The Asset Management Review

Editor
Paul Dickson

Law Business Research

The Asset Management Review

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For further information please email
Adam.Sargent@lbresearch.com

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Editor

Paul Dickson

Law Business Research Ltd

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Adam Sargent

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Nick Barette, Katherine Jablonowska, Alexandra Wan

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EDITOR'S PREFACE

2012 is an auspicious year for the first edition of *The Asset Management Review*, coming as it does in the wake of the global financial crisis and in the midst of a continuing period of economic uncertainty in the eurozone, both of which have had a significant impact on asset management activity around the globe. Many governments have spent the past few years reflecting upon the existing frameworks for regulation of their financial services industries with a view to avoiding a repetition of past regulatory failings and encouraging a more appropriate risk appetite among investors and investment managers. The products of that reflection are beginning to emerge in 2012 and it appears that in many cases, large-scale overhaul of asset management regulation and greater intervention in previously lightly regulated industry sectors are likely to be the end result.

In some countries, and particularly at the supranational level in the European Union, it appears that a greater appreciation of the systemic importance of asset management entities in the broader financial system has been another product of the financial crisis, with a corresponding increased focus on transparency and disclosure to permit national regulators to monitor their activities. As a result, the debate about the type and extent of information that funds and their managers may be required to divulge publicly looks set to be another recurring theme throughout the coming year and beyond.

While there has certainly been a rebound in asset management operations since the lows of 2008, it would be fair to say that the outlook for investment fund activity over the next year remains uncertain. The continuing volatility of equities on global stock exchanges and the ongoing turbulence in bond markets, particularly in relation to concerns about the quality of some sovereign debt, have led to changes in investment behaviour and have done little to dispel any nervousness among investors. Nonetheless, there are some bright spots in an otherwise clouded investment landscape, with new prospects opening up in emerging markets, particularly in parts of Asia and Latin America. Perhaps the best that one can say from the present vantage point is that the next 12 months look likely to feature a combination that will be familiar to any seasoned investor – that of risk and opportunity.

The publication of the first edition of *The Asset Management Review* is a significant achievement that would not have been possible without the support of the

many lawyers and law firms who have contributed so much of their valuable time, knowledge and experience to this edition. I am grateful to them all. I would also like to thank Gideon Roberton and his team at Law Business Research for all their efforts to bring this book into being.

It is hoped that *The Asset Management Review* will prove to be a useful and practical companion in the increasingly complex, globalised and regulated world of asset management as we face the impending challenges of the coming year.

Paul Dickson
Slaughter and May
London
September 2012

Chapter 24

PORTUGAL

Carlos Costa Andrade[1]

I OVERVIEW OF RECENT ACTIVITY

The asset management industry is a vital source of economic growth in Portugal, providing important employment opportunities in both core asset management and related services, and a link between investors seeking beneficial savings vehicles and the financing needs of the real economy.

At the end of 2011, assets managed by the Portuguese asset management industry amounted to €112.405 billion, reflecting a continuing and gradual decrease in activity since 2008:[2]

Year	*2008*	*2009*	*2010*	*2011*
Assets under management	€115.266 billion	€128.692 billion	€122.886 billion	€99.202 billion
Percentage of discretionary management	50.9	51.1	53.3	54.2
Percentage of investment funds	49.1	48.9	46.7	45.8

In contrast to investment funds, discretionary mandates are generally more conservatively invested, with more exposure to low-yield debt. Investment fund assets tend to be more heavily invested in equity. In 2011, discretionary mandates represented 54.2 per cent of total assets under management in Portugal, compared to 45.8 per cent in both open and closed-ended investment funds investing in securities or real estate. The key factor behind this large proportion is the significant number of financial conglomerates operating an

1 Carlos Costa Andrade is a partner at Uría Menéndez – Proença de Carvalho.

2 Asset Management Report of the Portuguese Securities Exchange Commission ('the CMVM'), 4Q, 2011, available at: www.cmvm.pt/cmvm/estatisticas/gest%20activos.

asset management company to carry out the group's general asset management in the manner of discretionary mandates.

Due to the financial crisis and the collapse in share prices, asset managers have observed a sharp fall (approximately 23 per cent since 2009) in the value of managed assets professionally managed in Portugal.

An important aspect of the Portuguese asset management industry's organisation is the extent to which asset management firms operate as stand-alone companies or form part of financial services groups. The activities of such groups are usually dominated by a certain type of financial services, or may consist of a mixture of asset management companies, banks and insurance undertakings.

With the entrance into force of Directive 2009/65/EC ('the UCITS IV Directive'), management companies will be permitted to manage cross-border funds and will not be required to appoint service providers in the fund's domicile, excluding the custodian bank. As such, asset management groups might reconsider the structure of their current service provider with a view toward creating an optimal structure. They could potentially reduce their number of management companies of cross-border UCITS and centralise their asset management, administration and risk-management operations.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

i Asset management in Portugal

Asset management activities in Portugal are, in general, divided into five core areas:

a securities investment funds;
b real estate investment funds;
c pension funds;
d securitisation; and
e private equity.

Securities investment funds and real estate investment funds

Investment funds are regulated under the legal framework on units of collective investment, codified in Decree-Law No. 252/2003 of 17 October 2003 on securities investment funds (as amended) and Decree-Law No. 60/2002 of 20 March 2002 on real estate investment funds (as amended). Both frameworks are regulated in more detail by CMVM Regulation No. 7/2007.

This legal framework is construed in accordance with Directive 2001/107/EC ('the UCITS III Directive'), which is currently pending amendment pursuant to the implementation of the UCITS IV Directive, which was submitted for a public consultation ending on 29 June 2012, but which has not yet been transposed into Portuguese law.

Pension funds

The legal framework on pension funds and management entities is set forth in Decree-Law No. 12/2006 of 20 January, transposing Directive 2003/41/EC into Portuguese law.

Pension funds are supervised by the insurance sector's regulator, the Insurance and Pension Funds Supervisory Authority ('the ISP').

Securitisation

Securitisation was introduced into Portuguese law through Decree-Law No. 453/99 of 5 November regulating the process of converting existing assets or future cash flows into marketable securities.

Private equity

The legal framework for private equity is set forth in Decree-Law No. 375/2007 of 8 November and CMVM Regulation 1/2008, which establish the main prudential rules.

ii Portugal's model of specialised supervision

Portugal's supervisory approach is based on three authorities: the Bank of Portugal, the ISP and the Portuguese Securities Exchange Commission ('the CMVM'). These entities, which are distinct and independent from each other, form a system referred to as 'institutional supervision'.

The system is considered to be specialised supervision given the existence of a supervisor for each financial sector – banking, insurance, securities and investment funds. Notwithstanding the apparent separation, the activities of financial entities are diversifying, and they interact in very significant ways, making supervision under this model more complex.

Banks have been carrying out transactions in capital markets and acquiring capacity to mediate insurance, thereby extending the range of services they provide. There has also been a general increase in the integration of financial services offered by financial conglomerates, providing services in sectors such as banking, insurance and collective investment schemes.

The goals of stability and financial health, traditionally linked to the banking sector, have also become objectives of the securities markets, where idiosyncratic risk is particularly significant, especially in clearing systems and counterparty structures for securities transactions.

