# FINANCIAL REGULATION: 2004 Q4

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### *Introduction*

As has lately become usual, a larger number of new provisions of a financial nature were enacted in the fourth quarter of 2004 than in the other quarters of the year.

The Banco de España issued two circulars relating to credit institutions. The first contains the new accounting regime for credit institutions, adapted to International Financial Reporting Standards (IFRS). The second repeals certain circulars that have mostly been, in practical terms, repealed since the adoption of the euro and its replacement of the peseta as the monetary and accounting unit for the national monetary system.

Second, a European Central Bank Guideline was published on the procurement of euro banknotes which, among other matters, establishes the eligibility and award criteria of the tender procedure.

Third, amendments were made to the legislation on book-entry State debt and the Regulations for the *Caja General de Depósitos* to resolve a malfunctioning that arises in certain cases when charged securities are redeemed.

Fourth, as usual in this period, there is a description of the changes made in the State Budget for 2005, mainly of a monetary, financial and fiscal nature. In the fiscal area, the amendment of the personal income tax (IRPF) regulations is highlighted. The average annual wage of all taxpayers has been updated and the withholding brackets applicable to earned income have been adjusted.

Finally, another four laws of economic interest have been published: the consolidated text of the Private Insurance Law; the general regulations for the tax penalty system; the adaptation of Spanish law to the new Community competition law framework; and measures to combat late payment in commercial transactions, adjusting the Spanish legal system in this area to Community law.

### *Credit institutions: public and prudential financial reporting rules and formats for financial statements and returns*

The Circular of the Banco de España CBE 4/1991 of 14 June 1991[1], which contains the accounting standards and formats for financial statements and returns for credit institutions, has been amended frequently to adapt its contents to the various changes affecting the credit system in recent years.

Recently, *CBE 4/2004 of 22 December 2004* on public and prudential financial reporting rules and formats for financial statements and returns (Official State Gazette (BOE) of 30 December 2004) has been published, which aims to modify the accounting regime for Spanish credit institutions contained in CBE 4/1991 (now repealed), to adapt it to the new accounting environment arising from the adoption by the European Union of IFRSs.

The Circular has the following structure: a rule regulating its scope; three titles regulating, respectively, public financial statements, prudential returns and internal control and management issues and mandatory registers; two additional provisions, on the submission of financial statements to the Banco de España and on the interpretation of the Circular; three transitional

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**1.** See "Regulación financiera: segundo trimestre de 1991", *Boletín Económico,* Banco de España, July/August 1991, pages 58-60.

provisions, addressing the problems involved in the changes that will occur when the Circular is first applied; a repealing provision, and a final provision relating to its entry into force. In addition, the Circular includes nine annexes: three on the formats for public statements, and four on the formats for prudential returns, one on the sectorisation criteria and the last one on credit risk.

The most salient aspects of the Circular are set out below.

SCOPE

The Circular applies to the preparation of the public individual and consolidated financial statements and the prudential returns of credit institutions, Spanish branches of foreign credit institutions, groups of credit institutions and consolidable groups of credit institutions.

PUBLIC FINANCIAL STATEMENTS

The most important part of the Circular refers to the preparation of the public financial statements. It starts by determining the institutions and, where applicable, the groups of credit institutions that are required to prepare individual and consolidated annual accounts, and the obligation to publish regularly, through their respective professional associations, other information to which the criteria of the Circular must be applied.

It then addresses the content of the annual accounts, the characteristics the financial information must have (being clear, relevant, reliable and comparable), the accounting policies to be applied and the definitions of the elements of the annual accounts (assets, liabilities, equity, expenses, income, gains and losses).

The Circular also defines the basic assumptions on which the financial information is compiled (accruals basis and going concern) and the main criteria on which it is based (recognition, no offset and matching of costs with revenues). Also, it defines the general measurement bases common to all types of assets and liabilities, including fair value, the criteria for recognising income and the treatment of errors and changes in accounting estimates, those applicable to events occurring between the balance sheet date and the date the financial statements are authorised for issue and the rules for translating amounts in foreign currency.

It also includes the definitions and characteristics of financial instruments (financial assets, financial liabilities and equity instruments), and of the portfolios into which they are classified for the purposes of their measurement, these being:

— "Instruments recorded at fair value through profit or loss", which include the trading portfolio and other financial instruments that fulfil certain requirements.

