Rules governing financial advisory firm membership of the Investment Guarantee Fund and other amendments thereto

Royal Decree 1180/2023, of 27 December, amends Royal Decree 948/2001 on investor compensation schemes to include financial advisory firms as contributors to the Investment Guarantee Fund and to reduce the fixed annual amounts of investment firm contributions to the fund.

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1. One of the main developments of the new Securities Markets and Investment Services Act was the mandatory membership of financial advisory firms in the Investment Guarantee Fund (FOGAIN). Under the previous rules - the 2015 Securities Market (Recast) Act - "in no case" were the activities carried out by financial advisory firms covered by the investment guarantee fund (Art. 143(5)). The new rules in the Securities Market Act, in mandatory transposition of Directive 2019/2034 of 27 November on the prudential supervision of investment firms (IF), obliges the national legislator to incorporate harmonised financial advisory firms into the Investment Guarantee Fund, so that all Spanish investment firms must join this fund (Art. 188 of Act 6/2023).

2. The legislative policy choice has been to recognise in the Securities Markets Act the reality of small investment firms operating in our country whilst providing the service of investment advice, so as to exclude them ministerio legis, or at the request of the firm, from the concept of 'investment firm' (Art. 128(5) of Act 6/2023). This has created a new type of financial entity, the national financial advisory companies (EAFINs), which do not have a European

passport for the provision of this investment service and are not subject to the third countries scheme.

3. Under the new prudential regime, financial advisory firms - investment firms - must have a share capital of seventy-five thousand euros, as opposed to the previous fifty thousand euros. Under the 2015 recast act, these firms could also avoid this minimum initial capital figure by taking out civil liability insurance to enable them to carry out the activity of financial advice as an investment service. As Directive 2019/2034 does not allow this second possibility, Article 5 of Royal Decree 813/2023 of 8 November on the legal regime for investment firms and other entities that provide investment services sets out – in accordance with Article 128 of the Securities Markets Act - the regime for these national financial advisory companies. For legal persons, it requires either an initial share capital of fifty thousand euros or "professional indemnity insurance, a surety or other equivalent guarantee to cover liability for negligence in the carrying out of their professional activity, with a minimum cover of 1 000 000 euros per claim for damages, and a total of 1 500 000 euros per year for all claims". If the consultancy activity is carried out by a natural person, this insurance must be taken out beforehand.

4. In view of the new prudential classification of investment firms and the legal recognition of national financial advisory companies, it was necessary to modify the rules on membership and contributions of these entities to the investment guarantee fund, which we analyse below.

5. One of the requirements for obtaining and maintaining authorisation as an investment firm is compulsory membership of the Investment Guarantee Fund, as established in Article 134 of the Securities Markets Act, which also obliges national financial advisory companies to join the fund and empowers the regulatory legislator to implement these matters.

6. This development has taken place through Royal Decree 1180/2023 of 27 December, amending Royal Decree 948/2001 of 3 August on investor compensation schemes, and the Regulations implementing the Collective Investment Schemes Act 35/2003 of 4 November 2024, approved by Royal Decree 1082/2012 of 13 July, which will enter into force on 17 January.

7. There are two notable modifications to the reform of the Investment Guarantee Fund rules contained in Royal Decree 948/2001: the first is the exclusion of professional investors from the fund's guarantee; the second, in addition to the inclusion of financial advisory firms as persons obliged to contribute to the fund, is the reduction of the fixed amounts of contributions to the fund by investment firms and the limitation of the variable amounts.

8. Article 4(4) of Royal Decree 948/2001 expressly excludes from the fund's guarantee money and securities and instruments entrusted by a series of investors (institutional investors, general government, etc.). The novelty is the incorporation of professional investors as persons excluded from the fund's guarantee (new letter n of this sub-article 4), professional investors "referred to in Article 194 of Act 6/2023, of 17 March, and in Article 112 of this Royal Decree". This is an obvious mistake, since Article 112 cannot be - it does not exist - in Royal Decree 948/2001; it refers to the same article of Royal Decree 813/2023, of 8 November, on the legal regime for investment firms, which contains a list of "professional clients" in the

implementation of Article 194 of the Securities Markets Act.

