AIFMD.

33 See, for example, articles 26.7 or 41 of the AIFMD.

process. Therefore the substantial regulation of AIFs which certain Member States possess may continue to be applied providing it does not hinder the exercise of the rights provided in the Directive.[34]

Thirdly, the detail needed to specify many aspects and concepts established by the Directive so as to ensure its effectiveness is entrusted to the development of level 2 and level 3 measures which must be prepared by the European Commission and by ESMA. The AIFMD has turned extensively to such measures - up to 99 cases[35] - and so the meaning and scope of many provisions cannot be determined until these measures have been prepared. In this regard, and unlike the provisions of the UCITS Directive,[36] the AIFMD does not provide a specific calendar for enacting these measures, although the European Commission has expressed its desire to proceed in accordance with the "UCITS model", i.e. at the end of the transposition of the level 1 Directive all future level 2 measures should also be effective in the Member States.

Fourthly, it is important to summarise the role which ESMA will play with regard to the AIFMD. The negotiations of the Directive and of the regulatory legislation of ESMA took place at the same time, which is reflected in the extensive and important presence which the new European authority has throughout the AIFMD. On the one hand, ESMA may act in accordance with its constituting legislation,[37] which designates it a series of functions such as coordination, mediation and intervention in regulatory processes and the homogenous application of financial legislation.[38] On the other hand, the AIFMD also attributes it with specific functions which go from the receipt of certain types of information[39] to coordination between the different competent authorities involved.[40]

Finally, it is important to mention the special role of the review clause included in Article 64 of the Directive, which, although a usual clause in European legislation, in this case may contribute to place into perspective the transition inherent to any new regulation. Accordingly, the Directive calls on the European Commission to initiate a review process of the application of the Directive four years after its transposition, which is noteworthy as the date for the review of this regulatory framework is prior to the full entry into force of more than one provision analysed in this paper.

34 In this regard, see recital 8 of the preamble of the AIFMD.

35 See Annex 1 of the provisional request for technical advice on level 2 measures required by the AIFMD.

36 Council Directive 2009/65/EC, of the European Parliament and the Council, of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS Directive).

37 Article 1.2 of Regulation (EU) No 1095/2010 of the European Parliament and the Council, of 24 November 2010, establishing a European Supervisory Authority (European Securities Markets Authority). Expressly includes the AIFMD within the competence of ESMA.

38 See articles 10 to 21 of Regulation (EU) No 1095/2010.

39 See, for example, articles 24 and 41 of the AIFMD.

40 An example of that function is found in the strengthened co-operation procedure of Article 25 of the AIFMD on the control of an entity's leverage.

IV Legislative Annex

New legislation approved since publication of the CNMV Bulletin for the fourth quarter of 2010, in chronological order, is as follows:

– Bank of Spain Circular 8/2010, of 30 November, to credit institutions, amending Circular 4/2004, of 22 December, on rules of public and reserved financial information, and presentation of financial statements.

  This Circular incorporates into Spanish law regulations (EC) 494/2009 and 495/2009, of the Commission, which adopted for the European Union the amendments to IFRS 27 on consolidated and separate financial statements, and IFRS 3 on business combinations.

– CNMV Circular 6/2010, of 21 December, on transactions with financial instruments of collective investment undertakings.

  Order EHA/888/2008 widens the scope of action of UCITS with regard to derivative instruments. The contents of the Circular are in line with Directive 2010/43/EU as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depository and a management company.

  The main aim of the Circular is to implement the methodology for calculating the limit for market risk associated with the use of derivative instruments. It also implements specific issues related to the joint diversification limits contained in article 39.4 of Royal Decree 1309/2005: limits to the use of derivative instruments for counterparty risk, requirements on operating in non-organised markets, valuation of positions and calculation of the debt limit.

  In addition, it implements a specific regime for UCITS with a specific return target.

– Bank of Spain Circular 9/2010, of 22 December, to credit institutions, modifying Circular 3/2008, of 22 May, to credit institutions, on determining and controlling minimum own funds.

  This Circular transposes several directives relating to own funds (Directive 2009/27/EC, of the Commission, of 7 April; Directive 2009/83/EC, of the Commission, of 27 July; and Directive 2009/111/EC, of 16 September). In particular, it establishes provisions aimed at strengthening the organisation and internal control relating to the management of liquidity risk and securitisation transactions. It also introduces other technical amendments, such as the treatment for tax purposes of own shares and changes in the value of the securities portfolio.

– Act 40/2010, of 29 December, on geological storage of carbon dioxide.

  The ninth final provision of this Act introduces an amendment in the taxing of SICAVs (investment companies). In particular, capital reduction with return of contributions is now the equivalent of a dividend payment for tax purposes.

– CNMV Circular 1/2011, of 21 January, amending Circular 12/2008, of 30 December, on solvency of investment firms and their consolidatable groups.

This Circular includes the content of Directive 2009/27/EC, of the Commission, amending Directive 2006/49/EC of the Parliament and of the Council as regards technical provisions concerning risk management, with regard to position risk and counterparty credit risk of certain credit derivatives. It also transposes Directive 2009/83/EC, as regards technical provisions concerning risk management.

It introduces some changes resulting from acquired experience, such as the items to consider when calculating own fund requirements for structural expenses; the exclusion of certain assets from the limits to major risks; and the need to deduct tax credits from base capital.

It adds an additional provision on financial advisory firms, in particular, on the verifications which must be performed by independent experts when the financial advisory firms are natural persons.

– Royal Decree-Law 2/2011, of 18 February, for the strengthening of the financial system.

This Royal Decree-Law has a twofold objective: to rectify the asset position of savings banks and to modernise their functioning and corporate governance, encouraging them to adopt organisational forms which allow them to access capital markets.

Firstly, to guarantee the solvency of savings banks, compliance with the international standards of Basel III has been brought forward. The minimal level of the core capital ratio has been set at 8%, and at 10% for those institutions which have not placed equity securities with third parties for at least 20% and which, in addition, have a wholesale funding ratio greater than 20%. The institutions which as of March do not reach the required level of core capital will have to inform the Bank of Spain about the strategy and schedule which will guarantee compliance with the new requirements. In the case of those institutions which request admission to trading of their shares on an official secondary market, the deadline will be extended until the first quarter of 2012. Similarly, temporary non-compliance of up to 20% of the core capital ratio required will mean that the Bank of Spain will impose restrictions on the distribution of profits, payment of dividends, allocation to social work, remuneration of preferred shares, variable remuneration of directors and executives and share repurchases.

Furthermore, the Royal Decree-Law imposes that the rectification by the FROB (Fund for Orderly Banking Restructuring) of institutions which are in difficulty will be carried out by means of temporary acquisition of ordinary shares of those institutions which do not comply with the required levels of own funds and which request said acquisition. This participation of the FROB will be extended for a maximum period of five years and the valuations will be carried out by experts appointed by the Fund. The acquisition of securities by the FROB will be dependent upon the entity preparing a Recapitalisation Plan in which it must assume commitments, such as to reduce structural costs or to improve corporate governance. Finally, it also provides the acquisition by FROB of preferred shares convertible into contributions to the share capital of credit cooperatives.

V Statistics Annex

1 Markets

1.1 Equity

Share issues and public offerings[1]

TABLE 1.1

	2008	2009	2010	2010 I	II	III	IV	2011 I[2]
CASH VALUE[3] (million euro)	16,349.3	11,390.7	16,012.7	241.5	5,115.3	2,322.6	8,333.3	1,311.1
Capital increases	16,339.7	11,388.7	15,407.0	241.5	4,580.9	2,322.6	8,262.0	1,311.1
Of which, primary offerings	292.0	17.4	958.7	14.8	923.7	6.0	14.2	0.0
With Spanish tranche	292.0	14.9	61.6	14.8	26.8	5.9	13.9	0.0
With international tranche	0.0	2.5	897.2	0.0	896.9	0.0	0.3	0.0
Secondary offerings	9.5	1.9	605.7	0.0	534.4	0.0	71.4	0.0
With Spanish tranche	9.5	1.9	79.1	0.0	7.7	0.0	71.4	0.0
With international tranche	0.0	0.0	526.7	0.0	526.7	0.0	0.0	0.0
NOMINAL VALUE (million euro)	1,835.8	1,892.1	6,313.4	143.8	2,851.9	2,234.5	1,083.2	268.4
Capital increases	1,835.7	1,892.0	6,304.4	143.8	2,851.9	2,234.5	1,074.3	268.4
Of which, primary offerings	100.0	0.1	1.9	0.1	0.2	0.7	1.0	0.0
With Spanish tranche	100.0	0.1	1.8	0.1	0.1	0.7	0.9	0.0
With international tranche	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0
Secondary offerings	0.1	0.0	9.0	0.0	0.0	0.0	8.9	0.0
With Spanish tranche	0.1	0.0	8.9	0.0	0.0	0.0	8.9	0.0
With international tranche	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NO. OF FILES[4]	54	53	69	10	18	12	29	11
Capital increases	53	53	67	10	17	12	28	11
Of which, primary offerings	2	2	12	2	4	2	4	0
Of which, bonus issues	18	11	15	1	4	3	7	2
Secondary offerings	2	1	3	0	2	0	1	0
NO. OF ISSUERS[4]	39	34	46	10	13	10	23	10
Capital increases	38	34	45	10	13	10	22	10
Of which, primary offerings	2	2	12	2	4	2	4	0
Secondary offerings	2	1	2	0	1	0	1	0

1 Includes registered offerings with issuance prospectuses and listings admitted to trading without register issuance prospectuses.
2 Available data: February 2011.
3 Does not include registered amounts that were not carried out.
4 Includes all registered offerings, including the issues that were not carried out.

Primary and secondary offerings. By type of subscriber

TABLE 1.2

Million euro	2008	2009	2010	2010 I	II	III	IV	2011 I[1]
PRIMARY OFFERINGS	292.0	17.3	958.7	14.8	923.7	6.0	14.2	0.0
Spanish tranche	282.0	14.9	61.6	14.8	26.8	5.9	13.9	0.0
Private subscribers	191.5	0.0	2.5	0.0	0.0	2.5	0.0	0.0
Institutional subscribers	90.5	14.9	59.0	14.8	26.8	3.4	13.9	0.0
International tranche	0.0	2.5	897.2	0.0	896.9	0.0	0.3	0.0
Employees	10.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SECONDARY OFFERINGS	9.5	1.9	605.7	0.0	534.4	0.0	71.4	0.0
Spanish tranche	9.5	1.5	79.1	0.0	7.7	0.0	71.4	0.0
Private subscribers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Institutional subscribers	9.5	1.5	79.1	0.0	7.7	0.0	71.4	0.0
International tranche	0.0	0.0	526.7	0.0	526.7	0.0	0.0	0.0
Employees	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

1 Available data: February 2011.

Companies listed[1]

TABLE 1.3

	2008	2009	2010	2010 I	II	III	IV	2011 I[2]
Total electronic market[3]	136	133	129	132	131	129	129	130
Of which, without Nuevo Mercado	136	133	129	132	131	129	129	130
Of which, Nuevo Mercado	0	0	0	0	0	0	0	0
Of which, foreign companies	5	5	6	5	5	5	6	7
Second Market	8	7	6	6	6	6	6	6
Madrid	2	2	2	2	2	2	2	2
Barcelona	6	5	4	4	4	4	4	4
Bilbao	0	0	0	0	0	0	0	0
Valencia	0	0	0	0	0	0	0	0
Open outcry ex SICAVs	29	29	28	29	28	28	28	28
Madrid	13	13	13	13	13	13	13	13
Barcelona	19	19	18	19	18	18	18	18
Bilbao	8	8	8	8	8	8	8	8
Valencia	7	6	6	6	6	6	6	6
Open outcry SICAVs	3	1	1	1	1	1	1	1
MAB[4]	3,347	3,251	3,144	3,213	3,193	3,175	3,144	3,121
Latibex	35	32	29	32	32	31	29	29

1 Data at the end of period.
2 Available data: February 2011.
3 Without ETFs (Exchange Traded Funds).
4 Alternative Stock Market.