The Bank of Portugal has been granted authority to supervise the conduct of credit institutions and financial companies. Therefore, this kind of supervision is no longer performed exclusively by the ISP and the CMVM.

III COMMON ASSET MANAGEMENT STRUCTURES

The main structures used for asset management in Portugal are investment companies and investment funds.

Investment companies are entities with legal personality that either carry out one of the activities, or purport to manage investment funds that pursue one of the activities, referred to in Section II, *supra*.

In contrast, investment funds are segregated assets lacking legal personality that are managed by a third entity (i.e., a managing entity, which may be an investment company); their investment policy is determined upon their creation.

Regarding structure, funds may be open or closed-ended.

Open-ended funds involve the investment of equity raised with the public, and are subject to risk sharing and pursuing the interest of the participants. Open-ended

funds are also associated with higher liquidity, where the unitholders are entitled to redeem units and be paid the corresponding net asset value.

Closed-ended funds in Portugal usually have a limited number of participants, and the unanimous consent of all unitholders is usually required to amend the *status quo* of the fund, including any change to the investment policy or to allow the entrance of new unitholders.

One final form to consider is the *tertium genus*, which is an exchange-traded fund ('ETF') characterised by:

a an investment policy based on replicating an index or a basket of securities; and
b its admission to trading on a regulated market, with higher liquidity resulting therefrom.

There are different types ETFs, such as leveraged ETFs, whose value increases or decreases exponentially in accordance with the appreciation or depreciation of the underlying asset, and inverse ETFs, whose value increases or decreases in connection with the depreciation or appreciation of the underlying asset.

Taking into account the concerns of European regulators regarding these instruments, it is likely that ETFs will soon be subject to more detailed regulation, both at the international and domestic level.

IV MAIN SOURCES OF INVESTMENT

On aggregate, institutional investors account for approximately 60 per cent of assets under management in Portugal, with retail clients accounting for the remaining 40 per cent. This statistic reflects Portugal's ability to attract large institutional mandates from insurance companies, whereas in other countries (e.g., the UK) this generally comes from pension funds. In this regard, assets managed for retail clients suffered a much sharper decline in 2008 than those managed for institutional clients. This occurred for two main reasons.

First, the equity exposure of financial portfolios generally tends to be higher for retail clients than for institutional investors. While European households are inclined to hold the majority of their financial wealth in cash, savings accounts and retirement products, which tend to be low-risk stores of value, retail clients tend to resort to the expertise of asset managers for managing the portion of their savings that is invested in equity and balanced funds, shares and other types of assets carrying more risk.

Second, insurance companies and pension funds – the two largest categories of institutional clients – primarily invest in debt securities and investment funds, which are managed in-house or by third-party asset managers.

V KEY TRENDS

i The UCITS IV Directive

The main novelty expected in 2012 regarding regulations on asset management in Portugal is the final transposition of the UCITS IV Directive.

The UCITS IV Directive adapts the UCITS legal framework to the modern concept of financial markets. Accordingly, it seeks to encourage further simplification and harmonisation among the domestic legislation of EU Member States governing UCITS, while also promoting the safeguarding of investors.

The most important aspects governed by the UCITS IV Directive are:

a management companies may be incorporated under the laws of one Member State while they manage UCITS incorporated in other Member States, and they may provide services in other jurisdictions by establishing branches or by resorting to the freedom to provide services;

b extensive regulation of the possibility of a merger between UCITS (or between compartments of UCITS), including cross-border mergers;

c expansion of the scope of assets in which UCITS may invest, with special attention on the assets' liquidity and the credit risk;

d comprehensive provisions regarding master-feeder structures, whereby a feeder UCITS may be authorised, subject to the satisfaction of certain requirements, to invest exclusively in units of a master UCITS;

e replacement of the simplified prospectus with a more easily understood document that must include key investor information and be made available to any investor prior to the subscription or acquisition of units or shares in any UCITS; and

f simplification of the procedure for the cross-border marketing of UCITS.

There is a clear legislative intent to conciliate the boosting of the UCITS market with additional transparency and security for investors. If taken to the extreme, however, the realisation of those goals may hinder the boosting of the UCITS market, thereby compromising the recovery of a market that has been losing pace in recent years.

The deadline for transposing the UCITS IV Directive expired on 30 June 2011. To mitigate the impact of this situation, the CMVM has issued an understanding stating that, as of July 2011, the notification process set out in Commission Regulation (EU) No. 584/2010 is already applicable to the cross-border marketing of the UCITS in Portugal under the UCITS IV Directive.

It is also important to highlight that whenever the UCITS IV Directive is ultimately transposed, it is likely that the Portuguese legislation will include some aspects that further develop the provisions of the Directive, which could therefore have an impact on the rules governing the distribution of funds in Portugal.

VI SECTORAL REGULATION

i Securities and real estate

Open-ended funds

The incorporation of open-ended funds is subject to authorisation from the CMVM.

This type of fund involves the investment of equity raised from public sources, and is subject to the principles of the allocation of risk and the pursuit of the interests of the investors.

A prospectus must be prepared for each open-ended fund and delivered to its subscribers prior to the subscription of investment units.

Closed-ended funds

Closed-ended funds in Portugal are limited to a maximum of 30 participants; their incorporation is also subject to authorisation from the CMVM.

The term of closed-ended funds may not exceed 10 years, although they may be renewed for an equal period. If no term is established, authorisation for the creation of the fund will only be granted if the incorporation documents foresee that the units will be listed and admitted to trading on a regulated market.

Unless otherwise established in the incorporation documents, unitholders of closed-ended funds hold a right of first refusal in connection with the subscription of new units.

Management entities

Both open-ended and closed-ended investment funds are offered by managing companies, which may be management entities of collective investment funds; or in the case of closed-ended investment funds, credit institutions such as banks, credit financial institutions or mortgage institutions.

The functions of management entities include:

a selecting the assets comprising the fund;
b managing the fund's assets;
c valuating the portfolio and the value of the units;
d distributing profits;
e issuing and redeeming participation units;
f conserving documents; and
g marketing the participation units.

Managing entities of both securities investment funds and real estate investment funds must have own funds of at least 0.5 per cent of the value of the assets under management if the value of the assets is not greater than €75 million; or 0.1 per cent of the value of the assets under management if the value of the assets is more than €75 million.

Finally, both securities investment funds and real estate investment funds are prevented from carrying out specific transactions, including:

a contracting loans;
b acquiring, on their own behalf, participation units in investment funds (excluding cash funds, provided that they are not managed by them);
c granting loans;
d granting security;
e acquiring real estate that is not indispensable for pursuing its commercial purpose; and
f short selling.

Investment companies

In 2010, Portuguese legislation established a legal framework for securities investment companies and real estate investment companies, which differ from investment funds and real estate investment funds, given that the former have legal personality.

Such companies may be self-managed (i.e., managed by their own management bodies) or managed by another company.

Furthermore, investment companies may be categorised as being of either variable or fixed capital. Investment companies of variable capital correspond to open-ended investment funds, whereas investment companies of fixed capital correspond to closed-ended funds.

As with investment funds, investment companies must receive authorisation from the CMVM.

