

# Spain

## Regulation

HEDGE FUNDS 2009

### Hedge fund managers/advisors

#### Regulation

##### Authorization requirements and process

The procedure to be followed for the establishment and operation of a hedge fund manager in Spain is regulated under the Act 35/2003, of 4 November, on Collective Investment Schemes (CIS). Its development regulation (Royal Decree 1309/2005, Order 1199/2006 of the Ministry of Economy and Finance and Circular of the Spanish Stock Exchange Commission (CNMV) - 1/2006) expressly regulates the figure of hedge funds under the name Instituciones de Inversión Colectiva de Inversión Libre, which literally means free investment collective investment schemes).

According to the Act 35/2003 (art. 41), applicable to the establishment of hedge fund managers in Spain, the incorporation procedure starts with an application to be submitted before the CNMV. Its Web site ([www.cnmv.es](http://www.cnmv.es)) provides access to a handbook on the approval of collective investment schemes managers (extensible to hedge funds), that contains the forms to be completed and the summary of the documentation needed for its submission before the CNMV. Among others, the documentation must include information about the corporate structure of the management company, the identity of the shareholders, accreditation about the identity, integrity, and professional background of the management body individuals, its foreseen activities, its internal procedures, as well as conduct and clientele relationship rules.

If it deems it necessary, the CNMV may request certain amendments to the documentation provided or ask for additional information during the application procedure.

##### Typical timescale to receive approval

The authorization is expressly granted by the Ministry of Economy within a three-month term since the application is submitted before the CNMV. If no express notification is received by the applicant, the authorization shall be

understood as granted in a five-month term since the application was submitted.

### Regulatory capital requirements

The standard minimum amount of share capital required for any hedge fund asset management company cannot be lower than the higher of the following two amounts (art. 70 of the Royal Decree 1309/2005):

- The amount of EUR 300,000 represented by registered shares, fully subscribed, and paid-in. This amount may be increased according to certain criteria depending on the effective value of the amount of assets under management.
- Twenty-five percent of the structure and operation expenses as appear in the profit and loss account of the precedent financial year.

### Significant restrictions on marketing to investors

As a general rule, any type of marketing or commercial activity of a non-domestic hedge fund addressed to Spanish investors is not authorized, unless it has been granted with the previous approval of the CNMV. Therefore, the commercialization of foreign hedge funds in Spain through their corresponding authorized intermediaries is subject to a prior authorization procedure before the CNMV in order to accredit that in their country of origin they are subject to certain rules aimed to protect the shareholders and participants interests' equivalent to those that exist under Spanish legislation. Besides, the regulatory authority of the country of origin of the hedge fund should provide a favorable report about its activities. Once such conditions are accredited, the fund would need to provide certain documentation before the CNMV until its final registration before the official Registry.

However, the CNMV could even deny the authorization for certain discretionary reasons, for example, if the fund does not offer enough level of protection to Spanish investors or if, for instance, Spanish hedge funds do not receive an equivalent treatment in the country of origin of the non-domestic fund.

With regard to domestic hedge funds, they can be commercialized to Spanish resident investors subject to the different requirements depending on the type of hedge fund as explained below.

## Hedge fund structures

### Regulation

#### Authorization requirements

The establishment of a hedge fund in Spain (either under the form of a unit fund or under the form of a SICAV) is subject to the prior authorization of the CNMV as explained below. With regard to the jurisdiction in which the manager should be located, according to the current Spanish regulation, and whether if the fund is managed by a manager or directly by a SICAV, it is required that their domicile as well as their effective managing and administration is located in Spain.

#### Restrictions on types of investments, concentration levels, and the manner in which hedge funds can invest and/or strategies

It is important to highlight that the current Spanish legislation regulates two types of hedge fund products which would be:

- hedge funds which directly invest in assets and are aimed to qualified investors only; and
- the so called funds of hedge funds, aimed to all type of investors, including non-qualified and particular ones.

This distinction is relevant because their investments levels and strategy, as envisaged by the current regulation, differs depending on the type of hedge fund product:

- In principle, hedge funds enjoy no restriction with regard to the investment in any type of assets or financial instruments as well as derivatives, regardless the nature of the underlying asset as soon as they comply with the general principles of risk diversification, liquidity, and transparency. As a particular rule, it should be noticed that the maximum leverage level of the hedge funds is five times its net asset value. In order to determine this level, it will not be taken into account instruments such as, repos, financing received under simultaneous transactions, or finance raised through securities loans.
- Funds of hedge funds are subject to a stricter regulation as they are enforced to diversify. No more than 10 percent of their assets can be invested into a single hedge fund. This limit may be exceeded only if such excess has been produced after the date of the last partial or total investment in the relevant assets. In this respect, such excess should be adjusted within a one year's period from the moment when this limit was exceeded. Notwithstanding this, when such limit is exceeded over 35

percent, the fund of hedge fund must adjust such excess, under the percentage of 35 percent, within a six-month period without prejudice of the total adjustment within the one year period already mentioned.