— "Held-to-maturity investments", which include securities representing a debt of the issuer when the investor entity fulfils certain requirements; these securities are recorded at amortised cost.

— "Loans and receivables", which include non-traded financial assets that represent debts for their issuer or obligor; they are recorded at amortised cost.

— "Available-for-sale financial assets", which include debt securities and equity instruments not recorded in other categories; they are measured at fair value, with changes in value recorded in equity until they are realised, at which point they shall be recognised in the income statement; except equity instruments whose fair value cannot be reliably estimated, which are measured at cost.

It also establishes the criteria for derecognition of financial assets, including securitisation or other transactions involving the mobilisation of assets. As a general rule, the rights of the assets must be transferred or must have expired. In the first case, for derecognition to take place, all the risks and benefits incorporated in the financial asset need to have been substantially transferred.

The next section, devoted to non-financial assets contains the specific rules for tangible and intangible assets and for inventories. Cost has been chosen as the measurement basis. However, the Circular provides for the exceptional possibility, when it is first applied, of measuring freely disposable tangible assets at fair value with any change recorded in reserves.

The Circular also regulates the rules applicable to asset impairment, distinguishing between financial and other assets. Allowances for losses on financial assets are envisaged, provided that they are based on objective evidence. To estimate the losses arising from the deterioration of credit risk the criteria of Annex IX shall be used, which envisages the need to make specific and general provisions for insolvency risk attributable to the customer, and specific provisions for country risk. For other assets, including goodwill, deterioration is considered to have occurred when the carrying amount of the asset exceeds its recoverable amount.

An important part of the Circular refers to hedge accounting. There are two sets of rules: one for the hedging of financial instruments, or groups of instruments that share similar risk characteristics (known as micro-hedges), and another for the hedging of the interest rate risk of a portfolio of financial instruments (macro-hedges). In both cases, except for the hedging of exchange risk, only derivatives can be used as hedging instruments.

Three types of hedge are defined: fair value, cash flow and net investment in a foreign operation. These are distinguished by the way in which the gain or loss on the hedged instrument (in the case of fair value hedges, in which the hedged instruments are measured at fair value) or on the hedging instrument (in the case of the other two types of hedge, in which changes in value are recorded in equity, until they are recognised in the income statement in a manner symmetrical with the gain or loss on the hedged instruments) is recorded. In the case of portfolio hedges of interest rate risk, the possibility of applying the criteria adopted by the European Union (accepting the hedging of stable deposits and relaxing the requirements for estimating the efficacy of the hedge) has been included as an option.

The Circular also establishes the criteria applicable to the accounting treatment of mergers and acquisitions and other corporate reorganisations, as well as the methods of integrating the financial statements of branches of the institution and the general criteria for recording investments in subsidiaries, associates and jointly controlled entities in consolidated statements. The most important change worth mentioning is the disappearance of the exclusion from consolidation by reason of activity and the strengthening of the concept of control to integrate globally and of significant influence to apply the equity method. Proportionate consolidation is established as the general rule for jointly controlled operations and, exceptionally, the equity method.

CONTENT OF THE FINANCIAL STATEMENTS

Another important aspect of the Circular explains the content of the various financial statements: balance sheet, income statement, statement of changes in equity and cash flow statement.

For their part, the rules relating to the content of the explanatory notes and the information on related parties represent a substantial increase in information and in levels of transparency with

respect to the current situation. Thus, the information relating to financial risks and their management, along with the strategies and internal organisation, including hedging policies is increased. In addition, information must be given on the fair values of those assets and liabilities that have not been valued in the balance sheet, applying this criterion (e.g. held-to-maturity investments and loans and receivables). As regards the transactions with related parties, the nature and relations with each party shall be disclosed, as well as the policies followed with them and the amounts in the balance sheet and income statement that are affected by these relationships.

PRUDENTIAL FINANCIAL RETURNS

The Circular establishes that the same criteria shall be used to prepare the prudential returns as are used to prepare the public statements. Also, it sets the criteria for presenting such statements, defining the content of the off-balance-sheet items and establishes criteria for sectorising the personal balances.