9. This is actually a relative change, since most of the institutional investors that are considered professional investors were already expressly included in the list of entities excluded from the fund's guarantee under Article 4 of Royal Decree 948/2001, with the exception of reinsurers and commodities and derivatives traders. The change therefore lies in regarding as professional clients (letter c of Article 112 RD 813/2023) those "persons who individually meet at least two of the following conditions: 1) That the total asset items are equal to or greater than twenty million euros. 2) That their annual turnover is equal to or exceeds forty million euros. 3) That their equity is equal to or greater than two million euros", without prejudice to the fact that these persons may request non-professional treatment, in which case we understand that their funds and securities would have to be covered by the fund's guarantee if the circumstances that trigger the coverage referred to in Article 5 of Royal Decree 948/2021 are met.

10. It is striking that the aforementioned Royal Decree 1180/2023 of 27 December, published in the Official Journal of Spain of 28 December, did not take into account the Commission Delegated Directive 2023/2775 of 17 October, which adjusts upwards the size criteria for micro, small, medium and large undertakings or groups. This delegated directive raises the quantitative criteria for an undertaking to be considered a medium-sized enterprise from 20 to 25 million for total assets and from 40 to 50 million for annual turnover (i.e. the criteria are raised by 25 % due to cumulative inflation). Although the deadline for transposition of the delegated directive is 24 December 2024, Member States have to apply the transposition rules for financial years beginning on or after 1 January 2024. It is true that the concept of professional client in Article 112 of the Royal Decree on investment firms comes from MiFID II (Annex II to the 2014 directive), but, in view of the foreseeable amendment of the European regulation, the opportunity could have been taken to raise the threshold of an undertaking considered to be a professional investor, insofar as this would result in greater investor protection as it would be covered by the fund's guarantee.

Financial advisory firms will have to contribute to FOGAIN's assets

11. The second change is that of Article 8 of Royal Decree 948/2001, dedicated to the economic regime of the annual contributions and surcharges of the members of the Investment Guarantee Fund. This amendment, according to the regulatory legislator, "seeks a greater degree of linkage between the contribution of each member to the fund and the risk that this could entail for the system as a whole".

12. The fixed annual contribution is set, depending on the investment services and activities carried out, at the following amounts:

    i) Portfolio management: 2,700 euros.

    ii) Trading on own account: 2,700 euros.

    iii) Receipt and transmission of client orders (including placement of financial instruments without a firm commitment basis): EUR 1000.

    iv) Investment advice: 800 euros.

v) Other investment services: 2700 euros.

vi) Auxiliary custody and administration service on behalf of clients: 2700 euros.

Previously, the criterion was gross fee earnings, so that investment firms with gross fee earnings of less than 5 million euros had to contribute 20,000 euros annually to the fund, 30,000 euros if the earnings were between 5 million and 20 million euros, and 40,000 euros if the earnings were above 20 million euros.

13. In addition, investment firms will have to contribute a variable amount consisting of 2 per thousand of the cash, with the introduction of a limit of 100,000 euros per covered client, and 0.08 per thousand of the cash value of the securities and financial instruments deposited or managed with them corresponding to clients covered by the guarantee (previously, the percentage was 0.05 per thousand). The contribution consisting of the result of multiplying by three euros the number of clients covered by the guarantee disappears.

14. The new sub-articles 3 and 4 of this Article 8 detail the way in which the fund manager calculates the amount of the annual contribution, as well as the formula for reducing the contributions of the members when the assets not committed in operations inherent in the purpose of the fund exceed certain amounts. It also includes the relevant regulatory authorisation for the development of certain contents of these two sub-articles.

15. By virtue of the provisions of the sole transitory provision of Royal Decree 1180/2023 of 27 December, financial advisory firms have a period of three months, until 17 April, to join the Investment Guarantee Fund. Investment firms already members of the Fund will be able to take advantage of a voluntary system of progressive adaptation to the new legal regime of contributions as detailed in the aforementioned transitional provision.