



TECHNICAL GUIDE 1/2018 TO RELATED-PARTY TRANSACTIONS OF COLLECTIVE INVESTMENT SCHEMES AND OTHER TRANSACTIONS OF COLLECTIVE INVESTMENT SCHEME MANAGEMENT COMPANIES

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CONTENTS

One. Scope of application	4
Two. Identification of related-party transactions	4
Three. Parties and related-party transactions	5
Four. Related-party transactions for which prior authorisation is required	6
Five. Special considerations on applications	8
Six. Contracts entered into on behalf of CIS between CIS management companies and related-parties	9
Seven. Treatment of conflicts of interest in other transactions carried out by CIS management companies	10

The Spanish and European regulations governing CIS have opted to protect investors by establishing rules of conduct aimed at preventing conflicts of interest by identifying and managing them, rather than impose restrictions or prohibitions on the possibilities of the financial activities of CIS in situations where such conflicts exist.

In this regard, Article 43(1)(j) of Law 35/2003, of 4 November, on CIS (hereinafter CISL), establishes the duty of management companies to be structured and organised so that risk is minimised in cases where the interests of CIS or of clients are harmed by conflicts of interest between the company and its clients, between clients, between clients and CIS or between CIS.

Article 106 of the CIS Regulations, approved by Royal Decree 1082/2012, of 13 July (hereinafter, CISR), specifies the foregoing, establishing the duty of the management companies to adopt all the necessary measures to detect, manage, control, minimise and prevent conflicts of interest, and when these cannot be prevented, to disclose them, in order to avoid damaging the interests of CIS and their investors. For its part, Article 144 of the CISR includes a description of the entities and persons that such conflicts of interest may arise between.

Finally, Article 67 of the CISL and Article 145 of the CISR, regulate the specific regime of conflicts of interest arising from the performance of transactions with related parties, identifying the transactions that must be considered as such and requiring management companies to have an internal procedure in place to ensure that they are carried out in the sole interest of CIS and at prices or under conditions that are the same as or better than those of the market. In addition, these requirements must be confirmed by an independent unit of the management company.

This Guide is the second published on related-party transactions in the CIS field. In the first one, CNMV conveyed to the management companies a set of criteria for specific aspects of the approval procedures for related-party transactions consisting of the purchase and sale of financial instruments, in relation to the obligation to verify and provide evidence that such purchase and sale transactions are carried out in the sole interest of CIS and at prices or under conditions that are the same as or better than those of the market.

With this Technical Guide, CNMV continues to pursue its objective of conveying to CIS management companies the criteria derived from its supervisory experience regarding the scope of what should be classified as "related parties", as well as the category in which the different types of related-party transactions should be placed, expressly identifying, given that the regulation does not make provisions in this regard, those that necessarily require prior authorisation taking into consideration the special conflicts of interest that may be involved.

Likewise, management companies are informed that the activities in which conflicts of interest may arise that are not expressly defined in the regulations as related-party transactions, a treatment equivalent to that provided for them would mean, in the opinion of CNMV, that management companies are adequately managing conflicts of interest. Specifically, this classification will be attributed to transactions with promoters and the provision of the discretionary portfolio management and investment advisory service will have this status.

CNMV will apply the criteria set out in this Technical Guide in its supervisory activities.

By virtue of this, on 27/02/2018, the CNMV Board, following a report by its Consultative Committee, approved this Technical Guide, pursuant to the provisions of Article 21(3) of the Consolidated text of the Securities Market Act, approved by Royal Legislative Decree 4/2015, of 23 October (SMA).

One. Scope of application

1. This Technical Guide will apply to the management transactions of CIS made by CIS management companies and by the entities to which they delegate asset management, consisting of related-party transactions, as well as the activities of such entities carried out with the other clients and other related entities in which conflicts of interest may arise.

Two. Identification of related-party transactions

2. The procedures of the related-party transactions of CIS management companies must incorporate as detailed as possible a list, in line with the management company's transactions, of all the transactions classified as such, specifically distinguishing those for which prior authorisation is necessary and those that may be subject to subsequent supervision.