At the same time, it establishes which are the prudential statements that must be sent to the Banco de España, as well as the frequency and submission deadlines.

Four types of statement are distinguished: individual, consolidated for the consolidable group of credit institutions and those relating to the statistical requirements of Economic and Monetary Union.

INTERNAL CONTROL AND MANAGEMENT CRITERIA

The Circular requires that entities have certain internal control and management criteria, and lays down the obligation to keep a centralised register of bank guarantees, as in the past, and to set up a register of powers of attorney granted and another of judicial and administrative procedures.

OTHER MATTERS

In the section containing the rules for preparing the public financial statements, a section of the Circular addresses certain matters that, owing to their relevance, need to be highlighted:

— Leases: including both operating and finance leases; the need for a put option to classify the lease as a finance lease has been dispensed with and operations are classified according to whether or not all the risks and rewards are transferred from the lessor to the lessee.

— Non-current assets held for sale: a rule to regulate assets with an economic life of more than one year, whose value the entity wishes to recover through sale instead of use. The rule requires a commitment by the board of directors to carry out the sale within the period envisaged which, save for exceptions, shall be one year. This rule includes the treatment of assets foreclosed as a consequence of breach of contract by the lender, and the criteria that shall be observed when this type of asset is sold with financing from the entity itself.

— Personnel expenses and equity-instrument based employee compensation: these two rules cover both short-term compensation, whatever the settlement formula, and long-term compensation which is normally paid from the time that the worker's working life ends; for this type of compensation, the possibility of using a corridor, even in the first application, to attribute the actuarial gains or losses that exceed a 10% limit with an attribution period of five years, is provided for.

— Other provisions and contingencies: the treatment of obligations whose nature is clearly identified, but the amount and timing of which are undetermined, provisions being required when losses are estimated.

— Commissions: the Circular classifies the treatment that shall be given to commissions received or paid, according to whether they are compensation for a service provided or for a cost incurred, or whether they are additional remuneration to the interest rate on the operation; the former are recognised as income when the service is performed or the cost incurred, and the latter are allocated over the life of the operation. Entities are expected to compensate the incremental costs they have incurred with part of the amount of the commissions received.

— Exchanges of assets: it is established how exchanges of assets should be recorded, which shall depend on whether or not they are commercial.

— Insurance contracts: the rule regulates the treatment of assets and liabilities having the nature of insurance transaction and, following the provisions of the International Financial Reporting Standards, does not propose a specific method for valuing the liabilities arising from these transactions, so that the entities shall apply the national regulation.

— Social funds and welfare projects: only affects savings banks and credit co-operatives; it is clarified that the transfers that are compulsory by nature shall be treated as an expenditure of the period and that the funds pending consumption and the tangible assets corresponding to these activities shall be presented in separate items of the balance sheet.

— Tax on company profits: following the recommendation of the White Book for the reform of accounting in Spain, the Spanish accounting treatment has been maintained, with the necessary adjustments to make it compatible with the IFRS.

Finally, the Circular establishes that the first statements that have to be presented to the Banco de España based on the new accounting criteria are those of 30 June 2005. In addition, the 2004 and 2005 statements must be restated using the new criteria.

The entry into force of the Circular is set for 1 January 2005, except for the individual financial statements, whose entry into force shall be 30 June 2005.

***Repeal of various Banco de España circulars***

CBE 22/1992 of 18 December 1992[2] on the foreign exchange market, regulated the functioning of that market, following the principle of free exchange rates and establishing the terms on which foreign-exchange buying and selling transactions (against both pesetas and other currencies) should be carried out and the days that are to be considered business days for such purposes. Also, the same Circular determined the foreign currencies quoted by the Banco de España and the obligation of the latter entity to publish the buying and selling rates for currencies applied to the ordinary transactions it carried out for its own account, which were considered "official rates" for the purposes of the provisions of the prevailing legislation that refer to such rates. However, on 1 January 1999 the euro was introduced and the peseta abolished as a monetary unit and a unit of account of the national monetary system, while exchange rate policy was attributed to the European Union. All of this has involved a radical change in the foreign exchange market, which is no longer local, but European in scope. Therefore, it is necessary to repeal this Circular. The same is the case with CBE 2/1997 of 25 March 1997[3],

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**2.** See "Regulación financiera: cuarto trimestre de 1992", *Boletín Económico,* Banco de España, January 1993, page 73. **3.** See "Regulación financiera: primer trimestre de 1997", *Boletín Económico,* Banco de España, April 1997, pages 113 and 114.

addressed to registered institutions, which regulates the reporting of daily foreign currency positions and merely repealed rule four of Circular 22/1992.