Capitalisation[1]

TABLE 1.4

Million euro	2008	2009	2010	2010 I	II	III	IV	2011 I[2]
Total electronic market[3]	531,194.2	634,762.8	590,182.8	590,182.8	506,500.6	568,142.8	565,585.2	623,674.7
Of which, without Nuevo Mercado	531,194.2	634,762.8	590,182.8	590,182.8	506,500.6	568,142.8	565,585.2	623,674.7
Of which, Nuevo Mercado	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which, foreign companies[4]	61,317.5	94,954.0	92,275.8	92,275.8	76,530.8	83,898.4	100,249.8	102,968.2
Ibex 35	322,806.6	404,997.3	376,747.6	376,747.6	321,072.6	364,914.0	348,998.9	392,450.4
Second Market	109.9	80.9	69.1	69.1	66.4	74.9	74.6	58.6
Madrid	22.8	24.9	23.4	23.4	24.8	26.4	24.7	24.7
Barcelona	87.1	56.0	45.7	45.7	41.5	48.5	49.9	33.9
Bilbao	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valencia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Open outcry ex SICAVs	5,340.7	4,226.5	4,159.1	4,159.1	4,065.6	3,859.2	4,128.2	4,025.9
Madrid	1,454.7	997.3	958.0	958.0	920.7	924.0	878.8	873.0
Barcelona	3,580.2	3,400.6	3,336.4	3,336.4	3,276.0	3,139.2	3,432.2	3,336.8
Bilbao	45.9	435.4	433.4	433.4	386.9	386.9	362.1	326.1
Valencia	760.4	559.2	554.8	554.8	543.4	475.2	458.7	449.8
Open outcry SICAVs[5]	126.8	28.5	28.1	28.1	31.0	30.9	32.6	34.1
MAB[5,6]	24,718.6	26,282.9	26,502.4	26,502.4	25,763.3	26,046.2	26,340.8	26,469.2
Latibex	210,773.5	412,628.9	437,016.7	437,016.7	405,461.9	408,834.8	435,337.8	432,861.7

1 Data at the end of period.
2 Available data: February 2011.
3 Without ETFs (Exchange Traded Funds).
4 Foreign companies capitalisation includes their entire shares, whether they are deposited in Spain or not.
5 It is only calculated with outstanding shares, but not with treasury shares, because they only report the capital stock at the end of the year.
6 Alternative Stock Market.

Trading

TABLE 1.5

Million euro	2008	2009	2010	2010 I	II	III	IV	2011 I[1]
Total electronic market[2]	1,228,392.4	877,073.5	1,026,478.5	226,191.0	294,779.6	213,520.2	291,987.6	163,902.0
Of which, without Nuevo Mercado	1,228,380.9	877,073.5	1,026,478.5	226,191.0	294,779.6	213,520.2	291,987.6	163,902.0
Of which, Nuevo Mercado	11.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which, foreign companies	1,407.1	4,750.4	6,415.3	1,704.5	2,294.1	1,158.2	1,258.6	995.5
Second Market	31.7	3.2	3.0	0.3	0.9	0.5	1.4	0.5
Madrid	3.4	2.0	2.8	0.3	0.6	0.5	1.3	0.4
Barcelona	28.3	1.2	0.3	0.0	0.2	0.0	0.0	0.1
Bilbao	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valencia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Open outcry ex SICAVs	182.1	52.8	157.2	14.1	8.9	53.1	81.2	15.7
Madrid	73.9	16.5	15.7	1.2	4.5	8.6	1.5	3.6
Barcelona	103.6	29.4	135.7	9.1	4.3	44.4	78.0	12.0
Bilbao	0.1	1.1	3.9	3.9	0.0	0.0	0.0	0.0
Valencia	4.5	5.9	1.9	0.0	0.2	0.1	1.7	0.1
Open outcry SICAVs	25.3	19.7	8.1	3.3	3.8	0.5	0.5	1.6
MAB[3]	7,060.3	5,080.1	4,147.9	1,089.0	1,143.6	768.4	1,146.9	536.1
Latibex	757.7	434.7	521.2	146.5	162.1	93.5	119.2	69.5

1 Available data: February 2011.
2 Without ETFs (Exchange Traded Funds).
3 Alternative Stock Market.

Trading on the electronic market by type of transaction[1]

TABLE 1.6

Million euro	2008	2009	2010	2010 I	II	III	IV	2011 I[2]
Regular trading	1,180,835.9	833,854.9	983,584.5	218,800.9	282,043.0	202,084.6	280,656.0	158,721.6
Orders	774,718.1	499,182.8	541,879.8	135,802.4	161,849.1	112,273.3	131,954.9	98,035.3
Put-throughs	105,673.9	51,335.8	58,678.1	14,134.7	16,114.0	12,924.2	15,505.2	15,290.9
Block trades	300,443.9	283,336.3	383,026.6	68,863.7	104,079.8	76,887.0	133,196.0	45,395.4
Off-hours	10,175.2	5,996.6	17,209.5	3,481.0	5,731.2	4,932.9	3,064.3	1,881.8
Authorised trades	3,183.2	4,695.6	2,660.5	246.2	1,188.4	200.2	1,025.8	750.2
Art. 36.1 SML trades	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tender offers	17,461.2	7,188.9	312.0	0.0	273.1	38.8	0.0	0.0
Public offerings for sale	292.0	1,325.0	1,448.2	0.0	1,448.2	0.0	0.0	0.0
Declared trades	1,066.8	5,202.6	2,273.4	0.0	0.7	2,272.7	0.0	0.0
Options	9,661.9	11,443.2	11,474.7	1,741.6	2,487.4	2,010.5	5,235.2	1,061.0
Hedge transactions	5,716.3	7,366.7	7,515.8	1,921.4	1,607.6	1,980.4	2,006.3	1,487.2

1 Without ETFs (Exchange Traded Funds).
2 Available data: February 2011.

Margin trading for sales and securities lending

TABLE 1.7

Million euro	2008	2009	2010	2010 I	II	III	IV	2011 I[1]
TRADING								
Securities lending[2]	583,950.8	471,007.1	556,246.7	116,966.4	161,045.4	123,594.7	154,640.3	76,694.2
Margin trading for sales of securities[3]	624.9	704.3	598.0	153.6	158.8	155.6	130.1	143.5
Margin trading for securities purchases[3]	154.7	106.4	65.9	19.0	17.0	12.9	16.9	13.8
OUTSTANDING BALANCE								
Securities lending[2]	43,647.8	47,322.2	36,195.9	42,162.6	39,413.7	37,101.6	36,195.9	39,446.7
Margin trading for sales of securities[3]	20.7	21.1	9.9	18.7	13.7	19.1	9.9	22.7
Margin trading for securities purchases[3]	7.0	5.6	5.0	4.8	5.0	3.4	5.0	4.3

1 Available data: February 2011.
2 Regulated by Article 36.7 of the Securities Market Law and Order ECO/764/2004.
3 Transactions performed in accordance with Ministerial Order dated 25 March 1991 on the margin system in spot transactions.

1.2 Fixed-income

Gross issues registered[1] at the CNMV

TABLE 1.8

				2010				2011
	2008	2009	2010	I	II	III	IV	I[2]
NO. OF ISSUERS	179	168	115	36	58	33	47	27
Mortgage covered bonds	19	27	25	9	18	13	13	10
Territorial covered bonds	7	1	6	2	3	1	1	0
Non-convertible bonds and debentures	30	50	39	16	24	11	11	4
Convertible bonds and debentures	1	3	2	0	0	0	2	1
Backed securities	88	68	36	5	9	7	15	4
Commercial paper	77	69	58	13	18	9	19	10
Of which, asset-backed	2	2	2	0	1	0	1	0
Of which, non-asset-backed	75	67	56	13	17	9	18	10
Other fixed-income issues	0	0	0	0	0	0	0	0
Preference shares	8	23	0	0	0	0	0	1
NO. OF ISSUES	337	512	349	70	121	60	98	38
Mortgage covered bonds	47	75	88	11	32	24	21	14
Territorial covered bonds	8	1	9	2	4	1	2	0
Non-convertible bonds and debentures	76	244	154	39	58	19	38	6
Convertible bonds and debentures	1	6	3	0	0	0	3	1
Backed securities	108	76	36	5	9	7	15	5
Commercial paper	88	73	59	13	18	9	19	10
Of which, asset-backed	2	2	2	0	1	0	1	0
Of which, non-asset-backed	86	71	57	13	17	9	18	10
Other fixed-income issues	0	0	0	0	0	0	0	0
Preference shares	9	37	0	0	0	0	0	2
NOMINAL AMOUNT (million euro)	476,275.7	387,475.8	226,448.9	51,667.5	57,409.7	61,634.8	55,736.9	42,152.9
Mortgage covered bonds	14,300.0	35,573.9	34,378.5	4,650.0	10,892.4	10,317.0	8,519.1	11,630.0
Territorial covered bonds	1,820.0	500.0	5,900.0	400.0	4,700.0	300.0	500.0	0.0
Non-convertible bonds and debentures	10,489.6	62,249.0	24,356.0	8,732.8	6,811.4	1,287.2	7,524.7	127.6
Convertible bonds and debentures	1,429.1	3,200.0	968.0	0.0	0.0	0.0	968.0	25.0
Backed securities	135,252.5	81,651.2	63,260.5	2,875.0	15,698.5	28,189.7	16,497.3	14,085.0
Spanish tranche	132,730.1	77,289.4	62,743.0	2,875.0	15,205.0	28,189.7	16,473.3	12,412.4
International tranche	2,522.4	4,361.9	517.5	0.0	493.5	0.0	24.0	1,672.6
Commercial paper[3]	311,738.5	191,341.7	97,586.0	35,009.7	19,307.5	21,540.9	21,727.9	16,085.3
Of which, asset-backed	2,843.1	4,758.4	5,057.0	995.0	930.0	1,723.0	1,409.0	373.0
Of which, non-asset-backed	308,895.4	186,583.3	92,529.0	34,014.7	18,377.5	19,817.9	20,318.9	15,712.3
Other fixed-income issues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Preference shares	1,246.0	12,960.0	0.0	0.0	0.0	0.0	0.0	200.0
Pro memoria:								
Subordinated issues	12,949.5	20,988.5	9,154.2	3,284.0	1,983.5	1,838.5	2,048.2	1,587.4
Underwritten issues	9,169.5	4,793.8	299.0	299.0	0.0	0.0	0.0	10.0

1 Includes issuance and trading prospectuses.
2 Available data: February 2011.
3 The figures for commercial paper refer to the amount placed in the year.