For these purposes, CNMV considers that it is not sufficient to only identify the transactions deemed to be of little relevance, determining by a process of elimination the one for which prior authorisation is required, or vice versa.

Three: Parties and related-party transactions

3. Related-party transactions are considered to be those carried out between a CIS and the persons or entities stated in the regulation (hereinafter, "related parties") which, in light of the provisions of Article 67 of the CISL and Article 145 of the CISR, are as indicated below. Consequently, management companies must include in their catalogue of related-party transactions, any business, transaction or provision of services carried out by decision of the management company which involves a CIS and in which some or other of the following related-parties participates:

- The CIS management company.
- The CIS depositary.
- Those who hold administration and management positions in the management company or depositary. In the case of a CIS with a corporate form, whoever holds administration and management positions in it are also related parties.
- Any company belonging to the group of the management company, the depositary or the SICAV and those who hold administration and management positions in those entities.
- Shareholders or unitholders of the managed CIS, when they hold significant stakes.
- Other CIS managed by the management company or entities in their group.
- Employees or a competent person in the management company or who has, directly or indirectly, a control relationship with the management company. Given that, in accordance with Article 144(1)(b) of the CISR, there are conflicts of interest, any transaction carried out by them, either directly or through intermediary companies, with CIS, must be treated as a related-party transaction.
- Clients of the management company. For these purposes, the client of the management company is understood to be the one to whom investment services are provided, such as the discretionary portfolio management service, advice or any other relating to financial instruments or assets. Consequently, any transaction for the purchase and sale of securities

participated in by a managed CIS and another client of the management company to which a service is being provided must be classified as a related-party transaction.

Four: Related-party transactions for which prior authorisation is required

4. Taking into account the special conflicts of interest to which they may give rise and that, in any case, have to be carried out in the sole interest of the CIS and at prices or under conditions that are the same as or better than those of the market, management companies must ensure that their internal procedures provide for the requirement to obtain prior authorisation, with the details indicated in number 5 of this section, at least the following related-party transactions:
 - a) Acquisition of securities in which the related parties act as an underwriter, insurer, director or adviser.
 - b) Acquisition of securities issued or guaranteed by related parties, both in the primary and secondary markets.
 - c) Purchase from and sale to counterparties that are related-parties of fixed income securities.
 - d) Purchase and sale of CIS managed by related parties.
 - e) Arrangement of bilateral transactions over-the-counter (OTC) and purchase of structured products from related parties, as well as acquisition and temporary assignment of assets (reverse repurchase agreement (reverse repo) and repurchase agreement (repo))
 - f) Purchase of deposits with related parties regardless of their term and amount.
 - g) Applications between CIS of the same management company or between a CIS and another client of discretionary portfolio management of the management company. This aspect is developed in the fifth section of this Guide.
 - h) Contracts on behalf of the CIS between CIS management companies and related-parties in relation to the rendering of services or to financial instruments and financial assets, as well as any whose cost is borne in full or in part by the CIS.

CNMV considers that the sale or disposal within the term that the CIS management company determines in its procedures of the securities acquired in accordance with

the provisions of paragraphs a) and b) above, must be communicated to the corresponding person or body in order to prove that the joint purchase and subsequent sale transaction has been made in the sole interest of the CIS and at prices or under conditions that are the same as or better than those of the market, thus reinforcing the management of conflicts of interest that may exist at the time of acquisition. CNMV considers that these transactions should be included in the information provided to the Board on related-party transactions.

5. However, management companies can only establish control in their procedures *a posteriori*, when they consider it appropriate in the following circumstances:
 - At the end of the period during which related-parties receive income, commission or other incentives for their activity that could generate conflicts of interest, in the case provided for in paragraph a) above.
 - In cases b) and c) above, when they are assets for which there is a representative trading market, except for primary market transactions.
A representative market for a security is understood as the existence of daily trading for it whereby the market price is determined through actual and regularly occurring market transactions on an arm's length basis.
 - When, in the case indicated in paragraph d) above, the criteria required to justify this, established by the management company in its procedures, such as the irrelevance of the percentage of the assets of the investing CIS or of the underlying CIS are that they represent, are met.
 - In the case of daily operations to cover the liquidity ratio or situations of a merely transitory nature, in the case of acquisition and temporary assignment of assets indicated in the previous letter.
 - When, in the case of OTC derivatives, among others those used to hedge currency risks, they are standardised contracts in which the price and exchange rate are fixed based on parameters or conditions that are objective and subsequently verifiable.