Each investment company might be divided into different compartments. The assets of each compartment are independent and segregated from the investment company, as well as from the assets of other compartments. The creation of each compartment is subject to authorisation from the CMVM.

Hedge funds

With regard to hedge funds in particular, there are no national funds established in Portugal that can really be characterised as hedge funds, nor are there any foreign hedge funds that are registered for investment by the public in the Portuguese territory. However, there is a recognised category of funds – special investment funds – that have some characteristics in common with hedge funds.

Hedge funds do not generally play an active role in the conduct and affairs of the companies in which they have an interest in the Portuguese market. In many cases, their exposure to companies is obtained by means of synthetic positions that do not provide them with voting rights or any other possibilities of influencing the course of their businesses. Even when they do possess these rights, their position tends to be of a strictly financial nature and they do not, as a general rule, intervene in the outcome of deals or in the definition of corporate strategy. Whether that changes as the effects of the financial crisis continue to be felt remains to be seen.

ii Pensions

Pursuant to the Portuguese legal framework, the assets of pension funds shall cover the pension plans underlying the funds, the payment of management and deposit remuneration, and the payment of insurance premiums.

Pension plans can be classified as:

a plans with a defined beneficiary, in which the benefits are previously defined and contributions are calculated in order to guarantee the payment of the benefits;

b plans of defined contribution, in which contributions are previously defined and benefits are determined pursuant to the amount of contributions delivered and the accumulated income; and

c 'mixed plans', which combine features of both types.

With regard to the financing structure, pension plans can be divided into contributive plans, involving contributions from participants, and non-contributive plans, which are financed exclusively by the associate.

The obligations under pension plans are borne exclusively by the fund's assets, or by the assets of each specific compartment of the fund, which net assets are the only security.

Pension funds may be either open-ended or closed-ended structures.

Open-ended pension funds do not require the existence of a connection between the participants. Participation is exclusively dependent on acceptance by the managing entity.

Closed-ended funds relate to one or more associates with a common interest involving a corporate, associative, professional or social nature. When there is plurality of associates, authorisation is required from each associate to admit new participants.

Pension funds may be managed by companies incorporated exclusively for that purpose, or by insurance undertakings that legally operate in the 'life' sector and hold a permanent establishment in Portugal.

iii Securitisation

The state and public legal persons, as well as credit institutions, financial companies, insurance undertakings, pension funds and pension fund management companies, are entitled to grant loans for securitisation purposes, as are other legal persons whose accounts for the previous three years have been legally certified by an auditor registered with the CMVM.

Only securitised funds and securitised companies (with the same difference as that between investment funds and investment companies) are permitted to acquire loans for securitisation.

Only loans that satisfy all of the following prerequisites may be granted for securitisation purposes:

a their transfer is not subject to legal or contractual requirements;
b they are pecuniary in nature;
c they are not subject to any conditions;
d they are not subject to litigation; they have not been granted as a guarantee; and
e they have not been judicially pledged, or subject to charges or encumbrances.

Securitisation funds

Securitisation funds hold stand-alone assets and belong to a group of persons who hold their units. Securitisation funds will not, under any circumstances, be held responsible for debts incurred by these persons, by entities responsible for their management or entities from which the loans have been acquired. The creation of securitisation funds requires prior authorisation from the CMVM.

Funds shall invest their assets in the initial or subsequent acquisition of loans, which may not represent less than 75 per cent of the fund's assets. Securitisation funds may, as an ancillary activity, apply their liquidity reserves in the acquisition of securities listed on a regulated market and short-term public or private debt securities, provided that such actions are appropriate for the efficient management of the fund.

Securitisation units grant their holders the following cumulative or exclusive rights:

a the right to receive periodic returns;
b the right to redeem the par value of securitisation units; and
c upon termination of the liquidation of the fund and apportionment of the proceeds, the right to receive a proportional quota from the amount remaining after the fund has made payment of periodic returns and all other expenses and charges.

Securitisation companies

Securitisation companies must be public limited companies and have as their sole purpose the performance of loan securitisation transactions by means of the acquisition, management and conveyance of loans, and the issuance of securitised bonds in order to repay the contracted loans. The creation of securitisation companies requires prior authorisation from the CMVM.

Securitisation companies may only extend credit to securitisation funds and other securitisation companies.

Securitisation bonds

Securitised bonds fall under multiple categories on the basis of the guarantees established in favour of their beneficiaries, the rates of remuneration (whether fixed or variable) and rank. Securitised bonds must have maturity dates that are appropriate in view of the maturity of the underlying loans.

The redemption and remuneration of securitised bonds, and the payment of expenses and charges related to the issuance may only be guaranteed by:

a loans directly related to them;

b the proceeds of their redemption;

c the income they generate; or

d other guarantees or risk coverage instruments taken out in connection with their issuance. Other assets of the securitisation company issuing the securitised bonds may not be used for that purpose.

iv Private equity

As defined by Portuguese law, private equity involves acquiring, for a limited period of time, equity and debt instruments in companies with high development potential in order to benefit from future appreciation.

Private equity activities can be carried out through three different structures: private equity companies, private equity funds and individual private equity investors.

Supervision is carried out by the CMVM, with whom the above entities must register before starting activities.

Private equity companies, private equity funds and individual private equity investors may not:

a enter into transactions not related to their scope or the respective investment policy;

b invest more than 30 per cent of the respective assets in securities admitted to trading on a regulated market; or

c hold equity instruments or securities, convertible or exchangeable instruments granting rights to acquire the same, or debt instruments, for a period of time (continuous or combined) exceeding 10 or five years, depending on whether they are private equity companies or private equity funds, respectively.

Private equity funds are independent and segregated assets, with no legal personality, and belong to the respective unitholders. They are managed by managing companies, which may be private equity companies.

The methods and criteria for evaluating the assets of the private equity fund and the private equity company must be expressly established in the corresponding management regulations, internal regulations, annual report and accounts. The methods are consistently utilised in successive financial years.

In this regard, the two valuation methods used most frequently by private equity funds and private equity companies are the fair value method and the conservative method.

The fair value method uses the value obtained on the basis of the following:

a materially relevant transactions carried out in the six months preceding the valuation;

b multiples of comparable companies with reference to the sector of activity, size and yield; and

c discounted cash flows.

The conservative value method is based solely on the acquisition value.

VII TAX LAW

i Securities investment funds

Portuguese tax law provides special tax rules only for income derived by securities investment funds that are created under Portuguese law. Thus, the special rules do not apply to income derived by non-resident securities investment funds (which are taxed under the same rules as apply to other non-resident entities).

Under the special tax regime applicable to income derived by a Portuguese resident securities investment fund, the following rules apply:

a income from a Portuguese source received by the securities investment fund, except for capital gains, is subject to a final withholding tax under the same rules as apply to resident individuals. If no withholding tax is due, a flat rate of 25 per cent must be levied and paid by the securities investment fund;

b income from a foreign source received by the securities investment fund, except for capital gains, is subject to tax at a flat rate of 20 per cent in the case of income derived from bonds, shares or investment funds units, and of 25 per cent in all other cases; and

c the positive difference between capital gains and capital losses from a Portuguese or foreign source obtained by the securities investment fund is subject to tax at a flat rate of 21.5 per cent (capital gains arising from the disposal of shares held for more than 12 months, bonds and other debt securities are not subject to tax, except for capital gains obtained by closed-ended or balanced funds, or by private subscription).

