On the New Legal forms of Collective Investment

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Abstract: In July 2013 the new Act on Investment Companies and Investment Funds entered into effect. The Act replaces the former Act on Collective Investment and brings to market several new legal forms of collective investment, which will be used mainly by those who establish funds for qualified investors.

The paper briefly analyses the basic features of the new regulation, with particular focus on new forms of collective legal investment - trusts, an investment company with variable capital (SICAV) and partnerships limited by investment certificates (SICAR). The task of the new legal forms is to approach the legislation to practices and legal forms abroad and make the collective investment in the Czech Republic more attractive especially for foreign investors.

Key words: Collective investment funds · Qualified investors funds · Trust · Investment company with variable capital · Partnership limited by investment certificates

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1 Introduction

In August 2013, the new Act No. 240/2013 Coll., on Investment Companies and Investment Funds (hereinafter “ZISIF") entered into effect. The new Act interfered substantially with the legal regulation of collective investment undertakings existing at that time and has completely replaced this legislation formed by the Act No. 189/2004 Coll., On collective investment schemes. Besides the necessary transposition of EU directives (in particular Directives 2009/65/EC and 2011/61/EU) it modernizes the area of investment fund according to the model existing in the Luxembourg, Ireland and Germany legislations. The act therefore brings several new features such as separation of services related to fund investment - when distinguishing between the management and administration of investment funds. Further on, it significantly expands the legal forms of investment funds.

In comparison with the previous Act on Collective Investment, ZISIF differs not only in its scope, but it also brings several major substantive changes. The former Act on Collective Investment was amended several times so that changes as to its original concept occurred. The concept of the new ZISIF responds to the changes in collective investment not only in the Czech Republic but also in Europe. It takes into account the experience of countries with highly developed fund sectors such as Luxembourg and Ireland. This is reflected for example in the creation of a fund administrator or in the expansion of permissible legal forms and investment strategies of special funds.

A visible innovation that might bring a slight confusion among investors is the new terminology. Whereas under the previous legislation collective investment funds were divided into investment funds and mutual funds, the new legislation divides investment funds into collective investment funds and funds of qualified investors. The collective investment funds are then further divided into standard funds and special funds (Šovar, 2013).

Another change will be felt by those who manage assets of several investors that is thereafter further invested according to specific strategies to achieve joint gains. In the new Act is also incorporated the EU Directive, which regulates investment in Alternative Investment Fund Managers (AIFM Directive) and the addition to the collective investment funds it concerns exactly those persons. The new Act therefore will therefore apply, among others, to development companies, private foundations, private equity, etc. The exceptions will represent e.g. holding companies, firms managing family property (so called family office vehicles) or entities collecting property exclusively for the purpose of funding specific research, production or trading. ZISIF also does not apply to insurance, pension funds, retirement savings, as well as the social insurance.

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2 Government Regulation No. 243/2013 Coll

As regards the companies concerned the decisive circumstance will be whether they administer assets under 100 million euros (where there is no permission from the CNB required, but the submission of an application for registration in the special list maintained by the CNB as well as meeting of specific information duties), or over 100 million euros (the permission from the CNB to operate as investment company or autonomous investment fund is required, as well as submission of Statute, meeting of capital requirements and other specific information duties towards the CNB and investors). Unless the administrator will not be placed on the list or not receive the permission, it may be fined up to 10 million Czech Crowns and the winding-up of the company may occur.

2 Methods - Qualified Investors Funds

The repealed Act on Collective Investment regulated special funds for qualified investors as the funds subject to less stringent regulatory requirements with respect to the persons of the investors. The new ZISIF does no more rule on qualified investor funds as a sub-category of special funds, as it was the case before. The qualified investor funds represent the second group of investment funds, next to the collective investment funds that are intended for the public and the Act divides them into standard funds (those that meet the requirements of the relevant provisions of EU law) and special funds (which do not meet these requirements). In the terminology used by the EU directives, the funds for qualified investors, as well as special investment funds of collective investment represent the so called alternative investment funds according to the AIFMD Directive, No. 2011/61/EU.