Issues admitted to trading on AIAF

TABLE 1.9

				2010				2011
Nominal amount in million euro	2008	2009	2010	I	II	III	IV	I[1]
Total	476,710.4	388,455.0	223,404.5	56,552.9	53,030.8	65,590.3	48,230.5	43,877.7
Commercial paper	314,417.4	191,427.7	99,784.4	37,414.8	18,699.8	22,148.0	21,521.8	16,416.1
Bonds and debentures	10,040.3	61,862.5	24,728.6	8,283.1	7,392.1	1,541.1	7,512.4	126.6
Mortgage covered bonds	14,150.0	35,568.9	32,861.0	4,775.0	9,820.0	9,767.0	8,499.1	9,250.0
Territorial covered bonds	1,930.0	500.0	5,900.0	125.0	4,975.0	300.0	500.0	0.0
Backed securities	135,926.6	85,542.9	60,030.5	5,855.0	12,144.0	31,834.2	10,197.3	17,885.0
Preference shares	246.0	13,552.9	100.0	100.0	0.0	0.0	0.0	200.0
Matador bonds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

1 Available data: February 2011.

AIAF. Issuers, issues and outstanding balance

TABLE 1.10

				2010				2011
	2008	2009	2010	I	II	III	IV	I[1]
NO. OF ISSUERS	556	614	634	618	618	628	634	632
Commercial paper	72	67	60	66	63	66	60	58
Bonds and debentures	93	91	93	92	91	91	93	93
Mortgage covered bonds	22	29	33	30	31	31	33	34
Territorial covered bonds	11	11	12	11	11	11	12	12
Backed securities	383	442	459	445	447	454	459	458
Preference shares	52	60	59	61	60	59	59	60
Matador bonds	12	12	12	12	12	12	12	12
NO. OF ISSUES	4,639	4,084	3,630	4,062	3,772	3,646	3,630	3,616
Commercial paper	2,489	1,507	958	1,464	1,144	999	958	956
Bonds and debentures	450	611	645	625	645	639	645	636
Mortgage covered bonds	146	202	253	210	220	239	253	263
Territorial covered bonds	26	25	26	23	24	25	26	24
Backed securities	1,436	1,629	1,641	1,630	1,630	1,637	1,641	1,629
Preference shares	78	96	93	96	95	93	93	94
Matador bonds	14	14	14	14	14	14	14	14
OUTSTANDING BALANCE[2] (million euro)	819,637.7	870,981.1	850,181.7	866,273.2	839,437.9	851,730.8	850,181.7	854,297.6
Commercial paper	71,762.2	41,647.0	23,233.6	45,347.2	32,547.3	27,299.7	23,233.6	24,869.3
Bonds and debentures	122,001.9	150,886.3	146,077.7	152,333.9	148,648.1	144,437.2	146,077.7	143,234.6
Mortgage covered bonds	162,465.5	185,343.8	195,734.8	186,018.8	183,028.7	189,145.7	195,734.8	199,634.8
Territorial covered bonds	17,030.0	16,030.0	18,350.0	15,725.0	18,350.0	18,650.0	18,350.0	17,550.0
Backed securities	422,010.7	442,831.5	434,835.1	432,505.7	422,610.5	440,244.9	434,835.1	436,858.3
Preference shares	23,308.6	33,183.8	30,891.8	33,283.8	33,194.5	30,894.5	30,891.8	31,091.8
Matador bonds	1,058.8	1,058.8	1,058.8	1,058.8	1,058.8	1,058.8	1,058.8	1,058.8

1 Available data: February 2011.
2 Nominal amount.

AIAF. Trading

TABLE 1.11

				2010				2011
Nominal amount in million euro	2008	2009	2010	I	II	III	IV	I[1]
BY TYPE OF ASSET	2,521,040.1	4,658,633.2	4,383,118.7	655,522.1	827,194.9	1,088,985.4	1,811,416.3	1,682,799.2
Commercial paper	591,943.8	533,331.0	385,238.9	116,534.6	103,792.8	92,307.2	72,604.4	47,800.1
Bonds and debentures	80,573.8	321,743.0	922,393.1	158,121.4	222,442.5	192,302.0	349,527.2	170,452.2
Mortgage covered bonds	129,995.3	263,150.0	271,441.8	20,802.8	67,916.3	86,114.0	96,608.6	121,523.6
Territorial covered bonds	10,142.3	7,209.0	14,458.2	889.3	8,430.6	3,213.7	1,924.7	1,456.4
Backed securities	1,704,341.8	3,527,486.4	2,784,775.4	357,996.5	423,251.4	714,081.4	1,289,446.1	1,340,812.6
Preference shares	4,030.0	5,668.5	4,635.7	1,176.7	1,218.4	966.9	1,273.8	726.8
Matador bonds	13.2	45.2	175.7	0.9	143.0	0.2	31.6	27.4
BY TYPE OF TRANSACTION	2,521,040.1	4,658,633.2	4,383,118.7	655,522.1	827,194.9	1,088,985.4	1,811,416.3	1,682,799.2
Outright	387,897.1	378,348.4	288,927.3	82,774.2	81,760.9	55,230.8	69,161.4	64,689.9
Repos	381,505.0	362,068.7	304,493.2	88,416.1	82,787.8	72,123.5	61,165.8	38,714.3
Sell-buybacks/Buy-sellbacks	1,751,638.0	3,918,216.1	3,789,698.3	484,331.9	662,646.2	961,631.2	1,681,089.0	1,579,395.0

1 Available data: February 2011.

AIAF. Third-party trading. By purchaser sector

TABLE 1.12

				2010				2011
Nominal amount in million euro	2008	2009	2010	I	II	III	IV	I[1]
Total	744,652.5	681,946.6	553,896.6	162,210.3	149,128.9	121,757.2	120,800.2	88,605.4
Non-financial companies	285,044.4	256,224.6	162,949.5	49,505.8	42,315.5	37,846.5	33,281.8	23,374.2
Financial institutions	334,851.6	298,909.1	289,950.4	75,137.6	78,266.4	68,828.4	67,718.0	48,413.2
Credit institutions	130,056.0	125,547.5	102,372.1	24,254.8	26,229.9	21,916.4	29,970.9	25,080.7
IICs[2], insurance and pension funds	154,709.8	115,865.3	125,899.4	35,927.1	36,015.0	31,339.1	22,618.2	15,255.3
Other financial institutions	50,085.8	57,496.3	61,678.9	14,955.7	16,021.4	15,572.8	15,128.9	8,077.2
General government	6,331.2	5,808.5	3,117.7	1,222.0	1,425.4	160.5	309.8	135.6
Households and NPISHs[3]	13,344.0	14,647.8	14,244.4	6,377.6	3,090.8	2,234.1	2,541.9	1,151.5
Rest of the world	105,081.2	106,356.6	83,634.6	29,967.2	24,030.8	12,687.8	16,948.7	15,530.9

1 Available data: February 2011.
2 IICs: Instituciones de Inversión Colectiva / CIS: Collective Investment Schemes.
3 Non-profit institutions serving households.

Issues admitted to trading on equity markets[1]

TABLE 1.13

				2010				2011
	2008	2009	2010	I	II	III	IV	I[2]
NOMINAL AMOUNTS (million euro)	3,390.6	5,866.8	868.0	200.0	200.0	0.0	468.0	500.0
Non-convertible bonds and debentures	0.0	0.0	400.0	200.0	200.0	0.0	0.0	0.0
Convertible bonds and debentures	0.0	4,510.8	468.0	0.0	0.0	0.0	468.0	500.0
Backed securities	3,390.6	1,356.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NO. OF ISSUES	33	10	8	3	4	0	1	1
Non-convertible bonds and debentures	0	0	7	3	4	0	0	0
Convertible bonds and debentures	0	4	1	0	0	0	1	1
Backed securities	33	6	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0

1 Private issuers. Includes issuance and trading prospectuses.
2 Available data: February 2011.

Equity markets. Issuers, issues and outstanding balances

TABLE 1.14

				2010				2011
	2008	2009	2010	I	II	III	IV	I[1]
NO. OF ISSUERS	58	62	60	61	62	62	60	58
Private issuers	45	48	46	47	48	48	46	44
Non-financial companies	5	6	5	5	5	5	5	4
Financial institutions	40	42	41	42	43	43	41	40
General government[3]	13	14	14	14	14	14	14	14
Regional governments	3	3	3	3	3	3	3	3
NO. OF ISSUES	271	269	247	260	258	257	247	241
Private issuers	157	155	145	152	151	150	145	139
Non-financial companies	9	10	7	8	8	8	7	7
Financial institutions	148	145	138	144	143	142	138	132
General government[3]	114	114	102	108	107	107	102	102
Regional governments	82	76	64	69	68	68	64	64
OUTSTANDING BALANCES[2] (million euro)	29,142.6	36,299.5	41,091.3	36,329.8	36,674.9	36,480.1	41,091.3	41,263.3
Private issuers	17,237.9	21,600.9	19,261.5	21,083.8	19,462.5	19,110.1	19,261.5	19,462.4
Non-financial companies	381.0	1,783.7	376.6	1,778.2	377.3	377.1	376.6	375.8
Financial institutions	16,856.9	19,817.2	18,884.8	19,305.6	19,085.2	18,733.0	18,884.8	19,086.5
General government[3]	11,904.7	14,698.6	21,829.9	15,246.0	17,212.3	17,370.0	21,829.9	21,800.9
Regional governments	9,972.5	12,338.3	19,442.4	12,836.3	14,803.4	14,961.8	19,442.4	19,413.5

1 Available data: February 2011.
2 Nominal amount.
3 Without public book-entry debt.

Trading on equity markets

TABLE 1.15

				2010				2011
Nominal amounts in million euro	2008	2009	2010	I	II	III	IV	I[1]
Electronic market	1,580.1	633.0	510.5	83.8	207.1	97.1	122.5	54.8
Open outcry	7,842.1	4,008.4	7,525.6	328.9	1,404.5	1,117.8	4,674.4	1,572.6
Madrid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Barcelona	7,674.9	3,821.1	7,146.7	101.5	1,373.0	1,051.6	4,620.6	1,548.3
Bilbao	6.1	4.6	2.3	0.8	0.7	0.4	0.5	0.1
Valencia	161.1	182.7	376.6	226.6	30.9	65.8	53.4	24.2
Public book-entry debt	46.2	49.1	331.1	11.8	304.0	6.3	9.1	2.8
Regional governments debt	71,054.9	70,065.8	59,017.0	18,577.3	13,490.5	13,613.0	13,336.2	7,464.6

1 Available data: February 2011.

Organised trading systems: SENAF y MTS. Public debt trading by type

TABLE 1.16

				2010				2011
Nominal amounts in million euro	2008	2009	2010	I	II	III	IV	I[1]
Total	132,327.4	202,120.5	265,966.0	83,724.5	64,903.8	75,677.6	41,660.2	15,762.2
Outright	89,010.5	114,314.0	110,011.0	53,396.0	19,326.0	16,173.0	21,116.0	15,462.0
Sell-buybacks/Buy-sellbacks	43,316.9	86,806.5	155,433.0	29,997.5	45,536.8	59,504.6	20,394.2	300.2
Others	0.0	1,000.0	522.0	331.0	41.0	0.0	150.0	0.0