It would also be appropriate to repeal CBE 1/1993 of 26 January 1993 on the payment regime with Colombia. This regime is no longer necessary as the Reciprocal Credit Agreement between the Bank of the Republic of Colombia and the Banco de España was terminated that year and all transactions that remained outstanding have been settled in the meantime.

Finally, CBE 12/1998 of 23 December 1998[4] on the redenomination of Certificates of the Banco de España should also be repealed, since all the certificates of deposit issued by the Banco de España have already been redeemed.

In accordance with the foregoing, *CBE 5/2004 of 22 December 2004* (BOE 30 December 2004) has been published, which repealed the aforementioned Circulars as from 30 December 2004, the date of its entry into force.

***Guideline of the European Central Bank on the procurement of euro banknotes***

The Treaty establishing the European Community and, in particular, the Statute of the European System of Central Banks and of the European Central Bank grant the Governing Council of the European Central Bank (ECB) the exclusive right to authorise the issue of euro banknotes within the Community. The ECB may allocate the responsibility for issuing euro banknotes to the national central banks of the Member States that have adopted the euro (NCBs), in accordance with the NCBs' percentage shares in the ECB's subscribed capital in the relevant financial year. Moreover, the ECB should allocate the responsibility for concluding and managing supply agreements for euro banknote production taking into account the principle of decentralisation and the need for an effective management framework.

On 10 July 2003, the Governing Council of the ECB decided that a common Eurosystem competitive approach to tendering (hereinafter the single Eurosystem tender procedure) should apply to the procurement of euro banknotes at the latest from 1 January 2012 onwards. NCBs that have an in-house printing works, or those using a public printing works may elect not to participate in the single Eurosystem tender procedure. In such cases, these printing works will remain responsible for the production of the euro banknotes that have been allocated to their NCBs in accordance with the capital key but will be excluded from participating in the single Eurosystem tender procedure.

Now, the *Guideline of the European Central Bank of 16 September 2004* on the procurement of euro banknotes (ECB/2004/18) (OJ of 21 October 2004) has been published which, among other matters, establishes the eligibility and award criteria of the tender procedure.

The single Eurosystem tender procedure will ensure a level playing field between all printing works participating in the procedure by permitting competition between them in a transparent and fair manner that does not give any of the participants an unfair advantage.

Finally, the Governing Council shall monitor all key raw materials and factors of production and, if necessary, take adequate measures to ensure that they are selected and procured so as to ensure the continuity of supply of euro banknotes and, without prejudice to European competition law and the European Commission's competencies, to prevent the Eu-

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**4.** See "Financial regulation: fourth quarter of 1998", *Economic Bulletin*, Banco de España, January 1999, p. 85.

rosystem suffering due to the abuse of a dominant market position by any contractor or supplier.

***Amendment of the law on book-entry State debt and the Regulations of the Caja General de Depósitos***

The current legal system applicable to the charging or attachment of book-entry government securities is contained, basically, in the Ministerial Order of 19 May 1987[5], implementing Royal Decree 505/1987 of 3 April 1987, which provides for the setting up of a book-entry system, and in the Ministerial Order of 7 January 2000, implementing Royal Decree 161/1997 of 7 February 1997, which establishes the Regulations of the *Caja General de Depósitos*.

Malfunctioning has been detected in this system, when book-entry securities that have been charged or attached are redeemed since, in certain circumstances, the redemption amount is withheld indefinitely.

To avoid this situation, *Order EHA/4260/2004 of 27 December 2004,* which amends the Order of 19 May 1987 and the Order of 7 January 2000 (BOE of 30 December 2000), has been published. This requires the person or authority requesting the immobilisation of the securities to designate a cash account into which the redemption amount is to be paid.