These rules (regarding both the taxation of the income and gains derived by the securities investment fund, and the taxation of the investors regarding the income and gains derived with respect to their investment units) also apply to securities investment companies created under Portuguese law.

ii Real estate investment funds

Income derived by a real estate investment fund created under Portuguese law is generally subject to the following tax rules:

a income derived from real property (after the deduction of conservation and maintenance costs) is subject to tax at a flat rate of 20 per cent. Any tax eventually withheld (as a general rule, income derived by real estate investment funds is exempt from withholding) is deemed a payment on account of the final tax due;

b capital gains arising from the transfer of real property are subject to tax at a flat rate of 25 per cent on 50 per cent of any positive difference between capital gains and capital losses incurred;

c other income derived in Portugal that does not qualify as a capital gain is subject to withholding tax on the same terms as if it were derived by an individual resident in Portugal. If the relevant income is not subject to withholding tax, a separate tax will be imposed at a 25 per cent rate, on the net value obtained in each year;

d income derived outside Portugal that does not qualify as a capital gain is subject to tax at a flat rate of 20 per cent in the case of income derived from debt securities, shares or units in investment funds, and of 25 per cent in any other case, on the net value obtained each year; and

e capital gains arising from the transfer for consideration of shares held by real estate investment funds for at least 12 months, bonds and other debt securities are not subject to tax. Other capital gains (not related to property) derived in Portugal or in a foreign country are subject to tax on the same terms as if they were derived by an individual resident in Portugal at a flat rate of 21.5 per cent (capital gains arising from the disposal of shares held for more than 12 months, bonds and other debt securities are not subject to tax, except for capital gains obtained by closed-ended or balanced funds, or private subscription).

These rules (regarding both the taxation of income and gains obtained by the real estate investment funds, and the taxation of the investors regarding income and gains obtained with respect to investment units) also apply to real estate investment companies created under Portuguese law.

iii Pension funds

Income derived by pension funds created under Portuguese law is generally exempt from tax.

Provided certain conditions are fulfilled, contributions made by a company to a pension fund for the benefit of its employees are deductible for corporate income tax purposes.

iv Private equity

Private equity companies are entitled to deduct from their taxable income (as computed after the deduction of any carry-forward losses) investments made in companies with potential growth and capital appreciation. The deduction is limited to the sum of the corporate income tax due in the previous five tax years (this deduction may be taken in

the tax year in which the relevant investment is made, or otherwise in the following five tax years).

Income derived by private equity funds created under Portuguese law is exempt from taxation.

Income derived by a Portuguese resident company from investment units held in a Portuguese private equity fund is generally subject to 10 per cent withholding tax on account of the final tax due (the investors must aggregate this income with their remaining taxable income subject to the standard corporate income tax rate, as applicable). Should the relevant income arise from a profit or from the liquidation of a company resident in Portugal and subject to corporate income tax, the investors are entitled to deduct 50 per cent of the income for tax purposes.

As a general rule, income and gains derived by non-resident entities and individuals from investment units held in Portuguese private equity funds are exempt from tax in Portugal (except in the case of non-resident investors resident in a listed tax haven, or that are more than 25 per cent held, directly or indirectly, by Portuguese residents, which will be subject to tax at a flat rate of 10 per cent).

VIII OUTLOOK

The legal framework regulating the creation and operation of different asset management structures in Portugal has recently been modified and is prepared to respond to the difficulties arising from the financial crisis.

In this regard, Portuguese legislation on asset management already grants the supervisors of Portugal's financial sector – the Bank of Portugal, the CMVM and the ISP – wide powers to control and sanction the activity of asset managers under Portuguese jurisdiction.

Furthermore, the legal framework for each sector of asset management establishes capital requirements designed to discourage excessive risk-taking. In particular, this is carried out through restrictions on the percentage of assets that may be invested in one sole entity and on the level of leverage that can be raised to finance the corresponding investment policy.

The main novelty expected for 2012 is the final transposition of the UCITS IV Directive into Portuguese law, with the changes mentioned in Section V, *supra*. This legislation will be an important tool to improve Portugal's position in terms of asset management, with more funds being commercialised in Portugal, more asset managers carrying out business in Portugal, and more foreign institutional and retail players investing in the Portuguese market for asset management.

Chapter 27

SPAIN

Juan Carlos Machuca and Miriam Pich-Aguilera[1]

I OVERVIEW OF RECENT ACTIVITY

The asset management market in Spain is relatively young in comparison to other EU jurisdictions. However, after approximately three decades of activity, it has developed significantly in the past few years to become a very professionalised market with high efficiency standards.

The financial crisis, and the European sovereign debt crisis particularly, has substantially affected Spanish undertakings for collective investments and pension funds, and, generally, asset management activity in Spain, which stalled to some extent in 2011.

The prolongation of the crisis and the deterioration of growth expectations means that the savings of Spanish households are destined to address basic needs and to reduce indebtedness, resulting in a decrease in the rate of savings. Indeed, the savings rate of Spanish households declined to less than 12 per cent of disposable income in 2011, compared with its peak levels of above 18 per cent in early 2010.[2]

In particular, assets managed by mutual funds totalled €132,369 million at the end of 2011, a fall of 8 per cent (€11,526 million) from year-end 2010, mainly due to redemptions (€10,853 million), which far exceeded subscriptions. The remainder of the fall in assets (€673 million) were the result of losses in mutual funds' portfolios.[3] As a consequence of the adverse performance of international stock markets in 2011 (including the Spanish stock market), the highest losses were suffered by euro and

1 Juan Carlos Machuca is a partner and Miriam Pich-Aguilera is an associate at Uría Menéndez Abogados, SLP.

2 Annual Report of the Spanish National Securities Market Commission ('the CNMV') regarding its actions and the securities markets in 2011.

3 Ibid.

international equity funds. Likewise, the volume of pension funds assets at year-end 2011 was €82,992 million, registering a decrease of 2.1 per cent in respect of 2010.[4]

Likewise, the number of management companies of undertakings for collective investments ('SGIICs') registered within the CNMV in 2011 amounted to 114, which is nine less than in 2010. Additionally, the number of managed undertakings for collective investments ('UCIs') continued falling significantly as a result of the intense process of mergers between funds.

Finally, during the past year several new regulations have been enacted that have affected the functioning of UCIs and pension funds; we have identified the main ones in Sections II and III, *infra*.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

Asset management in Spain is carried out by different entities, and thus asset management is subject to several regulatory frameworks regulating each of these entities as follows:

On the one hand, the Spanish regime on UCIs is regulated in Law 35/2003 of 4 November, as amended ('Law 35/2003'), and its developing legislation, including the recently enacted Royal Decree 1082/2012 of 13 July approving the regulation of the law on UCIs ('Royal Decree 1082/2012'). Spain amended Law 35/2003 on 31 October 2011 following the adoption of Directive 2009/65/EC,[5] generally speaking simplifying the regime of cross-border marketing of shares and collective investment schemes harmonised according to the Directive, and enhancing the supervision of UCIs and their managing entities by the CNMV.

