

## **NEW RULES IN SPAIN FOLLOWING IMPLEMENTATION OF THE UCITS IV DIRECTIVE THROUGH ACT 31/2011**

October 2011

After a long previous process and then swiftly passing through the Spanish parliament, Act 31/2011, of October 4 (hereinafter, the "ACT"), amending the Collective Investment Schemes Act 35/2003, of November 4 (hereinafter, the "CISA"), was published in the Official Gazette of the Spanish State on October 5, 2011.

As stated in its preamble, the main purpose of amending the CISA is to transpose into Spanish law the Directive 2009/65/EC of the European Parliament and the Council of July 13, 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (hereinafter, the "UCITS IV Directive") and the Directives amending it.

The measures adopted as a result of the transposition of the UCITS IV Directive include, among others, (i) amendments to simplify the crossborder marketing of Collective Investment Schemes (hereinafter, "CIS"), (ii) new rules on crossborder operations of CIS management companies (hereinafter, "CISMC"), (iii) provisions to reinforce the supervisory powers of the competent authorities and cooperation arrangements between them, and (iv) provisions on the so-called "key investor information document" (hereinafter, "KIID").

Although a number of changes have also been made to improve the competitive edge of the Spanish CIS industry, the impact of these changes will fall short of what was expected, because the lawmakers were not willing to include the somewhat drastic tax measures the industry was demanding. The amendments are summarised as follows:

### **Changes in the procedure to register a CIS**

#### *Marketing in Spain of units or shares issued by foreign CIS*

The procedure for marketing in Spain units or shares issued by CIS harmonised according to the UCITS IV Directive (hereinafter, "UCITS") has been simplified. As stated under UCITS IV Directive, the Act provides that these units and shares may be freely marketed from the date the competent authority of the home member state informs the CIS that it has forwarded the following documents to the Spanish Securities and Exchange Commission or "CNMV":

- the notification letter<sup>1</sup>;

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<sup>1</sup> Including information on the provisions and the forms for marketing units and shares in Spain, as well as their classes or series, as the case may be.

- the management regulations of the investment fund (hereinafter, "IF") or the investment company's instruments of incorporation (hereinafter, "IC");
- the prospectus;
- the latest annual report and, if the case may be, the subsequent semi-annual report;
- the KIID; and
- a certificate proving that the CIS fulfils the requirements of the UCITS IV Directive.

Once the foreign UCITS is registered, it must observe Spanish regulations for matters not included in the UCITS IV Directive, such as the regulations on advertising.

Also, foreign UCITS operating in Spain must supply Spanish investors with all the information and documents they are required to supply to investors under the regulations in their home member state.

One of the most important new requirements concerns the language in which the documents to be filed with the CNMV must be drawn up: (i) the KIID and any changes to this must be filed in Spanish or in another language admitted by the CNMV; and (ii) the prospectus, and the annual and semi-annual reports, and any changes to these, must be filed in Spanish, in a language normally used in the financial markets (generally English), or in another language admitted by the CNMV. CIS would be responsible for providing true and fair translations of the information in the original documents.

If any changes are to be made to the way the units or shares are marketed, or to the classes of units or shares, with respect to what has been reported in the notification letter, the CIS must report the proposed changes to the CNMV before these take place.

CIS must also report to the CNMV any changes made to the documents that have been filed as attachments to the notification letter, as well as to the documents that can be retrieved in electronic format.

#### *Marketing the units or shares of Spanish CIS in other EU member states*

The procedure to be followed by a Spanish UCITS to be able to market its units or shares in another EU member state has changed. Thus, the UCITS is now required to forward the documents mentioned in the previous section to the CNMV.

The CNMV will check that all the required documents have been submitted and will issue a certificate stating that the Spanish UCITS fulfils the requirements of the UCITS IV Directive. The CNMV must send the certificate electronically to the competent authority of the host member state within 10 business days of receiving the documents. Once the CNMV informs the Spanish UCITS that it has notified the regulatory authority of the host country, the UCITS may be marketed in the host member state.