Five. Special considerations on applications

6. For these purposes, application should be understood as any exchange of securities between one or several CIS, on the one hand, and another or other different CIS, on the other hand, as well as between one or several CIS, on the one hand, and one or several discretionary management clients, on the other hand, provided that it is carried out by decision of the CIS management company. Those transactions between related parties in which a third entity intermediates to execute them and settlement must also be considered as applications.
7. CNMV considers that, given that it may be difficult to justify contrasting decisions taken by the same entity with regard to the same value or instrument, the applications must be very exceptional and, therefore, can only be made on an exceptional basis. The applications will necessarily require prior authorisation and, in any case, management companies must provide substantial proof of compliance with the provisions of Article 67(3)(a) of the CISL, especially with regard to the fact that the transaction is in the sole interest of both parties and is made at prices or under conditions that are the same as or better than those of the market.

Six. Contracts entered into on behalf of CIS between CIS management companies and related-parties

8. CIS management companies, upon signing or formalising them, must obtain prior authorisation for the contracts for the provision of services entered into with related parties, the cost of which is borne by the CIS, or other contracts entered into with related parties relating to financial instruments and assets in which the applicable economic conditions are agreed upon.
CIS management companies must take all the necessary measures to ensure and be able to duly prove that the transactions derived from said contracts will be carried out at a price or under conditions equal to or better than those of the market, and in the sole interest of the CIS involved.
9. Specifically, prior authorisation must at least be obtained for intermediation and settlement contracts involving fixed income, equity and currencies, those related to current accounts (which should include the overdraft conditions), those whose purpose is the financial analysis on investments, as well as any others related to financial instruments or assets. Transactions carried out in accordance with the provisions of these types of contracts may be considered repetitive.

10. The economic conditions contained in such contracts must be those that are actually applicable and may be determined based on parameters or objective conditions, provided that they can subsequently be verified, with the establishment of only maximum rates or of ranges so wide that they do not represent market values not being deemed valid. Prior authorisation is also required to modify these conditions.
11. On the other hand, contracts with platforms or intermediaries that are related parties, the purpose of which is the subscription and reimbursement of CIS through them for the managed CIS, must also be considered a related-party transaction, and the contract that regulates its use must be subject to prior authorisation. The management company must ensure that the economic conditions derived from the use of the platform or intermediary are market conditions (or better). For these purposes such conditions should be understood as those that reflect the cost incurred by the CIS as a result of the use of the platform or the transactions with the intermediary.

Seven. Treatment of conflicts of interest in other transactions carried out by CIS management companies

12. Within the activities that the CIS management companies can carry on, the provision of the discretionary portfolio management service, investment advice, as well as the transactions that may be carried out by the CIS management companies with the promoters of the CIS that they manage, are not expressly established in the regulation as related-party transactions, although they must comply with the general regime provided for conflicts of interest situations.
13. Regarding the provision of the discretionary portfolio management service and investment advice, Article 145.2 of the SMA provides that the investment services provided by CIS management companies will be subject to the provisions contained in said law in relation to the need to appropriately manage and solve the conflicts of interest that may arise in the course of providing investment services.
14. Regarding the transactions indicated in this Technical Guide by CIS management companies with the promoters of the CIS that they manage, the CISL and CISR also establish the duty of the management companies to detect, manage and monitor conflicts of interest.
15. In view of the above, it is considered that the management companies that grant the transactions indicated in this section a treatment equivalent to that established for

related-party transactions are adequately managing conflicts of interest. In this regard, they must ensure that the transactions are carried out in the sole interest of the managed portfolio, advised investor or CIS, at prices or under conditions that are the same as or better than those of the market, and in accordance with the criteria contained in this Technical Guide as in the Technical Guide 2/2017 on related-party transactions related to financial instruments carried out by CIS management companies.