1 Available data: February 2011.

1.3 Derivatives and other products

1.3.1 Financial derivatives markets: MEFF

Trading on MEFF TABLE 1.17

				2010				2011
Number of contracts	2008	2009	2010	I	II	III	IV	I[1]
Debt products	12	18	14	4	4	4	2	2
Debt futures[2]	12	18	14	4	4	4	2	2
Ibex 35 products[3,4]	8,433,963	6,187,544	6,946,167	1,635,380	2,279,397	1,446,089	1,585,302	1,122,471
Ibex 35 plus futures	7,275,299	5,436,989	6,280,999	1,467,635	2,053,136	1,327,272	1,432,956	1,035,523
Ibex 35 mini futures	330,042	314,829	357,926	87,166	128,596	69,900	72,265	57,059
Call mini options	323,874	230,349	122,158	35,979	33,861	21,602	30,717	12,103
Put mini options	504,749	205,377	185,083	44,600	63,804	27,315	49,364	17,786
Stock products[5]	64,554,817	80,114,693	57,291,482	13,957,914	12,831,247	13,107,040	17,395,281	8,675,825
Futures	46,237,568	44,586,779	19,684,108	4,136,308	3,927,137	4,969,808	6,650,855	3,470,596
Call options	7,809,423	18,864,840	17,186,515	4,357,759	4,164,723	4,413,718	4,250,315	2,526,056
Put options	10,507,826	16,663,074	20,420,859	5,463,847	4,739,387	3,723,514	6,494,111	2,679,173
Pro-memoria: MEFF trading on Eurex								
Debt products[6]	869,105	558,848	373,113	137,861	103,847	59,521	71,884	53,986
Index products[7]	1,169,059	835,159	604,029	212,055	165,818	101,741	124,415	62,484

1 Available data: February 2011.
2 Contract size: 100 thousand euros.
3 The number of Ibex 35 mini futures (multiples of 1 euro) was standardised to the size of the Ibex 35 plus futures (multiples of 10 euro).
4 Contract size: Ibex 35, 10 euros.
5 Contract size: 100 Stocks.
6 Bund, Bobl and Schatz futures.
7 Dax 30, DJ EuroStoxx 50 and DJ Stoxx 50 futures.

1.3.2 Warrants, option buying and selling contracts, and ETF (Exchange Traded Funds)

Issues registered at the CNMV TABLE 1.18

				2010				2011
	2008	2009	2010	I	II	III	IV	I[1]
WARRANTS[2]								
Premium amount (million euro)	12,234.4	5,165.1	4,915.3	1,324.5	1,602.0	761.4	1,227.4	476.7
On stocks	6,914.1	2,607.1	2,537.4	699.4	829.8	302.5	705.7	226.4
On indexes	4,542.8	2,000.1	1,852.6	491.5	613.0	367.3	380.8	199.1
Other underlyings[3]	777.5	558.0	525.4	133.6	159.3	91.6	140.9	51.2
Number of issues	9,790	7,342	8,375	2,164	2,417	1,260	2,534	593
Number of issuers	8	9	9	7	8	6	7	2
OPTION BUYING AND SELLING CONTRACTS								
Nominal amounts (million euro)	77.0	35.0	64.0	5.0	32.0	20.0	7.0	0.0
On stocks	77.0	25.0	47.0	5.0	25.0	10.0	7.0	0.0
On indexes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other underlyings[3]	0.0	10.0	17.0	0.0	7.0	10.0	0.0	0.0
Number of issues	4	3	7	1	3	2	1	0
Number of issuers	1	1	1	1	1	1	1	0

1 Available data: February 2011.
2 Includes issuance and trading prospectuses.
3 Includes the following underlying: baskets of stocks, exchange rates, interest rates and commodities.

Equity markets. Warrants and ETF trading

TABLE 1.19

	2008	2009	2010	2010 I	II	III	IV	2011 I[1]
WARRANTS								
Trading (million euro)	2,943.7	1,768.4	1,603.2	335.5	503.6	397.9	366.2	300.3
On Spanish stocks	1,581.9	809.9	759.8	144.8	235.9	198.0	181.1	145.0
On foreign stocks	145.7	97.6	60.7	14.4	20.8	8.4	17.2	16.7
On indexes	1,063.3	761.2	689.5	159.9	229.6	169.2	130.8	105.2
Other underlyings[2]	152.8	99.7	93.2	16.4	17.3	22.4	37.1	33.3
Number of issues[3]	9,770	8,038	7,750	3,066	3,489	3,007	3,060	2,746
Number of issuers[3]	10	10	10	9	8	9	10	9
CERTIFICATES								
Trading (million euro)	16.8	39.2	22.0	6.5	4.1	7.8	3.7	1.8
Number of issues[3]	26	22	16	15	14	13	13	11
Number of issuers[3]	4	4	2	2	2	2	2	2
ETF								
Trading (million euro)	6,938.1	3,470.6	6,229.7	1,675.4	2,715.1	746.4	831.3	715.7
Number of funds	30	32	65	32	32	43	65	67
Assets[4] (million euro)	1,630.3	1,648.4	827.8	1,452.8	986.6	960.2	827.8	n.a.

1 Available data: February 2011.
2 Includes the following underlying: baskets of stocks, exchange rates, interest rates and commodities.
3 Issues or issuers which were traded in each period.
4 Assets from national collective investment schemes is only included because assets from foreign ones are not available.
n.a.: No available data.

1.3.3 Non-financial derivatives

Trading on MFAO[1]

TABLE 1.20

Number of contracts	2008	2009	2010	2010 I	II	III	IV	2011 I[2]
On olive oil								
Extra-virgin olive oil futures[3]	48,091	135,705	165,840	52,695	46,540	41,555	25,050	16,701

1 Olive oil futures market.
2 Available data: February 2011.
3 Nominal amount of the contract: 1,000 kg.

2 Investment services

Investment services. Spanish firms, branches and agents

TABLE 2.1

	2008	2009	2010	2010 I	II	III	IV	2011 I[1]
BROKER-DEALERS								
Spanish firms	51	50	202	50	51	51	50	51
Branches	79	78	317	80	79	79	80	75
Agents	6,041	6,102	25,309	6,455	6,284	6,387	6,455	6,534
BROKERS								
Spanish firms	50	50	194	47	48	47	47	45
Branches	9	9	35	10	8	8	10	11
Agents	639	638	2,678	665	662	660	665	691
PORTFOLIO MANAGEMENT COMPANIES								
Spanish firms	10	9	32	7	8	8	7	6
Branches	4	5	20	5	5	5	5	5
Agents	6	5	16	3	4	4	3	3
FINANCIAL ADVISORY FIRMS[2]								
Spanish firms	–	16	152	48	36	42	48	54
CREDIT INSTITUTIONS[3]								
Spanish firms	195	193	762	186	193	189	186	186

1 Available data: February 2011.
2 New type of investment services company, created by Law 47/2008, of 19 December, which modifies Law 24/1988, of 28 July, on the Securities Market, and regulated by Circular CR CNMV 10/2008, of 30 December.
3 Source: Banco de España.

Investment services. Foreign firms

TABLE 2.2

	2008	2009	2010	2010 I	II	III	IV	2011 I[1]
Total	2,232	2,364	2,604	2,443	2,496	2,563	2,604	2,668
European Economic Area investment services firms	1,818	1,940	2,176	2,011	2,065	2,129	2,176	2,235
Branches	37	36	41	35	39	40	41	40
Free provision of services	1,781	1,904	2,135	1,976	2,026	2,089	2,135	2,195
Credit institutions[2]	414	424	428	432	431	434	428	433
From EU member states	405	414	418	422	421	424	418	423
Branches	56	53	53	54	56	56	53	55
Free provision of services	348	360	364	367	364	367	364	368
Subsidiaries of free provision of services institutions	1	1	1	1	1	1	1	0
From non-EU states	9	10	10	10	10	10	10	10
Branches	8	8	8	8	8	8	8	8
Free provision of services	1	2	2	2	2	2	2	2

1 Available data: February 2011.
2 Source: Banco de España and CNMV.

Intermediation of spot transactions[1]

TABLE 2.3

	IV 2009				IV 2010			
Million euro	Spanish organised markets	Other Spanish markets	Foreign markets	Total	Spanish organised markets	Other Spanish markets	Foreign markets	Total
FIXED-INCOME								
Total	142,317	2,389,964	277,862	2,810,143	122,443	2,483,686	191,690	2,797,819
Broker-dealers	123,596	47,859	47,576	219,031	106,222	724,722	134,972	965,916
Brokers	18,721	2,342,105	230,286	2,591,112	16,221	1,758,964	56,718	1,831,903
EQUITY								
Total	452,577	1,634	14,456	468,667	272,011	1,060	24,864	297,935
Broker-dealers	440,300	1,416	12,974	454,690	265,832	826	23,696	290,354
Brokers	12,277	218	1,482	13,977	6,179	234	1,168	7,581

1 Period accumulated data.

Intermediation of derivative transactions[1,2]

TABLE 2.4

Million euro	IV 2009 Spanish organised markets	IV 2009 Foreign organised markets	IV 2009 Non-organised markets	IV 2009 Total	IV 2010 Spanish organised markets	IV 2010 Foreign organised markets	IV 2010 Non-organised markets	IV 2010 Total
Total	866,465	2,080,546	540,836	3,487,847	667,003	2,136,920	269,685	3,073,608
Broker-dealers	851,625	1,882,896	28,947	2,763,468	664,710	1,327,744	168,331	2,160,785
Brokers	14,840	197,650	511,889	724,379	2,293	809,176	101,354	912,823

1 The amount of the buy and sell transactions of financial assets, financial futures on values and interest rates, and other transactions on interest rates will be the securities nominal or notional value or the principal to which the contract reaches. The amount of the transactions on options will be the strike price of the underlying asset multiplied by the number of instruments committed.
2 Period accumulated data.

Portfolio management. Number of portfolios and assets under management[1]

TABLE 2.5

	IV 2009 Total	IV 2009 IIC[2]	IV 2009 Other[3]	IV 2010 Total	IV 2010 IIC[2]	IV 2010 Other[3]
NUMBER OF PORTFOLIOS						
Total	12,594	90	12,504	13,231	115	13,116
Broker-dealers	6,557	16	6,541	7,530	67	7,463
Brokers	3,460	45	3,415	3,690	43	3,647
Portfolio management companies	2,577	29	2,548	2,011	5	2,006
ASSETS UNDER MANAGEMENT (thousand euro)						
Total	8,674,359	686,470	7,987,888	9,347,508	1,798,097	7,549,411
Broker-dealers	3,293,125	153,472	3,139,653	4,078,668	838,039	3,240,629
Brokers	2,405,275	346,156	2,059,120	2,380,015	848,597	1,531,418
Portfolio management companies	2,975,958	186,842	2,789,116	2,888,825	111,461	2,777,364

1 Data at the end of period.
2 IIC: Instituciones de Inversión Colectiva / CIS: Collective Investment Schemes. Includes both resident and non resident IICs management.
3 Includes the rest of clients, both covered and not covered by the Investment Guarantee Fund, an investor compensation scheme regulated by Royal Decree 948/2001.