Specifically, as regards the Order of 19 May 1987, the Book-Entry System shall establish the procedure for immobilising the balances necessary for establishing rights over or charging book-entry State debt. Upon redemption, the cash corresponding to immobilised balances shall from now on be paid to the registered entity or account holder in whose name the redeemed securities are recorded or into the account that, in accordance with the rules regulating the system for recording securities, such entities or the applicant or beneficiary judicial or administrative authority may designate.

Likewise, as regards the Ministerial Order of 7 January 2000, it is provided that, when securities that have been charged as security at the *Caja General de Depósitos* are redeemed, the cash corresponding to such securities shall be paid into the account of the Treasury at the Banco de España, remaining subject to the rules for security in the form of cash. The cash amount arising from redemption shall be paid to the managing entity or the account holder in whose name the securities are entered at the time of their redemption, which shall dispose of such cash amount as appropriate. However, in the event of cash arising from the redemption of securities that have been immobilised to provide security at the *Caja General de Depósitos*, when the effectiveness of such security has been confirmed by the administrative agency, autonomous body or public entity at whose disposal it was established, the corresponding cash shall be paid into the account determined by the Treasury, the cash deposits being subject to the rules for security in the form of cash.

***State budget for 2005***

As usual in December, *Law 2/2004 of 27 December 2004* on the State budget for 2005 (BOE of 28 December 2005) has been published. The Law seeks to help increase the productivity of the Spanish economy, through public and infrastructure investment, a research drive, technological development and innovation and the expansion of the educational grants at all levels. In addition, it attempts to boost social spending in certain areas in which the needs are particularly pressing.

For the first time since 1993, the government has chosen this year to submit only the budget law to parliament, the usual practice being for it to be accompanied by the so-called law on fiscal, administrative and social measures.

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**5.** See "Regulación financiera: segundo trimestre de 1987", *Boletín Económico*, Banco de España, July-August 1987, pp. 46-48.

From the viewpoint of financial regulation, the following monetary, financial and fiscal sections are highlighted:

AMENDMENT OF THE LAW ON PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

The Budget Law, in its additional provisions, amends Law 41/1999 of 12 November 1999 on payment systems and securities settlement systems. Specifically, it addresses the new regulation of *Sociedad Española de Sistemas de Pago, Sociedad Anónima* (the Company), which will replace *Servicio de Pagos Interbancarios, Sociedad Anónima*, which shall be responsible for managing the National Electronic Clearing System (SNCE), planned for before 1 July 2005.

The Company shall act under the principle of financial balance and shall have as its sole object:

a) To facilitate the exchange, clearing and settlement of fund transfer orders between credit institutions, whatsoever the type of document, payment instrument or fund transmission giving rise to such transfer orders.

b) To facilitate the distribution, collection and treatment of means of payment of credit institutions.

c) To provide complementary or auxiliary technical or operating services to the above-mentioned activities, and any others requested so that the Company collaborates and co-ordinates its activities in relation to payment systems.

d) Those others entrusted by the Government, following a report by the Banco de España.

The Company may participate in the other systems regulated by this Law, without it being able to assume risks other than those deriving from the activity that constitutes its sole object. The Ministry of Economy and Finance, following a report of the Banco de España, shall establish those financial intermediation activities that the Company may carry out and which are necessary for the development of their functions.

Within the limits of its corporate object, the Company may establish with other bodies or entities that perform similar functions, within or outside domestic territory, the relations it deems appropriate for best performing its functions, and assume the management of other systems or services with similar aims, other than the SNCE. Also, credit institutions operating in Spain and registered in the Banco de España's compulsory official registers may also participate in the National System or other systems managed by the Company. In no event may specialised credit institutions do so.

The Company shall be supervised by the Banco de España, which shall be responsible for authorising, before they are adopted by the Company's relevant bodies, the articles of association and any amendments thereto, as well as the basic rules of functioning of the systems and services it manages. The *penalty system* established by Law 26/1998 of 28 July 1998 on discipline and intervention of credit institutions, with such specifications as may be legally determined, shall be applicable to the Company, as shall the intervention regime established in the same law.

AMENDMENT TO THE LAW OF AUTONOMY OF THE BANCO DE ESPAÑA

The budget law also amends article 16 of Law 13/1994 of 1 June 1994 on autonomy of the Banco de España, in order to bring about the integration of payment systems in Spain, a fundamental pillar for the correct functioning of the financial system and for financial stability itself.

