

New legal regime for private investment entities (Act 22/2014)

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1. Introduction

Act 22/2014 of 12 November, published in the Spanish Official Journal on 13 November, regulates private investment entities (ECRs), collective investment entities of a closed-ended type (EICCs) and managers of collective investment entities of a closed-ended type (SGEICs), and amends the Collective Investment Schemes Act 35/2003 of 4 November. On coming into force, the Private Investment Entities and their Managers (Regulation) Act 25/2005 of 24 November has been repealed.

The new text consists of 103 articles, three additional provisions, one repealing provision and eight final provisions divided into 4 titles. Moreover, any time soon it will be the subject of amendment, since the Promotion of Corporate Finance Bill, published in the Journals of the Houses of Parliament of 17 October 2014, contains a sixth final provision that gives a new wording to the introductory paragraph of art. 80 (on the marketing of ECRs and EICCs under management authorised in Spain under Directive 2011/61/EU); adds a new point z) *bis* to art. 93 (Very serious infringements); and, adds a new letter z) to art. 94 (Serious infringements).

The preamble to Act 22/2014 (the "Act") considers that, under present conditions, it is extremely important to encourage other sources of direct finance other than that of banks, amongst which collective investment becomes an increasingly relevant alternative. In this context, private capital, as alternative

investment, can be regarded as a particularly relevant source of finance for all stages of business development, covering both venture capital, aimed at the early stages of business development, and private equity as a resource to finance corporate restructuring.

The legislator has drawn up a new regime for private investment entities since, in addition to updating and correcting some aspects of the law that are now repealed, it was necessary to incorporate into our law (i) Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, and (ii) Directive 2013/14/EU of the European Parliament and of the Council of 21 May 2013 amending Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision, Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Funds Managers in respect of over-reliance on credit ratings.

2. Definitions

The legislative paper starts off by providing definitions for a number of terms:

- *Collective investment of a closed-ended type*: shall mean that made by private investment entities and other collective

investment entities where the redemption policy for its unitholders or shareholders complies with the requirements of art. 2.

- *Private investment entities*: shall mean collective investment entities of a closed-ended type which raise capital from a number of investors through commercial activity that seeks to generate profits or returns for such investors and whose main object is defined in art. 9 of the Act (art. 3).
- *Collective investment entities of a closed-ended type*: shall mean collective investment entities that, not having a commercial or industrial purpose, raise capital from a number of investors, by way of marketing activities, in order to invest it in all types of financial or non-financial assets in accordance with a defined investment policy (art. 4).
- *Financial institution*: shall mean that falling into any one of the following categories (art. 7(1)):
 - a) Credit institutions and financial credit establishments.
 - b) The companies that art. 1(1) of the Mortgage Loan and Credit Arrangements and Intermediation Services for Loan or Credit Agreements Act 2/2009 of 31 March refers to.
 - c) Financial services firms.
 - d) Insurance and reinsurance undertakings.
 - e) Collective investment firms, financial or non-financial.
 - f) SGIICs (managers of collective investment schemes) and pension or securitization fund managers.
 - g) SCRs (private investment firms), SICCs (collective investment firms of a closed ended type) and SGEICs.
 - h) Companies whose main activity is the holding of shares issued by financial institutions, as defined hereunder.

i) Mutual guarantee companies.

j) Electronic money institutions

k) Payment institutions

l) FCRs (private investment funds), FICCs (collective investment funds of a closed ended type), investment funds of an open ended type, pension funds and securitization funds.

m) Foreign undertakings, regardless of their legal denomination or regime, which, pursuant to applicable legislation, engage in business that is typical of the above.

- *Non-financial firms*: shall mean, in addition to those that are not included in the provided categories of financial institutions, those whose main activity is the holding of shares issued by companies belonging to non-financial sectors (art. 7(2)).

3. Denominations

The denominations “sociedad de capital-riesgo”, “fondo de capital-riesgo”, “sociedad de capital-riesgo-Pyme”, “fondo de capital-riesgo-Pyme” and “sociedad gestora de entidades de inversión de tipo cerrado”, or their abbreviations “SCR”, “FCR”, “SCR-Pyme”, “FCR-Pyme” and “SGEIC” shall be reserved for these entities incorporated in accordance with the Act and registered with the administrative register managed by the CNMV (Spanish Securities Market Authority) to this end (art. 11).

4. Activities of private investment entities

4.1. Main activity

The main object of ECRs consists of acquiring temporary shareholdings in companies (not of a real estate or financial nature) which, at the time of acquisition, are not listed on the primary stock exchange market or other equivalent regulated market in the EU or other member countries of the OECD. Additionally, in the circumstances provided in art. 9 of the Act, ECRs may extend their core business to investment in securities issued by companies whose assets are

in more than 50% real estate; acquiring temporary shareholdings in non-financial firms listed on the primary stock exchange market; and investment in other ECRs in accordance with the law.

4.2. *Ancillary activities*

ECRs may grant profit sharing loans; and carry out advisory activities aimed at companies that constitute the primary subject of ECR investment.

5. **Investment regime of private investment entities**

Arts. 13-25 provide a detailed investment regime for ECRs, in general, and for ECR-Pymes, a new legal construct that delimits the mandatory investment ratio as well as that which is unrestricted.

Note that the new statute promotes fundraising to allow the financing of a larger number of small- and medium-sized enterprises in their early stages of development and expansion beyond previous legislation.

6. **Private investment firms**

Private investment firms (SCRs) are subject to specific treatment in Part III of Title I of the Act (arts. 26-29), their definition and legal status detailed as follows:

6.1. *Definition*

SCRs are private investment entities which take the form of stock companies, whereby they are equally defined as collective investment entities of a closed ended type that raise capital from a number of investors through commercial activity that seeks to generate profits or returns for such investors.