The provisions of the UCITS IV Directive have not been accompanied by tax measures that allow greater flexibility in the marketing of Spanish CIS in other countries, so they can be expected to have little impact.

### Information documents and information to holders of units and shares

For each CIS they manage, CISM and IC are required to publish and circulate the KIID among their shareholders, unit holders, and the general public. The KIID must include the following information: (i) identification of the CIS; (ii) a short description of its investment objectives and investment policy<sup>2</sup>; (iii) past-performance presentation or, where relevant, performance scenarios; (iv) costs and associated charges; and (v) risk/reward profile of the investment.

The KIID is considered pre-contractual information and must be kept up to date. It must mention where additional information may be obtained on planned investments, the prospectus, the annual and semi-annual reports, and the language in which the information is available. Furthermore, the KIID is required to be drawn up in non-technical language, concisely and using a common format, so that it can be easily understood by investors.

An important point is that civil liability may be incurred if the contents of the KIID and any translation of it are deceitful, inaccurate or inconsistent with the prospectus.

The duties to be observed concerning the KIID also apply to CISM authorised in other EU member states under the UCITS IV Directive that manage UCITS authorised in Spain.

The latest semi-annual report and the KIID must be made available to investors before they subscribe the units or shares, and, on request, so must the prospectus and the latest published annual and quarterly reports. The prospectus and the KIID may be made available as hard copies, or online through the website of the IC or of the CISM, but not the semi-annual report according to the wording of the Act. However, the Act provides the possibility of communicating electronically with the holders of units or shares, on request.

### Pledging the assets of a CIS

One of the main developments, apart from the measures implementing the UCITS IV Directive, concerns the possibility of pledging the assets of CIS under over-the-counter (hereinafter, "OTC") derivatives contracts.

The possibility has been added of pledging securities and assets held as part of the portfolio of a CIS to back transactions the CIS carries out in OTC derivatives markets, in amounts not exceeding the daily net loss or gain resulting from changes in the value of these instruments, provided that they are covered by contractual offset arrangements or financial guarantees under Royal Decree-Law 5/2005, of March 11, on emergency reform measures to boost productivity and improve public procurement.

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<sup>2</sup> The KIID must mention that the markets in which the CIS plans to invest meet the requirements of operating regularly, affording an equivalent degree of protection, and having similar rules to those of official secondary markets. Also, the investment policy included in the KIID must mention any investments in derivative instruments traded on a market for such instruments.

Although the framework could have been more flexible by including the possibility to pledge assets in security loan transactions, it will at least enable entities to arrange transactions with a bilateral guarantee, thus increasing the possible consideration and reducing the cost of the transactions.

### Authorising and registering Spanish CIS and CISMIC

The procedure for authorising a CIS, if a CISMIC has been appointed to manage it, must be completed within two months of receipt of the application or of the date all the requisite documents are submitted. However, in the case of a self-managed IC, the three-month term currently in force for completing the authorisation procedure remains unchanged. The term for granting authorisation to a CISMIC has been extended from three months to six months, while the term for approving applications to open a branch office has been reduced from three months to two months.

### Omnibus accounts

The industry was also demanding that the marketing procedures available for IF be extended to include omnibus accounts. Under the Act, units held in IF, which are marketed through other entities authorised to provide investment services or through other CISMIC, may be included in the register of unit holders of the relevant CISMIC, mentioning at least their tax identification numbers and the distributor through which the units have been acquired.<sup>3</sup>

Thus, CIS can be marketed to third parties without needing to report the names of the clients. However, the Act has not provided a satisfactory solution for using omnibus accounts in the case of foreign investors, because the method of identification in the Act does not provide a way to make the "global account" compatible with the requirement to submit a residence certificate to the CISMIC, to be entitled to benefit from the exemptions for non-residents.