UCIs are defined in Law 35/2003 as entities whose aim is to obtain funds, assets or rights from the public (investors) in order to manage and invest them in assets, rights, securities or other instruments (financial or otherwise), provided that the investors' return is established on the basis of the collective profits.

Law 35/2003 regulates UCIs, as well as their management companies (i.e., SGIICs) and their depositaries, which are entities in charge of the deposit and custody of the securities and, in general, all the assets that are the subject to the investments carried out by the UCIs.

Furthermore, Directive 2011/61/EU on Alternative Investment Fund Managers ('the AIFM Directive') entered into force on 22 July 2011, but has not yet been transposed in Spain (Member States have until 22 July 2013 to transpose it to their national legislation). Its provisions will likely have an impact on the definition of alternative investment funds and their marketing in Spain, as it has for the first time

4 2011 Report of the Spanish Association of Investment and Pension Funds ('INVERCO') on undertakings for collective investments and pension funds, available at: www.inverco.es/acercaDeInverco.do.

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

created a harmonised set of rules for the marketing and management of investment funds in Europe. Certainly, the management of this type of fund will be substantially affected by the transposition into Spanish law of the AIFM Directive.

Likewise, Law 24/1988 of 28 July on the Securities Market ('LMV') regulates portfolio management companies, while venture capital entities and their management companies are contemplated under Law 25/2005 of 24 November.

The supervisory body for the Spanish securities markets is the CNMV, which, in particular, oversees UCIs and their activities. The CNMV also controls the activity of investment companies (including portfolio asset management companies) and of venture capital entities.

Pension funds and their management companies are regulated in Legislative Royal Decree 1/2002 of 29 November, as amended ('the Pension Funds Law') and its developing regulations, including Royal Decree 304/2004 of 20 February approving the Regulation of Pension Funds, as amended.

The Pension Funds Law has been modified by, among others, the provisions of Law 2/2011 of 4 March on Sustainable Economy, which reduced the equity requirements of management entities of pension funds, and clarified the obligations and responsibilities of the depositories of pension funds.

Pension funds and their management companies are subject to the supervision and inspection of the General Directorate of Insurance and Pension Funds. The same regulator also supervises the activities of insurance companies.

Finally, Royal Decree 6/2004 of 29 October 6/2004 on Private Insurances and Royal Decree 2486/1998 dated 20 November approving the regulation of private insurances (together, 'the Private Insurance Regulations') establish the regime of management of insurance companies' assets.

III COMMON ASSET MANAGEMENT STRUCTURES

Asset management structures in Spain vary depending on the sector and the type of institution that carries out the asset management activity.

i UCIs

There are two types of UCIs under Spanish law, based on their organisational structure: investment companies and investment funds.

Investment funds are UCIs that are structured as a separate group of assets without legal personality, which belong to a number of investors (including other UCIs). Their management and representation are performed by an SGIIC, and their object is to obtain funds, assets and rights from the public in order to invest them in assets, rights, securities or other instruments (financial or otherwise), provided that the investors' return is established on the basis of the collective profits.

Law 35/2003 permits the creation of investment funds with different divisions, each of which is given a different name but which are under the general name of the fund. Each division shall issue its own units, which shall represent the part of the net worth of the fund that is attributed to that division. The subscribers of the relevant units of the investment fund will be considered as 'participants'. Each fund must have at least

100 participants, who (apart from the amount that they have invested when acquiring the corresponding units) will not be responsible for the debts of the relevant fund.

The investment fund's management company, acting jointly with a depositary, exercises the powers corresponding to the owner of the fund, without being its owner. New Regulation 1082/2012 regarding UCIs has introduced novelties as regards SGIICs in terms of risk management, and in particular an obligation to specify the criteria used by the SGIIC to assess the adequacy and proportionality of its risk management policy with regard to the nature, scale and complexity of the activities of the management company and the UCIs managed by them. Similarly, the new Regulation has improved SGIIC rules to control and manage personal transactions in which conflicts of interest may arise as a consequence of the employee, or a person related to him or her or to the management company, having insider information.

In order to incorporate an SGIIC it is necessary to obtain the authorisation of the Minister of Economy (through the prior proposal of the CNMV). An SGIIC must be incorporated as a public limited company for an indefinite period, and have a share capital represented by registered shares and the following corporate purpose: the management, representation, making of investments and management of the subscriptions and reimbursements of investment funds and companies. In addition, its share capital will have to comply with a minimum required amount, fully paid up. The new Regulation enacted through Royal Decree 1082/2012 has modified the equity regime of SGIICs in order to further harmonise it with EU standards.

In addition, the company must have good administrative and accounting, as well as adequate technical and human, resources.

Management companies will be responsible in relation to the participants or shareholders of the relevant investment funds, or the companies they manage, for all damages arising from the infringement of their obligations.

As regards investment companies, according to Law 35/2003, they are UCIs that are structured as public limited companies and whose object is that of UCIs. The share capital of investment companies must be fully subscribed and paid up from their incorporation date, and is represented by shares. As in the case of investment funds, it will also be possible to create investment companies with different divisions. There cannot be less than 100 shareholders in investment companies, and in certain cases it will be necessary that these companies appoint a management company.

In addition, either of the two types of UCIs can be of a financial or non-financial nature (e.g., real estate UCIs). Financial investment companies must add *Sociedad de Inversión de Capital Variable* (or its acronym, 'SICAV') to their name.

ii Portfolio management companies

LMV also regulates portfolio management companies, which are investment services companies defined as companies that carry out financial services on a professional basis. They can perform only the following investment services activities: discretionary portfolio management activities in accordance with a mandate received from a client, and investment advice. In addition, they can perform the following ancillary services: advice to undertakings on capital structure, industrial strategy and related matters, and advice and services relating to mergers and the purchase of undertakings; and investment

research and financial analysis, or other forms of general recommendation relating to transactions in financial instruments.

For the purposes of carrying out investment services activities, portfolio management companies will have to be duly authorised and registered with the CNMV in the relevant registries. Among other requisites, portfolio management companies must underwrite an insurance policy in order to be registered.

iii Venture capital entities and their management companies

Venture capital entities may be classified in a venture capital fund ('FGR') or a venture capital company ('SGR').

Venture capital funds and the assets of venture capital companies may be managed by a venture capital management company ('SG') or by an SGIIC regulated by Law 35/2003 (with the prior authorisation of the CNMV). Additionally, the assets of venture capital companies may be managed by certain investment companies authorised by the CNMV.

SGs are open limited liability companies whose main aims are the management and administration of venture capital funds and assets of venture capital companies. They are regulated by Law 25/2005, and subsidiarily by the Spanish Corporate Law. Among other requisites, they must have a minimum share capital of €300,000, and good administrative and accounting, as well as adequate technical and human, resources.

iv Alternative investment funds

Alternative investment funds are regulated under Law 35/2003, Royal Decree 1082/2012 and additional regulations issued by the CNMV. There are two main types of alternative investment funds: free investment UCIs ('IICILs', known internationally as 'hedge funds'), which are funds that are almost completely free to develop their investment strategy; and UCIs of free investment UCIs ('IICIICILs', or 'funds of hedge funds'), which are basically funds of free investment funds that are subject to diversification and investor protection requirements that are similar to those of conventional UCIs, with certain particularities. Investors intending to acquire shares or units of alternative investment funds (except professional investors, or if the client has a portfolio management agreement authorising the investment in alternative investment funds) must sign a document declaring that they are aware of the risks arising from the investment.

v Pension funds and insurance companies

Pension funds are managed by pension funds management companies that have obtained the relevant administrative authorisation, that have the form of open liability companies and that are regulated in the Pension Funds Law (see Section VI.ii, *infra*, for further information). The Private Insurance Regulations set forth the regime for the management of insurance companies' assets, establishing among other requirements the constitution of technical provisions in respect of risks arising from insurance policies that they have underwritten (see Section VI.i, *infra*, for further information).