6.2. *Object*

- a) As main activity, they can engage in the following:
 - Acquire temporary shareholdings in companies (not of a real estate or financial nature) which, at the time of acquisition, are not listed on the primary stock exchange market or

other equivalent regulated market in the EU or other member countries of the OECD.

- Invest in securities issued by companies whose assets are in more than 50% real estate, provided that the real estate representing at least 85% of the total book value of the investee's real estate are attached, continuously throughout the holding of securities, to the carrying out of a business activity provided for by legislation on personal income tax, corporate income tax, non-resident income or wealth.
- Acquire temporary shareholdings in non-financial firms listed on the primary stock exchange market or other equivalent regulated market in the EU or other member countries of the OECD, provided that such firms are excluded from listing in the 12 months following acquisition.
- Invest in other ECRs in accordance with the new Act.

b) As ancillary activity:

- ECRs may grant profit sharing loans and other means of financing to investees that form part of the mandatory investment ratio.
- ECRs may carry out advisory activities aimed at companies that constitute the primary subject of ECR investment.

6.3. *Share capital*

SCRs must have an authorised minimum share capital of 1,200,000 euros (900,000 euros in the case of ECR-Pymes), at least 50% paid up at the time of incorporation, and the rest within a maximum period of three years from incorporation.

The minimum share capital may be paid up in cash, in assets eligible for ECR investment or in property that makes up its fixed assets. Remaining payments, or that of subsequent share capital increases, may also be made

in fixed assets or assets eligible for ECR investment.

6.4. *Shares*

Shares may be documented with share certificates or book entries.

Shares of classes different to the general one of the firm may be issued, provided that any preferential treatment is specified in the articles of association.

6.5. *Articles of association*

The articles, aside from containing the information required by the Spanish Companies Act, shall describe in detail the investment policy prescribed by law, the possible delegation of investment management and the regime of shares of classes different to the general one of the firm when issued

6.6. *Valuation*

The value of an SCR's equity is arrived at after deducting accounts payable from the sum of its real assets, in accordance with the criteria determined by the Minister of Economy or, with his express authorisation, the CNMV. As regards the determination of the net asset value per share, it shall be the result of dividing the net assets attributable to each series by the number of shares outstanding.

6.7. *Structural modifications*

The transformation, merger, division and other structural operations carried out by SCRs or that lead to the creation of SCRs must be notified to the CNMV in accordance with the requirements established by law for the incorporation of ECRs, provided the appropriate deed of amendment has been executed and registered with the Register of Companies.

If it were a merger, the exchange ratio will be based on the procedure laid down for the same in the articles of association.

6.8. *Management*

As noted above, the articles of association of SCRs may provide for the management of their assets by a SGEIC, a SGIIC or an investment services firm under the Securities Market Act. In these cases, the delegation resolution must be adopted by the general meeting or, by delegation, by the board of directors, which, in turn, is not released from the managerial duties and liabilities that apply. The resolution must also be executed in solemn form as a deed and registered with the Register of Companies, as well as with the appropriate administrative register, from which time the manager's designation shall be effective.

7. **Private investment funds**

7.1. *Definition*

With no distinct legal personality, the underlying assets belong to a number of investors, the management and representation of which lies with a manager, which exercises the powers of ownership without owning the fund. The status of unitholder is acquired by contributing to the pool (art. 30).

7.2. *Fund*

The minimum fund of FCRs shall be 1,650,000 euros.

Contributions to the initial establishment and subsequent contributions to the pool shall be made in cash or assets eligible for investment, provided that the fund management's rules provides for the procedure and conditions, including the procedure for the valuation of assets contributed, under which contributions in kind may be made.

FCR assets will be made up of the contributions made by members and the returns that have not been distributed. Unitholders shall not be liable for the debts of the fund but to the extent of its assets.

The fund shall not be liable for the debts of unitholders or managers.

The assets will be divided into units which confer on the holder a right of ownership over the same. The units have no par value, shall have the status of transferable securities and may be represented by share certificates or book entries (art. 31).

7.3. Management

The Act states that the administration and management of FCRs shall be governed by the provisions of each fund's management rules, such activity necessarily lying with a SGEIC or SGIIC (art. 35).

8. Collective investment entities of a closed-ended type, European Venture Capital Funds and European Social Entrepreneurship Funds

Art. 38 provides that the rules for SICCs and FICCs are those established for SCRs and FCRs, with the special considerations contained in said article.

9. Managers of collective investment entities of a closed-ended type

SGEICs are stock companies whose object is to manage the investments – and control and manage the associated risks – of one or more ECRs and EICCs. SCRs and SICCs may act themselves as manager if their governing body chooses not to designate an external

manager. The responsibility of ensuring legal compliance by managed entities lies with SGEICs (art. 41).

10. Marketing of private investment entities and collective investment entities of a closed ended type

According to art. 75, the shares or units of Spanish ECRs or EICCs shall be marketed exclusively to investors considered professional clients as defined in art. 78 bis (2) and (3) of the Securities Market Act. For marketing to other investors, the conditions provided in art. 75(2) of the Act must be met.

11. Rules of conduct

SGEICs, SGIICs managing ECRs or EICCs, SCRs and self-managed SICCs, as well as those who hold positions of management and administration in all of them and their employees, shall be subject to the rules of conduct contained in Title VII of the Securities Market Act, including the system of penalties for infringement of these rules set out in Title VIII of said Act. They shall also be subject to any implementing regulations and the rules contained in their internal codes of conduct (art. 84).

12. Scrutiny, inspection and penalty regime

Scrutiny and inspection of the institutions covered by the Act lies with the CNMV (art. 85), whereas infringements classified as very serious, serious and minor, are punishable in accordance with arts. 96-103 of the Act.