Financial advice. Number of contracts and assets advised[1]

TABLE 2.6

	IV 2009 Total[2]	IV 2009 Retail clients	IV 2009 Professional clients	IV 2010 Total[2]	IV 2010 Retail clients	IV 2010 Professional clients
NUMBER OF CONTRACTS						
Total	4,729	4,656	66	5,642	5,558	78
Broker-dealers	1,080	1,074	3	1,366	1,354	6
Brokers	3,049	2,991	54	3,374	3,311	63
Portfolio management companies	600	591	9	902	893	9
ASSETS ADVISED (thousand euro)						
Total	6,851,984	1,937,134	4,342,603	7,480,340	2,433,616	4,611,333
Broker-dealers	1,114,532	509,979	158,409	1,254,313	557,140	261,782
Brokers	2,059,176	1,088,078	948,081	2,433,074	1,494,751	938,323
Portfolio management companies	3,678,277	339,077	3,236,112	3,792,953	381,725	3,411,229

1 Data at the end of period.
2 Includes retail, professional and other clients.

Aggregated income statement. Broker-dealers[1]

TABLE 2.7

Thousand euro[2]	2008	2009	2010	2010 I	II	III	IV	2011 I[3]
I. Interest income	109,682	163,272	102,054	7,810	43,915	79,231	102,054	6,210
II. Net commission	674,204	562,082	533,858	131,174	279,871	391,165	533,858	44,361
Commission revenues	943,619	782,214	798,152	195,160	423,657	593,521	798,152	69,552
Brokering	648,036	548,362	555,207	137,816	306,583	420,088	555,207	52,802
Placement and underwriting	42,502	26,326	8,499	772	2,906	4,314	8,499	102
Securities deposit and recording	21,198	16,183	22,367	4,054	11,218	16,775	22,367	1,882
Portfolio management	17,306	11,768	13,880	3,043	6,366	10,044	13,880	1,242
Design and advising	56,671	60,477	53,722	14,069	27,094	38,344	53,722	3,226
Stocks search and placement	12	10	36	7	7	36	36	179
Market credit transactions	19	14	9	2	5	8	9	1
IICs marketing[4]	91,167	63,341	65,487	16,388	32,261	48,242	65,487	5,577
Other	66,708	55,733	78,944	19,009	37,217	55,672	78,944	4,541
Commission expenses	269,415	220,133	264,294	63,986	143,785	202,356	264,294	25,191
III. Financial investment income[5]	800,194	45,266	48,588	-4,943	76,990	9,841	48,588	44,796
IV. Net exchange differences and other operating products and expenses	-626,527	21,820	26,081	41,152	-36,773	39,867	26,081	-41,341
V. Gross income	957,553	792,440	710,580	175,192	364,004	520,104	710,580	54,026
VI. Operating income	434,209	339,706	276,253	72,507	149,310	197,788	276,253	18,111
VII. Earnings from continuous activities	365,374	250,984	196,834	64,583	132,181	173,280	196,834	13,485
VIII. Net earnings of the period	367,665	250,984	196,834	64,583	132,181	173,280	196,834	13,485

1 From IV quarter 2008 on data come from information sent to the CNMV by investment services companies (ESIs) according to the new accounting regulation CR CNMV 7/2008. With the aim of keeping the continuity of time series, some changes have been introduced in previous quarters.
2 Accumulated data from the beginning of the year to the last day of every quarter. It includes companies removed throughout the year.
3 Available data: January 2011.
4 Before IV quarter 2008 it refers to "IICs subscription and redemption".
5 Previously named "Net income from securities trading". Does not include provisions for losses in value of securities portfolio, nor their recovering and application. These items are included in "Operating income".

Results of proprietary trading. Broker-dealers

TABLE 2.8

Thousand euro[3]	Total IV 2009	Total IV 2010	Interest income IV 2009	Interest income IV 2010	Financial investment income[1] IV 2009	Financial investment income[1] IV 2010	Exchange differences and other items[2] IV 2009	Exchange differences and other items[2] IV 2010
Total	290,002	181,098	163,272	102,054	45,266	48,588	81,463	30,456
Money market assets and public debt	7,062	17,536	944	5,787	6,117	11,749	–	–
Other fixed-income securities	-154,985	67,555	70,793	21,774	-225,779	45,782	–	–
Domestic portfolio	-164,057	55,335	68,530	20,174	-232,586	35,160	–	–
Foreign portfolio	9,071	12,220	2,264	1,599	6,808	10,621	–	–
Equities	834,412	284,782	90,522	76,685	743,890	208,097	–	–
Domestic portfolio	301,998	-9,276	64,652	57,237	237,346	-66,514	–	–
Foreign portfolio	532,414	294,058	25,870	19,448	506,544	274,611	–	–
Derivatives	-471,071	-229,222	–	–	-471,071	-229,222	–	–
Repurchase agreements	-14,464	-2,166	-14,464	-2,166	–	–	–	–
Market credit transactions	0	0	0	0	–	–	–	–
Deposits and other transactions with financial Intermediaries	642	-359	642	-359	–	–	–	–
Net exchange differences	22,582	24,445	–	–	–	–	22,582	24,445
Other operating products and expenses	-762	1,635	–	–	–	–	-762	1,635
Other transactions	66,586	16,892	14,834	333	-7,891	12,183	59,643	4,375

1 Financial investment income does not include provisions for losses in value of securities portfolio, nor their recovering and application.
2 Former column "Other charges" has been replaced by a new column which includes, besides provisions for risks, net exchange results and other operating products and expenses.
3 Accumulated data from the beginning of the year to the last day of every quarter. It includes companies removed throughout the year.

Aggregated income statement. Brokers[1]

TABLE 2.9

				2010				2011
Thousand euro[2]	2008	2009	2010	I	II	III	IV	I[3]
I. Interest income	7,980	2,652	1,629	191	732	1,099	1,629	153
II. Net commission	149,874	127,410	109,165	33,173	56,876	80,234	109,165	8,528
Commission revenues	172,344	144,373	126,055	37,586	65,412	92,624	126,055	9,688
Brokering	62,345	53,988	38,176	13,953	21,791	29,565	38,176	3,264
Placement and underwriting	4,847	2,989	2,748	272	610	1,368	2,748	3
Securities deposit and recording	676	509	366	94	186	276	366	30
Portfolio management	21,137	19,633	19,489	4,704	8,808	13,861	19,489	1,313
Design and advising	4,962	2,806	3,618	719	2,032	1,972	3,618	258
Stocks search and placement	0	0	304	115	115	128	304	36
Market credit transactions	10	28	27	354	10	26	27	5
IICs marketing[4]	31,287	23,966	23,946	6,613	12,004	17,611	23,946	1,807
Other	47,081	40,453	37,381	10,763	19,855	27,816	37,381	2,973
Commission expenses	22,470	16,963	16,890	4,412	8,536	12,390	16,890	1,160
III. Financial investment income[5]	-1,176	1,709	456	-37	-104	23	456	67
IV. Net exchange differences and other operating products and expenses	3,526	-1,111	-1,416	-101	-376	-955	-1,416	-253
V. Gross income	160,204	130,661	109,834	33,226	57,128	80,400	109,834	8,495
VI. Operating income	20,377	9,090	9,457	4,461	4,894	6,330	9,457	1,036
VII. Earnings from continuous activities	14,372	4,862	6,452	4,088	4,443	5,700	6,452	1,074
VIII. Net earnings of the period	14,372	4,862	6,452	4,088	4,443	5,700	6,452	1,074

1 From IV quarter 2008 on data come from information sent to the CNMV by investment services companies (ESIs) according to the new accounting regulation CR CNMV 7/2008. With the aim of keeping the continuity of time series, some changes have been introduced in previous quarters.
2 Accumulated data from the beginning of the year to the last day of every quarter. It includes companies removed throughout the year.
3 Available data: January 2011.
4 Before IV quarter 2008 it refers to "IICs subscription and redemption".
5 Previously named "Net income from securities trading". Does not include provisions for losses in value of securities portfolio, nor their recovering and application. These items are included in "Operating income".

Aggregated income statement. Portfolio management companies[1]

TABLE 2.10

				2010				2011
Thousand euro[2]	2008	2009	2010	I	II	III	IV	I[3]
I. Interest income	1,482	341	407	63	165	274	407	38
II. Net commission	12,044	10,734	10,097	3,333	5,967	8,393	10,097	626
Commission revenues	23,877	21,750	20,994	6,085	11,440	16,559	20,994	1,471
Portfolio management	20,683	18,463	18,020	4,642	9,218	13,645	18,020	1,371
Design and advising	2,484	2,698	1,160	1,289	1,921	1,101	1,160	99
IICs marketing[4]	66	18	34	17	26	34	34	0
Other	644	571	1,779	138	275	1,779	1,779	0
Commission expenses	11,833	11,016	10,897	2,752	5,473	8,167	10,897	845
III. Financial investment income[5]	-108	92	51	-11	65	96	51	27
IV. Net exchange differences and other operating products and expenses	-418	-383	21	-111	-157	-265	21	8
V. Gross income	13,000	10,784	10,577	3,275	6,040	8,497	10,577	699
VI. Operating income	1,157	1,296	1,154	806	1,411	1,189	1,154	79
VII. Earnings from continuous activities	765	889	939	724	1,170	1,009	939	60
VIII. Net earnings of the period	765	889	939	724	1,170	1,009	939	60

1 From IV quarter 2008 on data come from information sent to the CNMV by investment services companies (ESIs) according to the new accounting regulation CR CNMV 7/2008. With the aim of keeping the continuity of time series, some changes have been introduced in previous quarters.
2 Accumulated data from the beginning of the year to the last day of every quarter. It includes companies removed throughout the year.
3 Available data: January 2011.
4 Before IV quarter 2008 it refers to "IICs subscription and redemption".
5 Previously named "Net income from securities trading". Does not include provisions for losses in value of securities portfolio, nor their recovering and application. These items are included in "Operating income".

Surplus equity over capital adequacy requirements[1,2]

TABLE 2.11

	Surplus		Number of companies according to its surplus percentage									
Thousand euro	Total amount	%[3]	< 50	<100	<150	<200	<300	<400	<500	<750	<1000	>1000
Total	1,399,885	313.47	11	18	14	5	17	11	6	8	8	3
Broker-dealers	1,315,284	331.24	1	7	4	2	13	8	4	4	5	2
Brokers	67,273	192.26	9	10	9	2	3	3	2	4	3	0
Portfolio management companies	17,328	119.49	1	1	1	1	1	0	0	0	0	1

1 Available data: December 2010.
2 Data collected from information reported according to new Circular CR CNMV 12/2008 on investment services companies solvency.
3 Average percentage is weighted by the required equity of each company. It is an indicator of the number of times, in percentage terms, that the surplus contains the required equity in an average company.

Rentabilidad sobre fondos propios (ROE) antes de impuestos[1,2]

TABLE 2.12

		Number of companies according to its annualized return								
	Average[3]	Losses	0-5%	6-15%	16-30%	31-45%	46-60%	61-75%	76-100%	>100%
Total	14.69	24	25	19	13	6	5	2	3	4
Broker-dealers	15.30	10	11	13	6	2	2	2	2	2
Brokers	8.14	13	10	6	6	4	3	0	1	2
Portfolio management companies	2.16	1	4	0	1	0	0	0	0	0

1 ROE has been calculated as:

$$ROE = \frac{\text{Earning before taxes (annualized)}}{\text{Own Funds}}$$

Own Funds = Share capital + Paid-in surplus + Reserves – Own shares + Prior year profits and retained earnings – Interim dividend.
2 Available data: December 2010.
3 Average weighted by equity, %.