Besides, funds of hedge funds must also invest at least 60 of their assets in domestic hedge funds or in similar non domestic hedge funds domiciled in an OECD country or managed by a manager domiciled in such countries.

### Rules regarding the publishing of the accounts and prospectuses

Circular 1/2006 of the CNMV establishes certain particular rules regarding the financial statements and the prospectuses to be issued by both hedge funds and funds of hedge funds.

With regard to the financial statements, managers must file before the CNMV monthly information about the investment portfolio and statements of statistical and operating data. At any time, the CNMV may ask the entities in general or specifically to provide such clarification and supplementary information as it may require about those statements.

With regard to the mandatory annual, biannual, and quarterly reports that must be submitted to the CNMV, it is not necessary to include information on the assets portfolio (that is, number and value). However, the CNMV may determine the level and the detail of information to be provided in this respect.

With regard to the prospectuses, hedge funds are enforced to issue, both, a complete and a simplified prospectus that should include the following complementary information:

- Information about subscription and redemption
- Information about the general policy of collateral provided by the institution, possibility that the beneficiaries may dispose of the assets delivered as collateral, maximum market value of collateral susceptible of being reused with respect to the fund's obligations, and minimum financial solvency of such beneficiaries.
- General information about agreements to outsource functions
- General information about advisory contracts
- Information about the CIS's investment and management strategy, the special risks that they may entail, and the criteria for concentration and diversification that may be relevant for assessing the risk which may be incurred. Hedge funds must also disclose the counterparty risk with a given entity. Funds of hedge funds must disclose the criteria for selecting the underlying CIS in which they invest and the criteria for diversification in terms of managers, strategies, and securities.

- Policy of investment in liquid assets and of managing liquidity to cater for redemptions
- Hedge funds must disclose the limit of indebtedness and the additional leverage through repos, simultaneous financing, financing via securities loans, and transactions with derivative financial instruments
- Hedge funds must disclose the criteria for valuing the assets in their portfolios
- Hedge funds and funds of hedge funds must disclose the maximum accumulated level of management and depository fees, both direct and indirect, that they will have to bear

### Time-scale of establishment of a hedge fund

It should be noticed that the current regulatory framework applicable to hedge funds in Spain is very recent and their authorization procedure is yet at an initial stage. According to the Royal Decree 1309/2005 (art. 8) the establishment of any type of CIS (including hedge funds) should follow the following steps:

- Prior authorization granted by the CNMV to the project of incorporation of the CIS. The CNMV has a term of three months since the application is submitted (art. 10 of the Act 35/2003) and if the CNMV does not send any express notification, the application shall be understood as approved in a five-month term following the application.
- Once the prior authorization is granted the fund or the investment company can be incorporated and, when applicable, duly registered before the Mercantile Registry.
- Finally, once the incorporation is completed, it must also be duly registered before a special Registry of the CNMV exclusively held for hedge funds within a one-month term. The CNMV will not register those funds when a six-month term has been exceeded since the initial approval described in bullet one was granted.

## Investors

### Regulation

#### Restrictions on which type of investors can invest in a hedge fund and/or the minimum/maximum number of investors in a hedge fund

With regard to these types of restrictions, the distinction between hedge funds and funds of hedge funds should be made again:

- The minimum number of shareholders or participants of a hedge fund is 25. Each of them should make a minimum subscription of EUR 50,000. Besides, and as mentioned above, hedge funds can only exercise commercialization activities addressed to qualified investors, which according to the Royal Decree 1310/2005 are legal entities authorized to operate in the financial markets, public institutions (such as national or regional governments), companies that are not Small or Medium size Enterprises (SME), certain SMEs who have expressly requested to be considered as qualified investors and individual persons that comply with certain conditions regarding the amount of their investments and knowledge of the financial markets.
- With regard to the funds of hedge funds none of those limits would apply as they can be commercialized to all types of investors, including the retail market. In this sense, retail investors will be able to invest in funds of hedge funds, which are highly diversified, and no minimum initial subscription is required by law.

Additionally, the investors will have to acknowledge the risks of hedge funds and their understanding of the product and prospectus.

In this sense, prior to the subscription of the assets, investors will have to sign a consent letter called *documento de consentimiento* where they acknowledge all the risks resulting from the investment.

Such document will not be necessary in case of qualified investors.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.