In performing its functions as a member of the ESCB, the Banco de España may, by means of Circulars, regulate payment clearing and settlement systems. In particular, it may implement and complete legal acts issued by the ECB and incorporate the recommendations of international agencies that constitute principles applicable to the safety and efficiency of payment systems and instruments. It may also manage, where applicable, the relevant payment clearing and settlement systems.

The Banco de España shall also be responsible for monitoring the functioning of clearing and payment systems. For this purpose it may require, both from the entity managing the payment system and from suppliers of payment services, including those entities that supply technical services for the aforementioned systems and services, all such information and documentation as it may consider necessary to assess the efficiency and safety of payment systems and instruments.

For reasons of prudence, the Banco de España may suspend the application of the decisions taken by the managing entity of a payment system, and take appropriate measures, when it considers that such decisions infringe the legislation in force or prejudice the smooth operation of clearing and settlement processes.

STATE DEBT

With regard to State debt, the government has been authorised to increase the outstanding amount of State debt as at 31 December during 2005, on condition that as at 31 December 2005 it shall not exceed the level at the beginning of the year by more than €14 billion. This limit may be exceeded during the course of the year with the prior authorisation of the Ministry of Economy and Finance, those cases in which it shall be automatically revised having being established.

TAX ASPECTS

As for personal income tax, the main measure is the updating of the tax rates to avoid an increase in the tax burden. Also, for the purposes of calculating the capital gains arising on property, the coefficients for adjusting the acquisition value have been raised by 2%.

Also the provisions that enable the loss of tax profits to be offset that affect certain taxpayers of the current personal income tax law, such as lessees and purchasers of first homes with respect to those established in the Personal Income Tax Law 18/1991 of 6 June 1991.

In relation to corporate income tax, the updating of the coefficients applicable to property assets is included, which enables the monetary depreciation in cases of transfer to be corrected. Finally, in relation to local taxes, the ratable values of properties are raised by 2%.

OTHER PROVISIONS

Other provisions of an economic nature relate to the legal interest rate, which is raised from 3.75% to 4%, and to default interest, which is raised from 4.75% to 5%. Likewise, the employment promotion programme is regulated, as is the financing of continued training. Finally, the public indicator of multiple effect income (IPREM), fruit of the new regulation of the minimum wage, has been introduced for 2005.

***Amendment of the personal income tax regulations***

The consolidated text of the Personal Income Tax Law, approved by Royal Legislative Decree 3/2004 of 5 March 2004[6], established that withholdings and payments on account in respect of earned income arising from employment relationships or those based on articles of association and from ordinary and public-sector pensions would be determined by regulations,

**6.** See "Financial regulation: 2004 Q1", *Economic Bulletin,* Banco de España, April 2004, Section 10.

taking as reference the amount that results from applying the tax rates to the income in relation to which the withholding or payment on account is to be made.

Consequently, and considering that the government's economic aims include maintaining the purchasing power of wages and pensions, *Royal Decree 2347/2004 of 23 December 2004* has been enacted to amend the personal income tax regulations approved by Royal Decree 1775/2004 of 30 July 2004 on the annual average wage for all taxpayers and on withholdings and payments on account on earned income (BOE of 24 December 2004).

First, the annual average wage for all persons submitting income tax returns has been raised from €17,900 to €19,600. This variable is used to calculate the maximum amount to which, where applicable, the reduction of 40% of earned income arising from the exercise of stock options by employees is applied. Second, each of the withholding brackets applicable to earned income has been raised by 2%

***Consolidated text of the Private Insurance Law***

The Private Insurance Law 30/1995 of 8 November 1995[7] incorporated Community provisions in force at the time into Spanish law, especially those relating to the control and supervision of insurance corporations, following the path forged by the Member States of the European Economic Area.

Subsequently, the Financial System Reform Law 44/2002 of 22 November 2002[8] made a number of amendments to Law 30/1995. First, it transposed the Community legislation published up to that date into Spanish internal law, and promoted the efficiency of the insurance market through the abolition of the *Comisión Liquidadora de Entidades Aseguradoras* (Insurance Corporation Liquidation Board) and the assumption of its functions by the *Consorcio de Compensación de Seguros* (Insurance Compensation Consortium). Second, some important changes were made in relation to the protection of financial services customers: infringements involving shortcomings in the administrative procedures and internal control of insurance corporations were defined, and the penalty system for insurance infringements was updated. Finally, the government was authorised to draft a consolidated text of the Private Insurance Law 30/1995 of 8 November 1995 within one year, and to standardise, clarify and harmonise the legal texts to be included therein.