IV MAIN SOURCES OF INVESTMENT

According to INVERCO, the Spanish Association of Investment and Pension Funds, in 2011 Spanish households invested 44.3 per cent of their financial assets in bank deposits, while products without bank intermediation, such as investment funds, pension funds, insurances and direct investment, represented 45.3 per cent of the total financial assets of Spanish households. Direct retail investment in variable equity registered its biggest decrease in 2011, while short-term fixed-income products registered their highest increase.

On one hand, UCIs assets at year-end 2011 (including IICILs and IICIICILs) amounted to €201,728 million (€199,214 million as of 30 June 2012), which represented a 7.82 per cent decrease in respect of 2010. As regards the number of participants and shareholders, there were 6.2 million at the end of 2011 (7.4 per cent less than the previous year). Moreover, there were 6,169 registered UCIs in 2011: 2,345 investment funds (84 less than in 2010) and 3,068 investment companies (287 less than in 2010).[6] In 2011:

a the total number of SICAVS was 3,056, and their assets amounted to €23,614 million, a fall of 9.7 per cent in comparison with the previous year mainly due to net redemptions and, to a lesser extent, the losses recorded;[7]

b the assets held by IICILs and IICIICILs totalled €1,301 million (a fall of 3 per cent compared with 2010). Overall, IICILs and IICIICILs accounted for less than 1 per cent of the total assets of Spanish UCIs; and

c real estate UCIs assets amounted to €4,817 million, a decrease of 25.1 per cent since the previous year, mainly due to the disappearance of one important real estate fund.

As regards mutual funds investors, resident natural persons made up 97.3 per cent of mutual fund investors and accounted for 80.5 per cent of the total assets, which was similar to the past two years. Likewise, in relation to SICAVS, the relative weight of domestic portfolios in the global composition of portfolios increased.

The number of foreign UCIs marketed in Spain fell by 18.3 per cent in 2011, which represented a larger fall than the decrease seen in Spanish UCIs. However, the number of foreign schemes registered with the CNMV rose from 660 at the end of 2010 to 739 at the end of 2011.

In relation to the structure of portfolios, in 2011 78.1 per cent of UCI portfolios were made up of fixed-income funds, with an increase in national fixed-income funds; and 82.7 per cent of portfolios of pension funds were made up of fixed-income funds.

Likewise, at the end of 2011 the assets managed by SGIICs totalled €164 billion (7.6 per cent less than the previous year) and the assets managed remained highly concentrated (the three largest SGIICs accounted for 38.6 per cent of assets of UCITS at the end of the year).

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6 Data taken from the 2011 Report of INVERCO on undertakings for collective investments and pension funds, available at: www.inverco.es/acercaDeInverco.do; and from the Annual Report of the CNMV regarding its actions and the securities markets 2011.

7 Annual Report of the CNMV regarding its actions and the securities markets 2011.

On the other hand, pension fund assets at the end of 2011 amounted to €82,992 million, representing a reduction of 8.1 per cent in respect of the previous year. Pension funds asset represented 8.1 per cent of Spanish GDP in 2011. Forty-eight per cent of the Spanish population had constituted a pension plan in 2011, which, although low in comparison with other EU countries, is a significant figure; the number of plans was 2,992 (an increase of 28 since 2010).[8]

As regards contributions to pension plans, these amounted to €4,961 in 2011 (€469 million less than the previous year).

V KEY TRENDS

The asset management market tends to move towards 'concentration'. Management companies have continued the process of merging funds in order to rationalise the offer of available funds. Specifically, of the 207 mutual funds withdrawn from the CNMV registries in 2011, 204 were absorbed by another mutual fund.

Additionally, the behaviour of investors in the Spanish market will continue to be predominantly conservative. According to the CNMV, of the total assets managed by mutual funds in 2011, fixed-income funds, as well as mixed-fixed income, guaranteed-fixed income and guaranteed equity, accounted for 79.5 per cent of the total assets managed.

Certainly, the global financial crisis will continue to affect the Spanish asset management market. In fact, the IMF foresees a negative growth in Spain of -1.7 per cent in 2012 and of -0.3 per cent in 2013, so uncertainty will remain as the main characteristic of the Spanish market.

Notwithstanding the above, the restructuring of the financial sector may entail a decrease in the revenues offered by debt products due to its impact on profit and loss accounts; this could lead to the channelling of investments towards other products such as investment funds. INVERCO estimates that, in such a scenario, the result for revenues of domestic UCIs and pension funds, and their net subscriptions, could be positive, and thus the assets managed by such entities could slightly increase.

VI SECTORAL REGULATION

i Insurance

The Private Insurance Regulations establish the regime for the management of insurance companies' assets. There are several types of insurance companies under Spanish law, including insurance companies with fixed premiums, insurance companies with variable premiums and insurance cooperatives.

Spanish insurance companies need to establish technical provisions in respect of risks arising from insurance policies they have underwritten. Such provisions may be invested in a series of acceptable assets, including securities traded on an OECD exchange and deposits held with OECD banks. Additionally, insurance companies must

8 Op. cit. 7.

maintain a sufficient solvency margin in respect of all their activities, and a minimum guarantee fund.

ii Pensions

Under the Pension Funds Law, the different types of pension plans may be classified as follows:

Depending on its constituents:

a employment system pension schemes – the promoter is an entity, company or corporation, and their participants are its employees;

b associate system pension schemes – the promoter is an association, syndicate or labour union, and the participants are its associates or members;

c individual system pension schemes – the promoter is one or several financial entities, and they are open to any participant; and

d employment system pension schemes and associate system pension schemes – these may have a single promoter or several promoters that constitute jointly one pension scheme. Jointly constituted employment system pension schemes are open to any company or are limited to certain companies, according to different criteria (small and medium-sized companies, intra-group companies, etc.). On the other hand, individual system pension schemes have only one promoter.

Depending on the agreed commitments:

a defined contribution schemes – schemes in which the contributions of the promoters or participants, or both, are defined;

b defined benefit schemes – schemes in which the amount of the benefit is defined, and the contributions will vary depending on the returns; and

c hybrid schemes – schemes that consider, simultaneously or separately, the amount of the benefit and of the contribution.

Pension funds are managed by pension funds management companies whose corporate object is exclusively the managing of pension funds. In addition, pension funds may also be managed by insurance companies authorised to operate in the life insurance area, provided that they have the minimum required financial reserves.

In order to be authorised and registered as pension funds management companies, these entities must comply with certain capital and reserves requirements. The main functions of the management company are:

a the fund's bookkeeping;

b determining the amount of the assets of different pension plans;

c controlling the depositary of the fund; and

d disclosing quarterly information to participants and beneficiaries regarding their consolidated and economic rights in the pension plan.