3 Collective investment schemes (IICs)[a,b,c,d]

Number, management companies and depositories of collective investment schemes registered at the CNMV

TABLE 3.1

				2010				2011
	2008	2009	2010	I	II	III	IV	I[1]
Total financial IICs	6,354	5,892	5,627	5,808	5,724	5,679	5,627	5,526
Mutual funds	2,943	2,593	2,429	2,534	2,464	2,443	2,429	2,422
Investment companies	3,347	3,232	3,133	3,206	3,195	3,171	3,133	3,104
Funds of hedge funds	40	38	32	37	34	33	32	32
Hedge funds	24	29	33	31	31	33	33	34
Total real estate IICs	18	16	16	16	16	16	16	16
Real estate investment funds	9	8	8	8	8	8	8	8
Real estate investment companies	9	8	8	8	8	8	8	8
Total foreign IICs marketed in Spain	563	582	660	615	636	652	660	664
Foreign funds marketed in Spain	312	324	379	353	365	376	379	380
Foreign companies marketed in Spain	251	258	281	262	271	276	281	284
Management companies	120	120	123	122	124	123	123	120
IIC depositories	125	124	114	123	122	117	114	113

1 Available data: February 2011.

Number of IICs investors and shareholders

TABLE 3.2

				2010				2011
	2008	2009	2010[1]	I	II	III	IV[1]	I[2]
Total financial IICs [3]	6,358,753	5,895,009	5,578,524	5,906,343	5,841,721	5,765,250	5,578,524	5,575,025
Mutual funds	5,923,352	5,475,403	5,160,889	5,489,598	5,423,206	5,348,536	5,160,889	5,158,280
Investment companies	435,401	419,606	417,635	416,745	419,307	416,714	417,635	416,745
Total real estate IICs	98,327	84,511	76,223	76,312	77,714	77,116	76,223	76,312
Real estate investment funds	97,39	83,583	75,28	75,369	76,772	76,182	75,28	75,369
Real estate investment companies	937	928	943	943	942	934	943	943
Total foreign IICs marketed in Spain	593,488	685,094	838,680	–	791,381	811,553	838,680	–
Foreign funds marketed in Spain	102,922	139,102	193,486	–	181,039	186,804	193,486	–
Foreign companies marketed in Spain	490,566	545,992	645,194	–	610,342	624,749	645,194	–

1 Provisional data for foreign IICs. Foreign IICs send this information quarterly.
2 Available data: January 2011.
3 Hedge funds and funds of hedge funds data are shown on table 3.12.

IICs total net assets

TABLE 3.3

				2010				2011
Million euro	2008	2009	2010[1]	I	II	III	IV[1]	I[2]
Total financial IICs[3]	200,522.4	196,472.5	170,073.1	193,941.8	180,899.1	178,778.0	170,073.1	169,688.5
Mutual funds[4]	175,865.5	170,547.7	143,918.2	167,524.3	155,295.5	152,646.5	143,918.2	143,388.9
Investment companies	24,656.9	25,924.8	26,155.0	26,417.5	25,602.6	26,131.5	26,155.0	26,299.6
Total real estate IICs	7,778.8	6,773.7	6,437.5	6,668.4	6,606.6	6,524.2	6,437.5	6,418.5
Real estate investment funds	7,406.9	6,465.1	6,115.6	6,363.7	6,279.6	6,201.5	6,115.6	6,096.5
Real estate investment companies	371.9	308.6	321.9	304.6	327.0	322.7	321.9	322.0
Total foreign IICs marketed in Spain	18,254.8	25,207.2	35,457.8	30,864.9	32,362.8	32,826.7	35,457.8	–
Foreign funds marketed in Spain	3,352.0	5,215.1	8,109.2	6,519.3	7,477.2	7,650.1	8,109.2	–
Foreign companies marketed in Spain	14,902.8	19,992.0	27,348.6	24,345.6	24,885.7	25,176.6	27,348.6	–

1 Provisional data for foreign IICs. Foreign IICs send this information quarterly.
2 Available data: January 2011.
3 Hedge funds and funds of hedge funds data are shown on table 3.12.
4 For January 2011, mutual funds investments in financial IICs reached 6.5 billion euro.

a IICs: Instituciones de Inversión Colectiva / CIS: Collective Investment Schemes.
b In this document, neither hedge funds nor funds of hedge funds are included in the figures referred to mutual funds.
c Due to the entry into force, on 31 December 2008, of CR CNMV 3/2008 and CR CNMV 7/2008, which modify accounting information to be reported to CNMV, data has been adapted to new regulation.
d From March 2009 on, foreign collective investments schemes shareholders and total net assets data do not include exchange traded funds (ETFs).

Mutual funds asset allocation[1]

TABLE 3.4

Million euro	2008	2009	2010	2009 IV	2010 I	II	III	IV
Asset	175,865.5	170,547.7	143,918.2	170,547.7	167,524.3	155,295.5	152,646.5	143,918.2
Portfolio investment	166,384.7	163,165.5	137,295.4	163,165.5	160,119.6	148,166.2	144,724.4	137,295.4
Domestic securities	107,347.7	100,642.6	89,630.2	100,642.6	96,322.9	92,605.7	91,413.1	89,630.2
Debt securities	81,904.6	74,628.9	68,575.1	74,628.9	71,916.5	69,173.9	68,366.9	68,575.1
Shares	4,023.2	4,741.0	3,829.2	4,741.0	4,384.1	3,611.2	3,994.8	3,829.2
Investment collective schemes	10,134.3	9,041.5	7,338.6	9,041.5	8,930.1	8,876.9	8,415.2	7,338.6
Deposits in Credit institutions	10,657.6	11,552.2	9,460.8	11,552.2	10,531.5	10,508.4	10,167.6	9,460.8
Derivatives	627.9	679.0	426.2	679.0	560.7	435.3	467.6	426.2
Other	0.1	0.0	0.4	0.0	0.0	0.0	1.0	0.4
Foreign securities	59,035.2	62,487.1	47,626.5	62,487.1	63,745.9	55,515.6	53,272.4	47,626.5
Debt securities	49,659.8	48,435.3	30,337.4	48,435.3	47,491.3	39,619.4	36,499.7	30,337.4
Shares	5,216.1	7,783.2	8,385.8	7,783.2	8,291.3	7,615.6	8,003.2	8,385.8
Investment collective schemes	3,524.5	5,666.4	8,404.7	5,666.4	7,398.7	7,844.9	8,264.9	8,404.7
Deposits in Credit institutions	17.5	82.4	108.0	82.4	79.9	81.5	73.1	108.0
Derivatives	599.5	518.7	387.1	518.7	483.6	349.2	427.4	387.1
Other	17.8	1.1	3.6	1.1	1.2	5.0	4.1	3.6
Doubtful assets and matured investment	1.8	35.8	38.6	35.8	49.9	44.9	38.9	38.6
Intangible assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net fixed assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash	8,703.2	7,267.7	6,531.4	7,267.7	7,350.8	6,817.4	7,933.3	6,531.4
Net balance (Debtors - Creditors)	777.7	114.5	91.4	114.5	53.9	311.9	-11.2	91.4

1 Hedge funds and funds of hedge funds are not included in these figures due to the entry into force, on 31 December 2008, of Circular CR CNMV 3/2008 which establishes a different deadline in reporting accounting information to CNMV.

Investment companies asset allocation

TABLE 3.5

Million euro	2008	2009	2010	2009 IV	2010 I	II	III	IV
Asset	24,656.9	25,924.8	26,155.0	25,924.8	26,417.5	25,602.6	26,131.5	26,155.0
Portfolio investment	23,446.9	24,813.5	25,187.3	24,813.5	25,334.6	24,471.5	25,015.5	25,187.3
Domestic securities	16,176.3	13,514.3	12,881.4	13,514.3	12,908.6	12,390.0	13,036.9	12,881.4
Debt securities	10,435.1	7,400.5	5,435.9	7,400.5	6,744.2	5,840.4	5,717.5	5,435.9
Shares	10,435.1	7,400.5	5,435.9	7,400.5	6,744.2	5,840.4	5,717.5	5,435.9
Investment collective schemes	3,214.9	3,376.3	2,988.6	3,376.3	3,153.2	2,754.0	2,945.3	2,988.6
Deposits in Credit institutions	1,108.8	1,091.1	758.7	1,091.1	987.1	831.9	807.6	758.7
Derivatives	1,383.5	1,631.5	3,675.2	1,631.5	2,014.0	2,963.0	3,546.8	3,675.2
Other	9.8	-6.6	-5.9	-6.6	-11.8	-22.4	-5.8	-5.9
Foreign securities	24.4	21.7	29.0	21.7	22.0	23.1	25.7	29.0
Debt securities	7,267.8	11,294.2	12,298.1	11,294.2	12,419.9	12,075.1	11,970.8	12,298.1
Shares	2,609.6	4,606.6	3,606.8	4,606.6	4,681.7	4,340.4	4,001.8	3,606.8
Investment collective schemes	2,014.6	3,559.3	4,166.0	3,559.3	4,002.4	3,793.3	3,852.6	4,166.0
Deposits in Credit institutions	2,486.4	2,987.4	4,390.5	2,987.4	3,611.3	3,807.1	3,930.4	4,390.5
Derivatives	28.9	26.3	12.1	26.3	16.8	18.0	44.5	12.1
Other	120.5	113.0	119.9	113.0	105.3	108.3	134.9	119.9
Doubtful assets and matured investment	7.8	1.6	2.8	1.6	2.4	8.0	6.6	2.8
Intangible assets	2.8	4.9	7.9	4.9	6.2	6.4	7.7	7.9
Net fixed assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net balance (Debtors - Creditors)	1,021.0	976.4	832.0	976.4	919.9	896.0	903.3	832.0

Financial mutual funds: number, investors and total net assets by category[1]

TABLE 3.6

				2010				2011
	2008	2009	2010	I	II	III	IV	I[2]
NO. OF FUNDS								
Total financial mutual funds	2,912	2,536	2,408	2,500	2,436	2,421	2,408	2,405
Fixed-income[3]	629	582	537	567	547	540	537	539
Mixed fixed-income[4]	195	169	160	171	168	162	160	160
Mixed equity[5]	202	165	138	161	143	140	138	138
Euro equity[6]	237	182	172	179	179	174	172	172
Foreign equity[7]	330	242	232	239	233	233	232	230
Guaranteed fixed-income	260	233	276	239	251	261	276	280
Guaranteed equity[8]	590	561	499	549	530	518	499	493
Global funds	469	187	192	182	181	189	192	192
Passive management[9]	–	69	61	66	64	61	61	61
Absolute return[9]	–	146	141	147	140	143	141	140
INVESTORS								
Total financial mutual funds	5,923,346	5,475,403	5,160,889	5,489,598	5,423,206	5,348,536	5,160,889	5,158,280
Fixed-income[3]	2,204,652	2,041,487	1,622,664	1,994,558	1,865,575	1,745,375	1,622,664	1,575,523
Mixed fixed-income[4]	277,629	290,151	270,341	298,542	295,325	280,230	270,341	265,230
Mixed equity[5]	209,782	182,542	171,336	180,722	185,111	182,860	171,336	169,221
Euro equity[6]	377,545	299,353	266,395	290,734	280,529	280,573	266,395	260,376
Foreign equity[7]	467,691	458,097	501,138	478,952	487,813	502,491	501,138	511,086
Guaranteed fixed-income	538,799	570,963	790,081	617,901	690,600	762,369	790,081	847,655
Guaranteed equity[8]	1,402,948	1,188,304	1,065,426	1,153,385	1,142,072	1,115,180	1,065,426	1,053,235
Global funds	444,300	88,337	105,720	94,630	99,163	110,538	105,720	108,756
Passive management[9]	–	85,403	90,343	92,352	97,949	93,049	90,343	89,026
Absolute return[9]	–	270,766	277,445	287,822	279,069	275,871	277,445	278,172
TOTAL NET ASSETS (million euro)								
Total financial mutual funds	175,865.2	170,547.7	143,918.2	167,524.3	155,295.5	152,646.5	143,918.2	143,388.9
Fixed-income[3]	92,813.1	84,657.2	56,614.6	79,655.6	69,654.5	64,102.1	56,614.6	53,941.3
Mixed fixed-income[4]	5,803.0	8,695.5	7,319.0	8,867.1	8,264.2	8,109.9	7,319.0	7,118.8
Mixed equity[5]	3,958.8	3,879.6	3,470.5	3,930.7	3,441.5	3,520.2	3,470.5	3,544.3
Euro equity[6]	5,936.9	6,321.6	5,356.8	6,017.6	5,181.2	5,504.4	5,356.8	5,542.9
Foreign equity[7]	4,256.6	5,902.4	8,037.3	6,869.4	6,682.5	7,203.6	8,037.3	8,161.8
Guaranteed fixed-income	21,281.6	21,033.4	26,180.2	22,047.8	23,520.3	25,795.6	26,180.2	27,806.4
Guaranteed equity[8]	30,742.4	25,665.8	22,046.5	24,814.2	23,981.7	23,600.0	22,046.5	21,858.1
Global funds	11,072.8	3,872.5	4,440.3	4,130.3	3,991.1	4,093.9	4,440.3	4,887.5
Passive management[9]	–	3,216.6	2,104.8	2,971.9	2,350.2	2,323.6	2,104.8	2,203.7
Absolute return[9]	–	7,303.0	8,348.1	8,219.9	8,228.4	8,393.2	8,348.1	8,324.2