For its part, the Insolvency Law 22/2003 of 9 July 2003 amended Private Insurance Law 30/1995 of 8 November 1995 to adapt the wording of some of its provisions to the new insolvency regulations.

Subsequently, Law 34/2003 of 4 November 2003 on the amendment and adaptation of private insurance legislation to Community law, among other aspects, introduced significant changes into Law 30/1995 of 8 November 1995, given the need to adapt it to the most recent Community directives in the area of insurance, and authorised the government to prepare a consolidated text of the Private Insurance Law, including the amendments contained in Law 44/2002 of 22 November, and those arising from the Insolvency Law 22/2003 of 9 July 2003.

*Legislative Royal Decree 6/2004 of 29 October 2004* (BOE of 5 November 2004), approving the consolidated text of the Private Insurance Law, has now been published to fulfil the mandate contained in the above-mentioned provisions. This Decree offers a systematic and unified

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**7.** See "Regulación financiera: cuarto trimestre de 1995", *Boletín Económico*, Banco de España, January 1996, pp. 36-91. **8.** See "Financial regulation: 2002 Q4", *Economic Bulletin,* Banco de España, January 2003, Section 2.

text, comprising the law applicable to private insurance, harmonising and clarifying the consolidated texts where necessary.

The consolidated text of the Private Insurance Law maintains the same structure and system as the Private Insurance Law 30/1995 of 8 November 1995.

***General regulations for the tax penalty system***

*Royal Decree 2063/2004 of 15 October 2004* (BOE of 28 October 2004) has been published, to approve the general regulations for the tax penalty system, to implement the General Tax Law 58/2003 of 17 December 2003 and to replace the legislation hitherto in force, basically Royal Decree 1930/1993 of 11 September 1998.

The new regulations are characterised, inter alia, by the following aspects:

a) The conceptual distinction between tax debts and tax penalties.

b) The new definition of infringements, which adopts the three-way classification of minor, serious and very serious of Law 30/1992 of 26 November 1992 on general government and the common administrative procedure.

c) The introduction of new penalty reductions for cases in which investigation findings are agreed and penalties paid without appeal.

d) The special importance given to the subjective aspect of the infringement, so that, generally, for an infringement to be classified as serious requires *concealment* and for an infringement to be classified as very serious requires the employment of *fraudulent means*, these being specific expressions of a fraudulent intent in relation to taxation.

e) And an increase in legal certainty, the aim having been to reduce the degree of administrative discretion in the application of the penalty system.

The latter two characteristics shape the content of the new regulations, which no longer specify the exact amount of the penalty, this being determined in most cases by law. Instead the regulations limit themselves to establishing the calculation formulae required for the correct application of certain legal concepts within the new system, as well as regulating the penalty procedure.

The new General Tax Law makes the cornerstone of infringements that generate financial loss the subjective element in each case, essentially *concealment* or *fraudulent means*. The fundamental rule for application of the new regime is unitary classification of the infringement, so that, when the presence of concealment, fraudulent means or any other circumstance that influences the classification of an infringement are simultaneously appreciated in a particular regularisation, the impact of each of these circumstances on the amount to which the penalty is applied shall be analysed in order to determine whether the infringement should be classified as minor, serious or very serious. Once classified, the infringement shall be considered to be the only one and the relevant penalty percentage applied.

As for infringements that do not involve any financial loss to the tax authorities and basically consist of breach of duties or formal obligations, the implementing regulations contain rules that attempt to clarify the incompatibility of certain infringement types in accordance with the principle of non-simultaneity of tax penalties.

With regard to the penalty procedure, the most notable change is the new conception of the right to separate proceedings for the penalty procedure as a right that may be waived by the parties in a tax application procedure. In relation to separate proceedings, the most important changes affect the resolution of the procedure, since it is provided that the body competent to resolve the procedure may order extension of the actions and rectify the proposed resolution. Also, it should be noted that the special rules relating to the penalty procedures conducted by tax inspection bodies are incorporated into the tax penalty system and that in the previous system they were to be found in the above-mentioned general tax inspection regulations.