As regards management fees for the services carried out by management companies, there is a maximum annual limit of the value of the account that reflects the pension plan's resources and returns, and that is integrated in the relevant pension fund.

The Pension Funds Law establishes the legal criteria according to which pension fund assets must be invested, including security, profitability, diversification, liquidity, monetary consistency and suitable terms.

Spanish regulations establish the following limits on investments for pension funds, depending on the characteristics of the assets:

Pension funds must invest 70 per cent of their assets in financial securities traded in regulated markets; derivatives traded in organised markets; banking deposits; credits with mortgage guarantees; properties and real estate investment funds; and UCIs.

Pension funds also have maximum investment limits, and some established maximum percentages that certain assets may represent in relation to the pension fund's total assets. Moreover, pension funds may not generally borrow funds (with certain exceptions), and they have restrictions on their use of derivatives. Finally, the financial and actuarial systems of the plans have to be revised by an actuary. This revision must be carried out at least every three years, in general, or annually in the case of pension plans that require solvency margins (such as defined benefit plans).

iii Real property

There are two main types of entities under Spanish law with the object of investing in real estate assets: real estate UCIs and real estate investment listed companies ('SOCIMIs').

Real estate UCIs are defined in Law 35/2003 as non-financial UCIs whose main object is investment in urban real estate assets for the purpose of letting. They can adopt the form of an investment fund or investment company. Real estate UCIs are also managed by SGIICs subject to Law 35/2003, as described in Section II, *supra*.

SOCIMIs are regulated under Law 11/2009 of 26 October ('Law 11/2009'), a regulation influenced by American real estate investment trusts that was intended to create a new investment vehicle for the real estate market (and in particular the rental market): listed open limited liability companies that may opt for a special tax regime provided that they comply with certain requisites (see Section VII, *infra*). To the extent that they are open limited liability companies, SOCIMIs are also subject to the Spanish Corporate Law, and in particular to the rules of conduct and obligations of listed companies.

Given their nature, SOCIMIs are subject to double supervision: on one hand, by the Spanish tax authorities in relation to their compliance with the requirements to opt for special tax treatment; on the other, by the CNMV as regards the operation of SOCIMIs in the securities market.

The object of SOCIMIs is the direct or indirect investment in urban real estate assets for rental, including housing and business premises, hotels, garages and offices. In order to enable indirect investment, SOCIMIs may also participate in other SOCIMIs or in other entities (which may or may not be resident in Spanish territory, and which may or may not be listed) that meet the investment and distribution of benefits requirements required of such entities.

Law 11/2009 also contains an exhaustive regulation regarding the assets in which SOCIMIs may invest. Additionally, at least 80 per cent of their invested assets must be invested in the assets of their main object. Furthermore, Law 11/2009 establishes

requisites as regards the revenue generated by a SOCIMIs' investments, financing and the distribution of benefits (dividends).

iv Hedge funds

As outlined in Section III.iii, *supra*, there are two main two types of alternative investment funds regulated by Law 35/2003 and Royal Decree 1082/2012 that may be used to set up hedge funds: the IICIL and IICIICIL.

Free investment funds are not defined as hedge funds, and Law 35/2003 does not intend to create a definition of hedge fund. Free investment UCIs are simply UCIs that are subject to different investment rules. In turn, IICIICILs are UCIs that invest in UCIs that are subject to different investment rules.

Alternative investment funds are subject to the investment rules of financial UCIs, with certain particularities (among others, in relation to the maximum investment limits, minimum initial investment required, minimum number of shareholders, calculation of fees, net asset value, and investment rules on financial instruments and derivatives).

v Private equity

Venture capital entities and venture capital management companies are regulated entities in Spain subject to the supervision of the CNMV. Their constitution is subject to the authorisation of the CNMV. They are financial entities whose main object is investment in non-financial companies, entities of a non-real estate nature and generally non-listed entities, and they must carry out their activities and invest in assets according to the requirements of Law 25/2005.

Regarding their legal structure, there are two types of venture capital entities: venture capital funds and venture capital companies.

Venture capital funds are structured as a separate group of assets without legal personality that belong to a plurality of investors, and are represented and managed by a venture capital management company (which must also be registered within the CNMV) or by an SGIIC. Venture capital companies are open limited liability companies that may be managed by a venture capital management company or may be operated by their corporate bodies.

Regarding their regime, Law 25/2005 foresees simplified venture capital entities (which must meet certain requirements, and are reserved essentially to qualified investors and other large investors) and common regime venture capital entities.

Spanish venture capital entities and venture capital management companies are subject to certain information, audit and investment policy requirements, and to certain rules of conduct.

VII TAX LAW

Although significant tax reforms have been passed during 2011 and 2012, Royal Decree-Law 5/2004 of 5 March 2004, which approved the revised text of the Non-resident Income Tax Law, which is in force, has not been significantly amended (with the exception of a temporary increase of applicable rates during 2012 and 2013). Therefore, short-term amendments to the non-resident income tax ('NRIT') rules are not expected.

Generally, non-resident taxpayers are subject to NRIT on Spanish source income, and must declare and pay NRIT during the first 20 days of April, July, October and January: NRIT is paid on income obtained during the calendar quarter immediately preceding these payment periods.

Spanish-source income would include interest paid by a Spanish-resident taxpayer or with respect to financing used in Spain; gains on the disposition of bonds issued by Spanish-resident persons; dividends distributed by Spanish-resident entities, including UCIs; and capital gains on the disposition of shares and units issued by Spanish-resident entities, including UCIs. Please note that regulated Spanish UCIs are non-transparent entities subject to Spanish corporate income tax (although at a rate of 1 per cent).

Income deemed to be obtained in Spain is generally subject to NRIT at a rate of 24.75 per cent (24 per cent as from 1 January 2014). However, a 21 per cent (19 per cent as from 1 January 2014) reduced tax rate is applied on dividends, interest and capital gains. Each income is subject to taxation separately on a gross basis (with certain exceptions, no expenses are deductible). Normally, a withholding tax equal to the non-resident's final tax liability is levied on interest, dividends and capital gains on UCIs.

As regards investment managers, any Spanish-source income earned when carrying out their management activity (fees, commissions or any other returns) will be subject to NRIT at the general 24.75 per cent tax rate (24 per cent as from 1 January 2014). However, most conventions for the avoidance of double taxation ('CDTs') entered into by Spain provide for an exemption from tax on business profits obtained in Spain.

A brief description of the Spanish taxation applicable to non-resident investors is provided below. Please note that this refers to individuals or entities not resident in Spain for tax purposes, and not acting through a permanent establishment located in Spain.

i Capital gains

In general, capital gains obtained in Spain by a non-resident taxpayer will be taxed under NRIT at a 21 per cent rate (19 per cent as from 1 January 2014). No withholding tax is levied on capital gains, except for those related to an investment in a Spanish UCI.

Domestic legislation provides for an exemption from tax for the benefit of residents of countries having concluded a CDT with Spain, and that includes an exchange of information clause in the case of transfers of shares or reimbursements of units in a UCI in a Spanish official secondary securities market.

