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New regulatory framework for collective investment undertakings in Spain

Draft Bill for the transposition of the Directive on Alternative Investment Fund Managers

On 18 July 2014, the Official Gazette published the Draft Bill which will transpose the Alternative Investment Fund Managers Directive (AIFMD) in Spain.

The transposition of the AIFMD in Spain through the Draft Bill will entail the amendment of the Spanish Private Equity Act, which regulates closed-ended funds, and the amendment of the Spanish Collective Investment Undertakings Act, which regulates open-ended funds (Funds Act).

One month ago we published a client briefing analysing the main new changes that the AIFMD introduces for Spanish private equity firms and other closed-ended collective investment undertakings. This briefing completes the analysis of the transposition regime of the AIFMD, and focuses on the developments that the AIFMD brings to open-ended collective investment undertakings.

Key Issues

- Which funds are regulated by the Funds Act?
- Which Management Companies are regulated by the Funds Act?
- Purpose, authorisation and revocationof authorisation of Management Companies
- Management of AIFs on a cross-border basis
- AIF marketing regime
- Obligations for Management Companies that manage AIFs which acquire major holdings and control over companies
- Legal regime of the depositaries
- Supervision and inspection
- Transitional regime

The main developments introduced by the Draft Bill are outlined below. A more detailed analysis will be produced when the Draft Bill is finally approved.

Initial assessment

Unlike the modifications that must be made to the Private Equity Act to implement the AIFMD, the impact of the AIFMD on open-ended collective investment undertakings in Spain is much lower, mainly because various aspects of the AIFMD are already covered in existing legislation. However, there are certain new aspects that we would like to highlight and which we summarise below.

Which funds are regulated by the Funds Act?

The Funds Act regulates open-ended collective investment undertakings (IIC), including both harmonised IIC, (such as UCITS) and non-harmonised IIC (also known as alternative investment funds (AIFs). These may adopt the legal form of collective investment companies or collective investment funds.

The Funds Act regulates the following AIFs:

- Financial non-harmonised IIC
- Spanish Hedge Funds and Spanish Funds of Hedge Funds
- Real Estate IIC

The Draft Bill includes a definition of "open-ended IIC" and "marketing of IIC", which were already included in the previous version of the Funds Act, and restates the non-application to these open-ended IIC of the private placement regime of Article 30bis of the Securities Market Act, which will only apply to collective investment undertakings of closed-ended type.

Which Management Companies are regulated by the Funds Act?

The Funds Act regulates all management companies of collective investment undertakings (SGIIC). However, it provides for a lighter regime for SGIIC where (i) they only manage investment entities and the cumulative assets under management fall below a threshold of EUR 100 million or (ii) EUR 500 million for SGIIC that manage only unleveraged investment entities that do not grant investors redemption rights during a period of 5 years.

The obligations from which the SGIIC will be exempt when meeting these requirements will be determined by further regulation.

In any event, the SGIIC must inform the CNMV of the IIC they manage and provide information on the investment strategies applicable to them. In addition, they must provide to the CNMV information on the main instruments in which they invest and the main risks and concentrations, as established in the regulations that will implement the Draft Bill. Lastly, these SGIIC must inform the CNMV if they cease to comply with the above conditions.

The rule clarifies that these exemptions will not be applicable to SGIIC which market IIC to investors who are not professionals.

Purpose, authorisation and revocation of authorisation of Management Companies

Purpose

Together with providing the services of investment management, administration, representation and management of subscriptions and redemptions of the funds and the investment entities, the service of "control and manage risks" is included as a corporate purpose of a SGIIC.

In addition, the service of "reception and transmission of orders in relation to one or

several financial instruments" is included as a complementary service, which will only be able to be carried out by a SGIIC able to discretionally manage portfolios.

Authorisation

The term for authorisation of a SGIIC falls from a period of 6 months to 3 months, and its resolution must be duly reasoned. However, the initial term of 3 months may be extended by another 3 months when the CNMV deems it necessary and provides the SGIIC with prior notification. In addition, the power to authorise a SGIIC passes from the Ministry of Economy (after the proposal of the CNMV) to only the CNMV.

To grant authorisation to a SGIIC, the CNMV will require it to include information on the remuneration policies and practices and arrangements for the delegation and sub-delegation of functions to third parties.

Revocation

As for the authorisation process, the CNMV is now solely responsible for revocation procedures, which was previously held by the Ministry of Economy, after the proposal of the CNMV.

Management of AIFs on a cross-border basis

A new article is included in order to allow SGIIC to manage EU AIFs established in another Member State either directly or by establishing a branch, provided that the SGIIC is authorised to manage that type of AIF. The same provision exists for managers authorised in another Member State who want to manage Spanish AIF, either directly or by establishing a branch in Spain.

Lastly, the Draft Bill closes the chapter on cross-border management with the inclusion of an article regulating the conditions to allow to the SGIIC to manage AIF not domiciled in a Member State and which are not marketed in the EU Member States. For this purpose, the SGIIC must meet two requirements: (i) that the SGIIC complies in respect to such AIF with all the requirements established in the Funds Act, except for the requirement to appoint a depositary and the obligation to audit the annual report, and (ii) regulatory cooperation arrangements should be in place between the CNMV and the authority of the state of origin of the AIF.

AIF Marketing Regime

One of the most interesting developments of the Draft Bill is the marketing regime of Spanish AIFs abroad and foreign AIFs in Spain.

In this client briefing, we provide an initial assessment of the proposed regime, focusing on the marketing of open-ended foreign AIFs in Spain.