Finally, it should be pointed out that some special provisions have been introduced regulating the imposition of non-monetary penalties and actions in relation to offences against the tax authorities.

***Spanish adaptation to the new Community competition law framework***

Royal Decree 295/1998 of 27 February 1998 relating to the application in Spain of European competition rules regulated the application of these provisions by the national bodies responsible for fair trading, and generally attributed powers to each of the national authorities, the fair trade tribunal (*Tribunal de Defensa de la Competencia*) and the office for fair trading (*Servicio de Defensa de la Competencia*). It also regulated the duty of secrecy and the treatment of confidential information and established, generally, the application of the rules of procedure in Law 16/1989 of 17 July 1989 on fair trading, and in its implementing provisions.

Recently, important changes have been made to Community competition law that have had to be incorporated into Spanish law and this has been carried out by the publication of *Royal Decree 2295/2004 of 10 December 2004* relating to the application in Spain of the Community competition rules (BOE of 23 December 2004).

The Royal Decree transposes into Spanish law Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty establishing the European Community and Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

In this respect, Royal Decree 2295/2004 attributes the powers and obligations arising from Community law to the State fair trading bodies, these being the competition authorities in Spain for the purposes of Community law (these powers were previously divided between the State and the regional governments). Also, it regulates collaboration with the European Commission, with the national courts and with the national competition authorities of other Member States, it defines the powers of the officials or agents who undertake inspections in Spain, it establishes the rules applicable to the duty of secrecy and to confidential information with respect to the actions arising from the application of this Royal Decree, as well as the co-operation with jurisdictional bodies and, finally, it determines the rules of procedure that shall govern the application of the Community rules by the national authorities.

***Measures to combat late payment in commercial transactions***

The European Union has been paying increasing attention to the problems of excessively long payment periods and delay in the payment of contractual debts, since they reduce the profitability of firms, having particularly negative effects on small and medium-sized firms.

The initiatives of the European Union in this area led to Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions. Its aim was to promote greater transparency in the determination of payment periods in commercial transactions, and also compliance therewith. Its scope was limited to

payments made as remuneration for commercial transactions between undertakings or between undertakings and the public sector. It did not regulate transactions with consumers, interest in connection with other payments, e.g. payments under the laws on cheques and bills of exchange, or payments made as compensation for damages.

This Directive has recently been transposed into Spanish law by means of *Law 3/2004 of 29 December 2004* on combating late payment in commercial transactions (BOE of 30 December 2004).

The purpose of the Law is to combat late payment of money debts and the abuse, to the detriment of the creditor, in the setting of payment periods in commercial transactions giving rise to the delivery of goods or the provision of services between undertakings or between undertakings and the government. Its scope does not extend to: a) payments made in commercial transactions with consumers; b) interest in connection with the laws on cheques, promissory notes and bills of exchange and payments made as compensation for damages, including payments from insurance companies; and c) debts that are subject to insolvency proceedings instituted against the debtor, which shall be governed by the special legislation applicable.

The substantive measures against late payment regulated by the Law basically consist of establishing, generally, the period during which interest for late payment is payable, determining its automatic accrual, stating the rate of interest for late payment and granting the creditor the right to claim reasonable compensation from the debtor for recovery costs. In addition, the Law permits the use of retention of title clauses, whereby the seller retains title to goods until they are fully paid for.

The provisions of the Law determining the period in which interest for late payment is payable and the rate at which it is payable apply in the absence of agreement between the parties. That said, freedom of contract should not shelter abusive practices involving the imposition of clauses providing for longer payment periods or interest rates for late payment below those provided for in this Law, so that the courts may modify such agreements if, having considered the circumstances of the case, they are abusive to the creditor. In this respect, the fact that the agreement mainly serves to provide the debtor with extra liquidity at the expense of the creditor or for the main contractor to impose on its suppliers or subcontractors payment conditions that that are not justified by the obligations it assumes may be considered to amount to abuse. The Law also regulates collective actions to prevent the use of such clauses when they have been drafted for general use.