1 Mutual funds that have sent reports to the CNMV (therefore mutual funds in a process of dissolution or liquidation are not included).
2 Available data: January 2011.
3 Until I 2009 this category includes: Short-term fixed income, Long-term fixed income, Foreign fixed-income and Monetary market funds. From II 2009 on includes: Fixed income euro, Foreign fixed-income and Monetary market funds.
4 Until I 2009 this category includes: Mixed fixed-income and Foreign mixed fixed-income. From II 2009 on includes: Mixed euro fixed-income and Foreign mixed fixed-income.
5 Until I 2009 this category includes: Mixed equity and Foreign mixed equity. From II 2009 on includes: Mixed euro equity and Foreign mixed equity.
6 Until I 2009 this category includes: Spanish equity and Euro Equity. From II 2009 on includes: Euro equity (which includes domestic equity).
7 Until I 2009 this category includes: Foreign equity Europe, Foreign equity Japan, Foreign equity USA, Foreign equity emerging countries and Other foreign equity. From II 2009 on includes: Foreign equity.
8 Until I 2009 this category includes: Guaranteed equity. From II 2009 on includes: Guaranteed equity and partial guarantee.
9 New categories from II 2009 on. Before it, absolute return funds were classified as global Funds.

Financial mutual funds: Detail of investors and total net assets by type of investors[1]

TABLE 3.7

				2010				2011
	2008	2009	2010	I	II	III	IV	I[2]
INVESTORS	5,923,352	5,475,403	5,160,889	5,489,598	5,423,206	5,348,536	5,160,889	5,158,280
Individuals	5,754,049	5,322,214	5,019,902	5,334,304	5,272,045	5,201,334	5,019,902	5,018,135
Residents	5,677,123	5,252,126	4,954,891	5,264,655	5,203,616	5,134,719	4,954,891	4,953,572
Non-residents	76,926	70,088	65,011	69,649	68,429	66,615	65,011	64,563
Legal entities	169,303	153,189	140,987	155,294	151,161	147,202	140,987	140,145
Credit Institutions	1,713	674	524	631	582	568	524	513
Other resident Institutions	166,041	151,479	139,550	153,637	149,581	145,690	139,550	138,698
Non-resident Institutions	1,549	1,036	913	1,026	998	944	913	934
TOTAL NET ASSETS (million euro)	175,865.5	170,547.7	143,918.1	167,524.3	155,295.5	152,646.5	143,918.1	143,388.9
Individuals	135,756.2	132,860.5	113,660.6	130,952.8	121,762.4	119,808.3	113,660.6	113,819.7
Residents	133,878.1	130,954.4	111,900.1	129,010.4	119,898.1	117,961.2	111,900.1	112,160.4
Non-residents	1,878.1	1,906.0	1,760.5	1,942.4	1,864.3	1,847.1	1,760.5	1,659.4
Legal entities	40,109.3	37,687.2	30,257.5	36,571.4	33,533.9	32,838.1	30,257.5	29,569.2
Credit Institutions	4,193.0	2,572.0	1,926.1	2,437.5	2,145.0	2,152.9	1,926.1	1,934.1
Other resident Institutions	34,738.0	34,065.1	27,644.6	33,287.2	30,614.8	29,926.8	27,644.6	26,921.5
Non-resident Institutions	1,178.4	1,050.1	686.9	846.7	774.1	758.5	686.9	713.6

1 Hedge funds and funds of hedge funds are not included.
2 Available data: January 2011.

Subscriptions and redemptions of financial mutual funds by category[1]

TABLE 3.8

				2009	2010			
Million euro	2008	2009[2]	2010	IV	I	II	III	IV
SUBSCRIPTIONS								
Total financial mutual funds	135,461.7	109,915.2	78,805.2	33,164.3	25,226.0	24,172.2	13,395.6	16,011.4
Fixed-income	101,909.7	73,718.8	41,656.1	20,150.3	15,240.8	13,605.3	6,206.7	6,603.3
Mixed fixed-income	1,914.5	5,267.6	3,538.8	3,309.0	1,243.5	1,082.2	571.7	641.4
Mixed equity	1,350.2	1,135.4	1,221.7	366.6	292.1	556.5	118.5	254.6
Euro equity	2,858.0	2,183.8	1,673.0	743.2	582.5	464.0	291.1	335.4
Foreign equity	3,309.6	2,929.5	4,455.2	1,165.3	1,259.1	1,190.3	778.5	1,227.3
Guaranteed fixed-income	11,937.0	11,755.4	11,513.4	2,246.8	2,359.6	3,244.1	3,403.9	2,505.8
Guaranteed equity	6,544.7	5,589.1	5,120.1	1,899.6	1,607.4	1,539.4	726.8	1,246.5
Global funds	5,638.0	2,754.4	3,018.1	792.9	545.0	440.6	265.4	1,767.1
Passive management	–	535.5	683.8	269.0	242.6	271.1	73.7	96.4
Absolute return	–	4,045.7	5,924.8	2,221.5	1,853.3	1,778.8	959.1	1,333.6
REDEMPTIONS								
Total financial mutual funds	202,864.1	122,617.5	104,385.6	32,945.1	28,324.7	33,041.1	18,442.3	24,577.5
Fixed-income	124,242.9	81,197.6	68,806.1	21,710.4	19,940.5	22,951.2	12,006.3	13,908.1
Mixed fixed-income	8,136.6	2,724.4	4,955.7	792.3	1,106.0	1,653.8	812.4	1,383.5
Mixed equity	4,675.6	1,596.5	1,311.8	264.9	225.7	601.2	168.0	316.9
Euro equity	8,617.2	2,457.8	2,369.9	734.9	709.6	673.9	452.4	534.0
Foreign equity	8,657.3	2,165.3	3,303.3	609.5	704.9	991.1	625.5	981.8
Guaranteed fixed-income	9,499.1	15,004.5	6,797.4	4,070.5	2,135.7	1,529.0	1,414.2	1,718.5
Guaranteed equity	18,216.4	10,990.8	7,620.2	2,574.1	1,818.0	1,852.4	1,399.8	2,550.0
Global funds	20,819.0	2,548.6	2,694.4	280.5	269.3	461.1	382.9	1,581.1
Passive management	–	708.0	1,474.1	235.9	396.2	682.1	141.6	254.2
Absolute return	–	3,224.0	5,053.0	1,672.1	1,018.9	1,645.3	1,039.3	1,349.5

1 Estimated data.
2 For Passive Management and absolute return, data refers to the last three quarters of the year.

Financial mutual funds asset change by category: Net subscriptions/redemptions and return on assets[1]

TABLE 3.9

Million euro	2008	2009[2]	2010	2009 IV	2010 I	II	III	IV
NET SUBSCRIPTIONS/REDEMPTIONS[3]								
Total financial mutual funds	-67,402.4	-12,702.3	-25,580.6	219.1	-3,098.8	-8,868.9	-5,046.8	-8,566.1
Fixed-income	-22,333.2	-7,478.8	-27,149.9	-1,560.1	-4,699.7	-9,345.8	-5,799.6	-7,304.8
Mixed fixed-income	-6,222.1	2,543.2	-1,417.0	2,516.7	137.5	-571.7	-240.7	-742.1
Mixed equity	-3,325.4	-461.1	-90.0	101.7	66.5	-44.7	-49.4	-62.4
Euro equity	-5,759.2	-274.0	-696.9	8.3	-127.1	-210.0	-161.2	-198.6
Foreign equity	-5,347.7	764.2	1,152.1	555.9	554.2	199.2	153.1	245.6
Guaranteed fixed-income	2,437.9	-3,249.1	4,716.0	-1,823.7	223.8	1,715.1	1,989.8	787.3
Guaranteed equity	-11,671.7	-5,401.7	-2,500.1	-674.5	-210.6	-313.0	-673.0	-1,303.5
Global funds	-15,181.0	205.8	323.6	512.3	275.7	-20.5	-117.5	185.9
Passive management	–	-172.5	-790.3	33.1	-153.6	-411.1	-67.9	-157.7
Absolute return	–	821.7	871.7	549.4	834.4	133.5	-80.3	-15.9
RETURN ON ASSETS								
Total financial mutual funds	-11,988.0	8,389.8	135.7	1,364.5	930.1	-3,097.2	2,418.3	-115.5
Fixed-income	1,927.7	1,535.3	64.5	192.4	359.6	-486.4	409.7	-218.4
Mixed fixed-income	-716.8	507.9	-56.4	160.6	34.1	-194.3	148.0	-44.2
Mixed equity	-1,589.0	529.9	-53.4	76.6	-10.0	-227.6	158.1	26.1
Euro equity	-5,172.6	1,477.1	-254.1	195.0	-184.3	-638.6	509.2	59.6
Foreign equity	-4,092.4	1,309.0	877.4	354.6	346.4	-390.0	342.8	578.2
Guaranteed fixed-income	597.6	830.5	-170.4	87.5	213.6	-286.3	229.7	-327.4
Guaranteed equity	-1,310.4	1,024.0	-392.8	43.0	94.7	-438.4	266.4	-315.5
Global funds	-1,632.1	272.2	123.1	67.3	55.6	-121.9	109.4	80.0
Passive management	–	657.8	-109.7	134.5	-52.8	-205.1	144.7	3.5
Absolute return	–	246.4	107.7	53.2	73.3	-108.4	100.2	42.6

1 Mutual funds that have sent reports to the CNMV (therefore mutual funds in a process of dissolution or liquidation are not included).
2 The data refers to the last three quarters of the year for Passive Management and absolute return categories.
3 Estimated data.