We are working on a specific client briefing analysing this point in detail which will be available shortly.

In our opinion, the new regime established by the Draft Bill has made few advances in respect of the marketing of foreign AIFs, except for the possibility of marketing through the passport open-ended AIFs managed by EU managers to professional investors in Spain, which to date has been practically impossible as the marketing of non-UCITS in Spain requires authorisation from the CNMV, which was extremely difficult to obtain.

For the remainder of open-ended AIFs (non-European AIFs managed by European managers or AIFs from any location managed by a non-EU manager), the situation has in practice

not changed since it is already difficult to market to professional and to retail investors in Spain, requiring authorisation and registration with the CNMV and compliance with numerous requirements. The requirements already set out in the Funds Act which must be fulfilled are:

- Spanish regulations must recognise the same category of IIC,
- the AIF or the manager acting on its behalf must be subject to specific rules in its state of origin in relation to the protection of shareholders or unitholders which are similar to the Spanish rules in this regard, and
- there must be a favourable report issued by the authority of the state of origin of the AIF.

In addition, now the new requirements established in the AIFMD, listed below, must be fulfilled as well:

- regulatory cooperation arrangements must be in place,
- the country where the non-EU AIF is incorporated should not be listed as non-cooperative by the FATF, and
- the third-party country in which the non-EU AIF is established must have signed an agreement with Spain which ensures an effective exchange of information in tax matters, including, where appropriate, multilateral agreements on taxation.

Obligations for Management Companies that manage AIFs which acquire major holdings and control over companies

The SGIIC must notify the CNMV, within 10 working days, of any major shareholding that an AIF managed by it acquires, disposes of or holds in a non-listed company. In the event of a controlling holding, the SGIIC must notify the CNMV, the non-listed company and its shareholders and provide them with certain information set out in the Draft Bill. Likewise the annual report of AIFs exercising control over non-listed companies must include specific information. Lastly, there are limitations on the SGIIC, which, for a period of 24 months following the acquisition of control of the non-listed company by the AIF, must not undertake certain transactions (eg. capital reductions, distributions under certain circumstances, redemption and/or acquisition of own shares, etc.) which means "asset stripping", i.e. speculative acquisitions of companies with the sole objective of subsequently selling it off in parts.

The Draft Bill exempts some non-listed companies (eg. small and medium-sized enterprises) from these obligations. However, it is stated that some of these obligations will apply also to a SGIIC managing AIFs that acquire control over listed companies.

Legal regime of the depositaries

The Draft Bill includes a new legal regime for both the depositaries of AIFs and of UCITS, thereby anticipating the implementation of the UCITS V Directive on this matter, although some of the issues set out in the UCITS V are more restrictive than those set out in the Draft Bill. See our recent client brefing "*Legal Regime for depositaries under UCITS V"* from April 2014.

Under the Draft Bill, the appointment of the depositary must be evidenced by a written contract. The Draft Bill details the obligation of the depositaries in relation to (i) the safe-keeping, differentiating between financial instruments that can be held in custody and the deposit of other assets for which the depositary must verify the

ownership and maintain a record of those assets, and (ii) the monitoring of the cash flows and the valuation of the units or shares of the AIF, which must be calculated in accordance with the applicable national law and the documentation of the AIF.

The depositary may delegate to third parties the safekeeping function, which, may, in turn, sub-delegate that function to other entities subject to certain requirements.

As far as the liability of the depositary is concerned, the general principle is that the depositary will be liable to the investors for all other losses they suffer as a result of the depositary's negligent or intentional failure to properly fulfil its legal obligations. Likewise, the depositary should be liable for the loss of the financial assets by the depositary or a third party to whom the custody of financial instruments has been delegated.

In the case of a loss of a financial instrument held in custody, the depositary must return a financial instrument of identical type or the corresponding amount to the AIF without undue delay. The depositary will not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

Lastly there is a new provision that regulates the possibility for the depositary, in case of a loss of financial instruments held in custody by a third party, to transfer such liability to the third party if certain requirements are met.

Supervision and inspection

There is a new article regulating the exchange of information by the CNMV with other competent authorities in relation to the systemic consequences of the activities of the AIFM in accordance with the AIFMD. Likewise there is a new article regulating the supervisory regime of the leverage limits and of the adequacy of the credit assessment processes.

Some of the breaches and their sanctions are amended. The Draft Bill grants the CNMV the authorisation to impose sanctions for very serious breaches which previously was a power granted to the Ministry of Economy at the proposal of the CNMV.

Transitional regime

The law's entry into force will take place the day after it is published in the Official State Gazette, although the following transitional regime will apply:

Management Companies authorised prior to the entry into force of the law need to begin working to comply with the legislation since they must:

- send to the CNMV, within 3 months from that date, a statement in which they declare that they have adapted the company to the law's requirements, as well as, if applicable, modified the activities programme which includes the adaptations;
- update and send to the CNMV, within 12 months from that date, the rest of the information that it should provide to according to law.

The CNMV and, if applicable, the Mercantile Registry, must adapt at their own initiative (*ex officio*) their records in order to include the amendment of the by-laws of the SGIIC to comply with the new law.

Lastly, there are certain circumstances in which the Management Company will not have to adapt to the AIFMD or where the adaptation will

be more flexible (e.g. management companies insofar as they manage closed-ended AIFs before the entry into force of the law which do not make any additional investments after such date; or management companies insofar as they manage closed-ended AIFs whose subscription period for investors has closed prior to the entry into force of the Directive and are constituted for a period of time which expires at the latest on 22 July 2016).

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