As the name of the qualified investor funds suggests, these are funds that are aimed at investors - professionals, not at the so called retail investors. This means that investing in these funds is allowed only to selected, specially designated entities. These include financial institutions, such as banks, insurance companies, pension companies, and the like. Qualified investors may, however, be also persons who declare in writing that they are aware of the risks associated with investing in funds of qualified investors, while their investment shall amount at least to € 125,000. In the case of the qualifying venture capital funds (EuVECA) and European social fund entrepreneurship (EuSEF), where the group of qualified investors is determined by the relevant EU regulations, is this amount lower and corresponds to € 100,000.

Narrowing of the list of allowed investors, however, does not mean that the funds for qualified investors could not be offered to the public. Under the threat of administrative sanctions, however, it is always necessary to draw attention to the fact, that only the qualified investor can become investor.

In spite of the aim and purpose of the funds of qualified investors it is logical that given the reduced need to protect investors, these funds are subject to less stringent regulatory requirements than investment funds. Many rules are established only as alternative, and it is thus possible to depart from them by private regulation. Unlike the collective investment funds, the funds of qualified investors may collect also assets valuable by money (except, if the fund has the form of a limited partnership with investment certificates where deposits can be only monetary).

Extended are the options of qualified investors funds also as to the permissible legal forms. These funds may have a legal form of mutual funds, limited liability companies, cooperatives, Societas Europea, trusts, limited partnerships or joint-stock companies. As to the latter forms, new modifications thereof can be used as well, i.e. the partnership limited by investment certificates and/or investment companies with variable capital (SICAV). However, it must be noted that these new legal forms as well as and legal status of a trust are conditioned by the re-codification of private law – represented primarily by the New Civil Code (Act No. 89/2012 Coll.) and the Business Corporation Act (Act. No. 90/2012 Coll.) - that should enter into from January 1st 2014. In the following text we will therefore analyse in brief the main features of these new three legal forms.

3 Research results - New legal forms for the qualified investors funds

Among the most important news introduces by the new ZISIF we find the legal forms that extend the originally used forms of joint stock company or mutual funds. These are trusts, investment companies with variable capital (Société d'Investissement à Capital Variable, SICAV) and partnerships limited by investment certificates (a form of venture capital investment vehicle, SICAR). The task of the new legal forms is to approach the legislation to practices and legal

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4 See for §§ 148 – 196 of the Act on Investment Companies and Investment Funds (Parlament ČR, 2013)
forms abroad and make the collective investment in the Czech Republic more attractive especially for foreign investors. The new legal forms are designed especially for qualified investors funds.5

3.1 Trust

General legal regulation of the trust is to be found in the New Civil Code (NCC). The trust is created by separation of property owned by the settlor, the management of that takes over an administrator called as trustee. The settlor defines in the Statute of the trust conditions for the administration and activities of the trust. He also determines the trustee and scope of beneficiaries to whom the trustee shall be required to provide benefits. The benefits may be distributed among the beneficiaries unequally. Any properties (money, movable or immovable property) may be allocated to the trust. An example may be the allocation of shares to the trust. Dividends on these shares will constitute income of the Trust, which shall be redistributed among the beneficiaries. Another example may be is the allocation of real property where the benefits will be created by the income from the rents collected.

For the establishment of a trust, a contract (Statute) shall be drawn up. This is an important deed, to the preparation of which attention must be paid not only from the legal aspects, but also from the point of view of taxation and account-keeping. It contains basic rules on the trust - its name, scope of property when founded, purpose of the trust and identification of its beneficiaries. Of great significance is also a careful adjustment of the supervisory arrangements that shall prevent any disposal with the property against the will of the settlor. One of the supervisory arrangements can be the obligation to audit the accounts of the trust, which may the settlor rule in the Statute. The trust shall be founded at the time when the trustee accepts credentials to his administration6 the property of a trust must thus enjoy permanent protection and professional administration.

From the general regulation the NCC deviates the ZISIF is several issues. The trust under ZISIF can be founded only by a contract and can’t be created by separation of assets of an collective investment fund. Trusts have no legal personality, they are established for a limited period of time and exclusively for the purpose of investing of the assets entrusted. Statute of the trust shall be governed by the regulations under ZISIF (not by the NCC) and as the trustee can be appointed only an investment company.