Financial mutual funds return on assets. Detail by category

TABLE 3.10

% of daily average total net assets	2008	2009[1]	2010	2009 IV	2010 I	II	III	IV
MANAGEMENT YIELDS								
Total financial mutual funds	-4.09	6.13	1.09	1.09	0.80	-1.67	1.82	0.17
Fixed-income	2.53	2.69	0.78	0.44	0.62	-0.47	0.81	-0.18
Mixed fixed-income	-5.75	9.34	0.61	2.46	0.71	-1.94	2.13	-0.25
Mixed equity	-23.30	16.44	0.11	2.45	0.24	-5.96	4.95	1.19
Euro equity	-47.02	31.02	-3.05	3.73	-2.57	-10.85	9.84	1.62
Foreign equity	-49.55	33.16	14.8	7.23	6.06	-5.08	5.48	8.11
Guaranteed fixed-income	3.39	4.10	-0.11	0.57	1.15	-1.10	1.05	-1.18
Guaranteed equity	-1.88	5.08	-0.46	0.49	0.70	-1.50	1.44	-1.07
Global funds	-7.36	10.82	4.15	2.16	1.71	-2.67	2.97	2.17
Passive management	–	–	-2.5	4.60	-1.54	-7.34	6.43	0.41
Absolute return	–	–	2.49	1.11	1.25	-1.04	1.48	0.8
EXPENSES. MANAGEMENT FEE								
Total financial mutual funds	0.87	0.87	0.91	0.23	0.22	0.22	0.23	0.24
Fixed-income	0.58	0.63	0.65	0.17	0.16	0.16	0.16	0.16
Mixed fixed-income	1.14	1.14	1.20	0.31	0.29	0.29	0.30	0.30
Mixed equity	1.54	1.58	1.65	0.40	0.38	0.39	0.41	0.41
Euro equity	1.60	1.75	1.78	0.45	0.43	0.43	0.45	0.45
Foreign equity	1.69	1.79	1.84	0.47	0.46	0.42	0.45	0.50
Guaranteed fixed-income	0.49	0.65	0.62	0.16	0.14	0.15	0.16	0.17
Guaranteed equity	1.29	1.26	1.24	0.31	0.29	0.30	0.30	0.31
Global funds	1.04	1.08	1.06	0.27	0.27	0.22	0.27	0.30
Passive management	–	–	0.72	0.17	0.16	0.16	0.18	0.19
Absolute return	–	–	1.06	0.29	0.28	0.25	0.26	0.28
EXPENSES. DEPOSITORY FEE								
Total financial mutual funds	0.08	0.09	0.09	0.02	0.02	0.02	0.02	0.02
Fixed-income	0.08	0.08	0.08	0.02	0.02	0.02	0.02	0.02
Mixed fixed-income	0.09	0.09	0.10	0.02	0.02	0.02	0.03	0.03
Mixed equity	0.11	0.10	0.12	0.03	0.03	0.03	0.03	0.03
Euro equity	0.10	0.10	0.11	0.03	0.02	0.03	0.03	0.03
Foreign equity	0.12	0.12	0.12	0.03	0.03	0.03	0.03	0.03
Guaranteed fixed-income	0.07	0.08	0.07	0.02	0.02	0.02	0.02	0.02
Guaranteed equity	0.11	0.11	0.10	0.03	0.02	0.02	0.02	0.03
Global funds	0.09	0.08	0.09	0.02	0.02	0.02	0.02	0.02
Passive management	–	–	0.07	0.02	0.02	0.02	0.02	0.02
Absolute return	–	–	0.08	0.02	0.02	0.02	0.02	0.02

1 Passive management and absolute annual returns are not included because they are new categories from II 2009 on.

Mutual funds quarterly returns. Detail by category

TABLE 3.11

In %	2008	2009[1]	2010	2009 IV	2010 I	II	III	IV
Total financial mutual funds	-4.21	5.73	0.35	0.73	0.61	-1.83	1.64	-0.04
Fixed-income	2.06	1.91	0.11	0.24	0.46	-0.62	0.63	-0.35
Mixed fixed-income	-7.14	6.85	-0.54	0.63	0.42	-2.18	1.82	-0.56
Mixed equity	-22.21	16.47	-0.98	1.99	-0.14	-6.00	4.67	0.78
Euro equity	-39.78	32.41	-2.94	3.06	-2.57	-10.66	10.11	1.27
Foreign equity	-41.71	37.28	14.22	6.30	5.63	-4.97	5.35	8.01
Guaranteed fixed-income	3.29	3.81	-0.67	0.37	0.98	-1.24	0.89	-1.28
Guaranteed equity	-2.61	3.56	-1.79	0.16	0.39	-1.91	1.20	-1.45
Global funds	-8.64	10.90	3.22	1.87	1.43	-2.82	2.80	1.87
Passive management	–	–	-2.36	4.61	-1.26	-7.28	6.32	0.31
Absolute return	–	–	1.53	0.70	0.98	-1.19	1.17	0.58

1 Passive management and absolute annual returns are not included because they are new categories from II 2009 on.

Hedge funds and funds of hedge funds

TABLE 3.12

				2009	2010			
	2007	2008	2009	IV	I	II	III	IV[1]
HEDGE FUNDS								
Investors/shareholders	1,127	1,589	1,917	1,917	2,137	2,061	1,925	1,873
Total net assets (million euro)	445.8	539.4	652	652	722.4	674.1	639.3	617.1
Subscriptions (million euro)	378.2	390.4	248.7	73.4	108	59	20.4	11.8
Redemptions (million euro)	2.6	258.3	198.3	32.5	53.2	82.2	72.3	34.1
Net subscriptions/redemptions (million euro)	164.7	132.7	50.4	40.9	54.8	-23.2	-52.2	-22.3
Return on assets (million euro)	0.2	-39.1	62.2	7.9	15.6	-25.1	17.4	0.2
Returns (%)	0.84	-4.82	14.94	1.45	2.23	-3.17	2.97	0.11
Management yields (%)[2]	0.57	-2.51	13.76	1.8	2.9	-3.24	3.24	0.38
Management fee (%)[2]	1.39	2.5	2.55	0.48	0.59	0.35	0.47	0.31
Financial expenses (%)[2]	0.33	0.16	0.11	0.03	0.01	0.02	0.02	0.02
FUNDS OF HEDGE FUNDS								
Investors/shareholders	3,950	8,516	5,321	5,321	5,311	5,109	4,901	4,605
Total net assets (million euro)	1,000.6	1,021.3	810.2	810.2	793.9	738	726.8	709.2
Subscriptions (million euro)	1,071.2	967.3	302.4	87.6	21.4	2.2	13.9	–
Redemptions (million euro)	65.9	700.9	585.4	135.9	51.1	52.8	23.7	–
Net subscriptions/redemptions (million euro)	1,005.5	266.4	-283	-48.3	-29.7	-50.6	-9.8	–
Return on assets (million euro)	-9.6	-245.7	71.9	11.6	13.4	-5.3	-1.3	–
Returns (%)	-0.43	-17.8	7.85	0.83	1.72	-0.61	-0.1	1.59
Management yields (%)[3]	-1.36	-17.84	11.54	1.77	2.08	-0.34	0.14	–
Management fee (%)[3]	1.15	1.63	1.34	0.29	0.31	-0.3	0.31	–
Depository fee (%)[3]	0.06	0.11	0.11	0.02	0.02	-0.02	0.02	–

1 Available data: November 2010. Return refers to the period September-November 2010.
2 % of monthly average total net assets.
3 % of daily average total net assets.

Management companies. Number of portfolios and assets under management[1]

TABLE 3.13

				2010				2011
	2008	2009	2010	I	II	III	IV	I[2]
NUMBER OF PORTFOLIOS								
Mutual funds	2,943	2,593	2,429	2,534	2,464	2,443	2,429	2,422
Investment companies	3,240	3,135	3,068	3,111	3,110	3,096	3,068	3,079
Funds of hedge funds	40	38	32	37	34	33	32	32
Hedge funds	24	28	31	30	30	32	32	33
Real estate investment fund	9	8	8	8	8	8	8	8
Real estate investment companies	9	8	8	8	8	8	8	8
ASSETS UNDER MANAGEMENT (million euro)								
Mutual funds	175,865.5	170,547.7	143,918.2	167,524.3	155,295.5	152,646.5	143,918.2	143,388.9
Investment companies	23,656.1	24,952.8	25,361.3	25,416.6	24,758.4	25,307.7	25,361.3	25,643.7
Funds of hedge funds[3]	1,021.3	810.2	709.2	793.9	738.0	726.8	709.2	–
Hedge funds[3]	539.4	652.0	614.5	716.5	669.8	635.5	614.5	–
Real estate investment fund	7,406.9	6,465.1	6,115.6	6,363.7	6,279.6	6,201.5	6,115.6	6,096.5
Real estate investment companies	371.9	308.5	321.9	304.6	327.0	322.7	321.9	322.0

1 From II quarter 2009 on it is considered as “assets under management” all the assets of the investment companies which are co-managed by management companies and other different companies.
2 Available data: January 2011.
3 Available data for IV quarter 2010: November 2010.

Foreign Collective Investment schemes marketed in Spain[1]

TABLE 3.14

				2009	2010			
	2008	2009	2010[2]	IV	I	II	III	IV[2]
INVESTMENT VOLUME[3] (million euro)	18,254.8	25,207.2	35,457.9	25,207.2	30,864.9	32,362.8	32,826.7	35,457.9
Mutual funds	3,352.0	5,215.1	8,109.3	5,215.1	6,519.3	7,477.2	7,650.1	8,109.3
Investment companies	14,902.8	19,992.0	27,348.6	19,992.0	24,345.6	24,885.7	25,176.6	27,348.6
INVESTORS/SHAREHOLDERS	593,488	685,094	838,680	685,094	748,749	791,381	811,553	865,767
Mutual funds	102,922	139,102	193,486	139,102	157,027	181,039	186,804	199,233
Investment companies	490,566	545,992	645,194	545,992	591,722	610,342	624,749	666,534
NUMBER OF SCHEMES	563	582	660	582	615	636	652	660
Mutual funds	312	324	379	324	353	365	376	379
Investment companies	251	258	281	258	262	271	276	281
COUNTRY								
Luxembourg	274	275	290	275	278	288	287	290
France	161	178	225	178	201	210	222	225
Ireland	63	64	75	64	67	69	74	75
Germany	16	17	20	17	19	20	20	20
UK	14	14	16	14	15	15	15	16
The Netherlands	1	1	1	1	1	1	1	1
Austria	28	27	27	27	28	27	27	27
Belgium	5	5	5	5	5	5	5	5
Malta	1	1	1	1	1	1	1	1

1 From December 2008 on, foreign collective investments schemes shareholders and total net assets data do not include exchange traded funds (ETFs).
2 Provisional data.
3 Investment volume: participations or shares owned by the investors/shareholders at the end of the period valued at that moment.

Real estate investment schemes

TABLE 3.15

				2010				2011
	2008	2009	2010	I	II	III	IV	I[1]
REAL ESTATE MUTUAL FUNDS								
Number	9	8	8	8	8	8	8	8
Investors	97,390	83,583	75,280	81,647	76,772	76,182	75,280	75,369
Asset (million euro)	7,406.9	6,465.1	6,115.6	6,363.7	6,279.6	6,201.5	6,115.6	6,096.5
Return on assets (%)	0.69	-8.31	-4.74	-1.63	-0.99	-1.31	-0.9	-0.32
REAL ESTATE INVESTMENT COMPANIES								
Number	9	8	8	8	8	8	8	8
Shareholders	937	928	943	927	942	934	943	943
Asset (million euro)	371.9	308.6	321.9	304.6	327	322.7	321.9	322

1 Available data: January 2011. In this case, return on assets is monthly.