In addition, EU residents are entitled to an exemption on capital gains obtained upon disposal of shares, provided that the assets of the company to which the shares belong do not consist mainly (direct or indirectly) of real estate located in Spain; and further provided that the non-resident has not held a participation of at least 25 per cent in the share capital of the Spanish company during the 12 months prior to the transfer of the shares, and that the capital gain is not obtained through a tax haven jurisdiction.

Finally, most CDTs provide for an exemption from capital gains tax, except when the assets are allocated to a Spanish permanent establishment or when the assets are Spanish real property. In some cases, when the assets consist of shares in a Spanish-resident entity, the exemption is conditioned to the fact that the holding is below significant participation thresholds (below 15 per cent or 25 per cent).

ii Interest and dividends

In general, interest and dividends obtained in Spain by a non-resident taxpayer will be taxed under NRIT at a 21 per cent rate (19 per cent as from 1 January 2014) and will be subject to withholding tax.

Domestic rules provide certain tax exemptions on income obtained by non-residents (e.g., income derived from Spanish public debt or interest accrued on non-residents' bank accounts).

In addition, EU residents are entitled to an exemption on interest obtained in Spain, provided that the interest is not obtained through a tax haven jurisdiction.

Regarding dividends, under the Parent-Subsidiary Directive no Spanish withholding taxes should be levied on the dividends distributed by a Spanish subsidiary to its EU parent company, to the extent that:

a the EU parent company maintains a direct holding in the capital of the Spanish subsidiary of at least 5 per cent uninterruptedly during the year prior to the date on which the distributed profit is due;

b the EU parent company is incorporated under the laws of a EU Member State and is subject to corporate income tax in a Member State, without the possibility of being exempt; and

c the distributed dividends do not derive from the subsidiary's liquidation.

The Spanish implementation of the Parent-Subsidiary Directive includes an anti-abuse provision, by virtue of which the withholding tax exemption will not be applicable where the majority of the voting rights of the parent company are held directly or indirectly by individuals or entities not resident in the EU, except where certain requirements apply.

Finally, non-residents that are resident in a country that has entered into a CDT with Spain will be entitled to apply the reduced tax rates provided in the relevant CDT (CDTs usually establish rates ranging from 5 per cent to 15 per cent on interest and dividends).

iii Special tax regimes

Spanish SOCIMIs are subject to a reduced 19 per cent corporate income tax rate on qualified income. They must comply with a number of regulatory requirements, including that they must be listed companies and must distribute least 90 per cent of their ordinary profits as dividends. Non-resident investors will be exempt on the dividend income, and totally or partially exempt on the capital gains, on disposal of the shares (up to the total amount of exempt dividends received, or the amount equivalent to 10 per cent of the acquisition value of the shares multiplied by the number of years during which the participation has been held). The excess gain will be subject to a tax rate of 19 per cent, unless any of the above described exemptions on capital gains tax applies.

Regulated Spanish venture capital entities benefit from a full exemption from tax on qualified dividends and a 99 per cent exemption on capital gains triggered from the transfer of shares in qualified entities. In addition, dividends or capital gains triggered by non-resident shareholders of a Spanish venture capital company are not subject to Spanish taxation (to the extent that the shareholder is not resident in a tax haven jurisdiction). EU UCITS (regulated by Directive 2009/65/EC of the European

Parliament and of the Council) earning Spanish source income are taxed at the reduced 1 per cent rate (although specific exemptions, as discussed, may also apply).

iv Anti-avoidance rules

No specific anti-avoidance measures have been approved by Spain in connection with these types of investments and investors, except for the previously mentioned rules that limit the application of tax exemptions or other tax benefits to investors acting through a tax haven jurisdiction, as defined under Spanish tax provisions.

VIII OUTLOOK

Although household savings rates are often acyclic (decreasing in growth periods and increasing in recession periods), due to the prolongation of the financial crisis and the worsening of expectations of growth, Spanish household saving rates have slightly decreased in the past year and are likely to continue to do so. The deteriorated Spanish and international macroeconomic and financial environment will result in more economic uncertainty in the future, which will also affect asset management activity in Spain. Additionally, several funds and other market players have already undergone merger processes in the past 12 months; this trend is expected to continue, resulting in a decrease in the number of investment funds and entities in general.

From a regulatory point of view, asset management in Spain will be significantly influenced by the implementation of the AIFM Directive and by the adoption by the European Commission of 'Level 2' implementing measures. In particular, it seems that Law 25/2005[9] will be amended in order to transpose the AIFM Directive into Spanish law, and with the aim of introducing additional improvements in the regulation, supervision and administrative intervention regime in order to make it more flexible.

9 According to the CNMV activity plan for 2012.

Appendix 1

ABOUT THE AUTHORS

CARLOS COSTA ANDRADE

Uría Menéndez – Proença de Carvalho

Carlos Costa Andrade has been a partner in the Lisbon office of Uría Menéndez since 2005. Between 1996 and 1999 he was in-house counsel (issuers and market division) at NYSE Euronext Lisbon.

His practice includes M&A, capital markets and banking laws. He has advised on takeovers and other public M&A transactions, public offers and listings of shares, structured bonds and other complex securities, regulated and non-regulated securities markets, regulatory authorities on the drafting of new regulations, corporate governance and structured finance agreements.

Carlos is currently the secretary to the shareholders meeting of OPEX and is a member of the equity, fixed income and derivatives committee of BM&FBOVESPA.

Carlos is among the most highly regarded banking and finance and capital markets lawyers in Portugal according to *Chambers Global Portugal* and *Chambers Europe*, *IFLR1000 Portugal* and *Legal 500*.

JUAN CARLOS MACHUCA

Uría Menéndez Abogados, SLP

Juan Carlos Machuca joined Uría Menéndez in Madrid in 1996 and has worked out of the firm's London office since January 2000. He is the current resident partner in the London office.

Juan Carlos' practice focuses on corporate law, banking, finance, regulatory, investment funds, private equity and capital markets. He also advises clients on M&A transactions and on insolvency and restructuring proceedings.

In 2007, Juan Carlos was one of the winners of the Iberian Lawyer 40 Under Forty Awards, which recognise the achievements of the new generation of top lawyers in Spain and Portugal.

MIRIAM PICH-AGUILERA

Uría Menéndez Abogados, SLP

Miriam Pich-Aguilera joined Uría Menéndez's Barcelona office in 2009 and has worked at the firm's London office since September 2011. She also did a six-month placement in Hengeler Mueller's Berlin office in the corporate – M&A department.

Miriam's practice is mainly focused on corporate law, M&A transactions, finance, investment funds, regulatory and capital markets. She also advises clients on restructuring proceedings and distressed acquisitions.

URÍA MENÉNDEZ ABOGADOS, SLP

125 Old Broad Street, 17th Floor
London EC2N 1AR
United Kingdom
Tel: +44 20 7260 1800
Fax: +44 20 7260 1812
juancarlos.machuca@uria.com
miriam.pich@uria.com
www.uria.com

URÍA MENÉNDEZ – PROENÇA DE CARVALHO

Rua Duque de Palmela, 23
1250-097 Lisbon
Portugal
Tel: +351 21 030 86 00
Fax: +351 21 030 86 01
carlos.andrade@uria.com
www.uria.com