3.2 Investment company with variable capital

The form of an investment company with variable capital was taken over from the German and Luxembourg legal regulations. The main benefit should be the possibility of flexible changes in capital without administrative and time delays than as compared to conventional joint stock companies. The new legislation makes it possible public bidding of securities by the qualified investors funds, what was not possible according to the previous legislation. However, the call for purchase of investment instruments will have to draw attention to the fact that it is intended for qualified investors only.

The investment company with variable capital is a legal form that allows connection of advantages following from the legal personality of the company (e.g. protection of shareholder assets - investors, opportunities for greater involvement in decision-making processes with regard to the fundamental questions relating to the Fund) with the advantages of an open form of collective investment entity (high liquidity of investments, so this form is suitable for retail investors as well). A common feature of this legal form in all European countries is that, unlike ordinary joint stock company, the Act does not prescribe complex procedures for raising and lowering the equity, but variations of the equity occur automatically on the issue and redemption of the investment shares (Parlament ČR, 2013).

The investment company with variable capital can create so called sub-funds that have the character of assets and liabilities separates in the accounting. Debts incurred in connection with the management of the sub-fund shall be paid exclusively out of the assets of the latter. For each sub-fund the company shall issue investment shares. The provisions ruling the investment of mutual funds shall be used under ZISIF mutatis mutandis for investment of sub-funds. The aim and purpose of the regulation of sub-funds is to allow investment funds having the legal form of investment company with variable capital to set up several funds with different investment strategies, as is standard in several fund centres.

5 The Ministry of Finance itself as the Authority submitting the Draft of the new legislation admits that funds for qualified investors are currently the one who moves with the market for collective investment in the Czech Republic (the standard mutual funds show an apparent stagnation) and the new Act aims precisely at this area in order to make it more attractive to investors at home and abroad.

6 From this regulation departs the so called trust on death, for the foundation of which the settlor must write disposition of property upon death, i.e. a will, inheritance contract or codicil. The Trust on death then shall arise at the time of death of the settlor. The Trust is an alternative to inheritance. Unlike the latter, however, it allows to avoid the loss of value of assets by its fragmentation among legitimate heirs, whereas it provides for regular financial or economic benefits for the designated person (beneficiaries). (Bednaříková, 2012)
3.3 Partnership limited by investment certificates

For funds of corporate investments, a special regulation of a partnership limited by investment certificates under ZISIF shall be applied. The rules for the partnership limited by investment certificates make it possible, among other, to incorporate the shares of limited partners to share security, it provides also for a looser conditions for limited partner leaving the company. In the event of termination of the participation of key partners it also provides a stronger protection should an enforcement order for share of the partner be issued.

Partnership limited by investment certificates is also intended only for qualified investors funds and is the most suitable form for private equity funds and venture capital funds. This partnership will have only one partner with unlimited liability for the debts of the company (general partner) and shares of limited partners whose liability for the debts of the company shall be limited by the investment certificates. Investment certificate is physical security to the order with limited transferability to the extent to which the transferability of limited partner share is limited in accordance with general legal regulation. Its public (stock) market trading shall be prohibited. In contrast to the Business Corporations Act as the administrator of deposits shall act only the future general partner, the contribution of whom must be equal to 2% of the total deposits of the founding limited partners. Unlike other forms of qualified investors funds, there shall be no in-kind deposits permissible in the limited partnership.

4. Conclusions

It follows from the above quoted characteristics that the largest changes in the ZISIF have focused just on the group of qualified investors fund. It is particularly the case of these funds where the extension of the legal forms should bring more opportunities for companies setting up the funds.

Although we could find a lot of positive features attached to the new legal forms of qualified investors funds, the principal criterion for any living legal institute or legal system should be the answer to the question: "Does it work in practice?" The final answer to this question is, of course, to be awaited in a few more years. At this time, however, it can be said that there is no obvious reason why the regulation of collective investment received in the legal forms specified should not be functioning in practice. Although the chosen legal solutions break with some previous established forms, it is highly likely that the special relationship between the trustee (administrator), the fund's assets and its purpose will be in a short term period accepted by investors as a legislative fact.

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