### Changes concerning CISMIC

#### *Passports of Spanish CISMIC*

Until now, the EU member state of residence of the CISMIC and the depositary was required to be the same as that of the CIS. Although investment services—normally asset management services—were allowed to be provided in other EU member states by opening branch offices there or under the principle of freedom to provide services, proper crossborder management of CIS was not permitted. Thus, with reference to CIS, Spanish managers normally managed assets of self-managed foreign IC.

However, under the UCITS IV Directive, a Spanish CISMIC may establish a UCITS in another EU member state or manage the assets of a UCITS established in another EU member state by

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<sup>3</sup> Each distributor is required to keep a register of the unit holders that have subscribed the units through it. In these cases, the distributor is responsible for issuing the certificates of units held in the IF.

obtaining what is known as a management company passport<sup>4</sup>. This development, designed to widen the scope of action of CISMIC, may not make much difference in practice, because it clashes with the tax provisions under which the country of residence for tax purposes is determined by the place of effective management.

CISMIC that engage in crossborder management of CIS must implement procedures to make the relevant information available to the public or to the competent authority of the home member state of the CIS, when they request it, as well as to guarantee that investors perform, and that the CISMIC comply with, the duties imposed on them by the host member state.

#### *CISMIC authorised in another EU member state*

In line with what is stated in the previous section, the Act also provides for the possibility, only for Spanish CIS that have UCITS status, to appoint as their manager a company authorised in another EU member state according to the UCITS IV Directive. The foreign management company must submit the following documents to the CNMV: (i) a written agreement with the depositary; (ii) information on the arrangements for delegating the duties of conducting the business and managing the assets of the CIS; and (iii) a certificate from the competent authority in the CISMIC's home member state stating whether the type of CIS for which authorisation has been applied for falls within the scope of the authorisation granted to the CISMIC.

A CISMIC authorised in another EU member state that wishes to carry on in Spain the activities of running, representing and managing the investments of UCITS, as well as handling the subscriptions and redemption of units and shares, whether by opening a branch office or under the principle of the freedom to provide services, must meet, among other provisions, those on establishing and authorising CIS, issuing and redeeming units and shares, and the rules of conduct.

#### **Proposed centralised register of holders of units or shares in foreign CII s**

In a last-minute addition to the Act, authority is granted, by way of a regulation, under which, when a foreign UCITS would be distributed in Spain through more than one distributor, an entity must be appointed to keep a centralised register of all those that have acquired units or shares in that UCITS in Spain from the different distributors.

The distributors are required to report to this entity, before any transactions involving the subscription, acquisition and redemption or transfer of units or shares are carried out, identifying each unit or share holder through the distributor by their tax identification numbers, to enable the entity keeping the register to determine the result of each transaction and report it back to the

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<sup>4</sup> The CNMV must forward the following documents to the competent authority of the host member state: (i) the business plan; (ii) a certificate proving that the CISMIC has been authorised in line with the UCITS IV Directive, (iii) a description of the scope of the authorisation, and (iv) any restrictions on the types of IF and IC it may manage.

distributor. Although transfer of units or shares has not been included in the transactions to be reported, we understand that they must be reported too.

The entity keeping the centralised register must observe the following tax obligations: (i) charging withholding tax or interim tax and paying this in to the Treasury on behalf of the parties concerned, as a payment on account of tax accruing on transfers or redemptions of units or shares in CIS, in line with the Spanish personal income tax, corporate income tax and non-resident income tax regulations; and (ii) informing the tax administration of transactions involving units or shares in CIS, as required by the personal income tax, corporate income tax and non-resident income tax regulations.

This Act will call for third-party entities to implement a complex reporting system to centralise tax information, which will surely lead to a heated debate, if developed.

At first sight, it seems that the purposed aim of preserving the first-in-first-out rule where there is more than one distributor does not justify implementing such a burdensome system for foreign entities.

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