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PRIVATE CLOSED-END INVESTMENT FUNDS OF NON-PUBLIC ASSETS AS A FORM OF COLLECTIVE INVESTMENT ON THE CAPITAL MARKET IN POLAND

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Abstract
The purpose of this paper is to establish whether a private closed-end investment fund of non-public assets may constitute a non-typical form of collective investment on the capital market, subject to legal regulations that are more flexible in comparison to other types of investment funds. This paper was prepared using a legal dogmatic method, upon analysing the provisions of the Act on Investment Funds and the Management of Alternative Investment Funds, and on the basis of an empirical analysis of the scale of assets located in the funds of this type. Each part of the paper synthetically defines the compounds of the special form of cumulative investing in the form of a private closed-end investment fund of non-public assets. The paper describes the essence of investment funds as a form of collective investment in the capital market, taking into account closed-end investment funds in particular. The issues analyzed include the private nature of the fund and the possibility of owning non-public assets, and the financial and economic benefits of such investments.

Key words: *investment funds; private investments funds; financial assets; investments*

JEL Classification: *K22, G23*

I. INTRODUCTION

The idea of collective investment means gathering independent and scattered money capital from many (usually small) investors, which together constitute the assets of the collective investment institutions (Gabryelczyk, 2006: p.15). This idea is implemented by collective investment institutions that were created and developed due to the disproportion between unused capital and the possibility of investing capital on the financial market (Sas Kulczycka, Choryło, Król & Lasota, 1999: p.2). Collective investing means that the money of certain participants of the fund are invested within the same fund, and the benefits or losses are divided up proportionately between the participants, depending on their respective shares (Socha, 1998: p.154).

Basic investment objectives that should be performed by the collective investment activities include ensuring the security of invested capital by maintaining its purchasing power (Dziawgo & Dziawgo, 1994: p.17); increasing the value of entrusted capital; and bringing in a constant income, paid periodically by the investment fund (Meluch, Nietrzepka & Orlik, 1993: p.27; Wilmowska & Madeła, 1998: p.28).

The main research thesis of this paper is to establish that a private closed-end investment fund is an alternative form of collective investment subject to much less strict regulation on the one hand, but with an increased level of dedication and personalisation on the other hand. The study empirically examined the number of closed-end investment funds of non-public assets against the total number of all investment funds in Poland.

The verification of the research hypothesis should be started by emphasising that the financial market, of which the capital market is a part, is an integral part of every modern economy. It provides a platform for making transactions in cash capital (Gabryelczyk et al., 2006: 15). The money from investment funds contributes to the development of the national economy of a given country. Investment funds are an important link between savers and companies in need of capital, and their absence should be considered as a factor hampering economic development (Sas Kulczycka, Choryło, Król & Lasota et al., 1999: 2; Bonser-Neal, Brauer, Neal & Wheatley; 1990; pp.45–47).

One of the basic features of the capital market is to associate the interests of all its participants, which on the one hand are entities with free resources, namely capital providers interested in increasing their capital, and on the other hand entities seeking such resources, namely the capital takers (Jajuga, Kuziak & Markowski, 1997: p.69). In economic terms, an investor who acquires a participation title in an investment fund becomes its shareholder, which means that it becomes a co-owner of the assets accumulated in the fund, in proportion to the money invested (Mirosław, 1999: p.9).

Two basic types of investors may be found on the capital market (Meluch, Nietrzepka & Orlik et al., 1993: p.27; Wilmowska & Madeła et al., 1998: p.28). The first type of investor is the individual (households),

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namely those who make investment decisions on their own (Dziawgo, 2003: p.39). The second type of investor is the institutional (collective) investor, including financial institutions where the core object of their business is investing the money entrusted to them by individual investors (Michalski & Sobolewski, 1999). Such institutional investors include insurance institutions, pension funds and banks, and investment funds. In the second case, institutional investors act in the name and for their participants (Grabowski, 1996) and they differ from individual investors in terms of the scale of funds invested, and the fact that these funds are managed professionally (Jajuga & Jajuga, 2001: 22; Schmitz, Glaser & Weber, 2009).

Investment funds are therefore one of the forms of collective investment in the capital market, which includes all forms of investment from the smallest individual investor to the largest institutional entities (Mroczkowski, 2011; Zawadzka, 2009). The genesis and reasons for collective investment institutions to emerge indicates that the tendency to save grows along with economic development (Sas Kulczycka, Choryło, Król & Lasota et al., 1999: p.2).

From a legal point of view, it is worth noting that the provisions of law do not directly define collective investing. In the Polish Securities Law (The Act on Public Trading in Securities and Trust Funds of 22 March 1991 (Journal of Laws, item 155, as amended)). which has been in force since 2005, the term "collective investment" was defined for the first time, specifying that it could take place in the form of trust funds established for this purpose, being the common property of the participants.

At present, the legislator uses the concept of “mutual investment” or rather “mutual investment institutions”, which includes investment funds and alternative investment companies. According to Article 3 point 3 of the Act on Trading in Financial Instruments of 29 July 2005, the participation titles in mutual investment institutions issued on the basis of applicable provisions of Polish law or foreign law, are securities or financial instruments other than securities representing property rights assigned to participants of mutual investment institutions, including participation units in investment funds. Investment certificates issued by closed-end investment funds are securities belonging to the category of participation titles in mutual investment institutions.

Locating money collectively in capital market instruments may be considered one of the main trends on the contemporary financial market. As of 31 October 2019, the value of all assets under management by investment fund companies in Poland amounted to PLN 262,301 billion, of which the funds accumulated in funds of non-public assets amounted to PLN 89,881 billion, which constitutes 34.26% of total assets (https://www.izfa.pl/raporty – The Report of the Chamber of Funds and Assets Managers <20191031> in Polish). However, it is worth pointing out that, in terms of the engagement of certain investment fund companies in the sector of funds on the non-public market (which, according to the assumed methodology, in addition to funds of non-public assets includes also securitisation funds and real property funds), more than half of all assets are managed by one investment fund company, the thesis on the popularity of this type of special structure of funds in general becomes partially untrue.

II. INVESTMENT FUNDS

From an economics approach, the term investment fund can be defined in many ways. In the literature on this subject, an investment fund is characterised as: a financial institution operating on its own behalf but for its participants (Gabryelczyk et al., 2006: p.128); a financial institution locating entrusted funds in undertakings that are to return a profit (Tarczyński, 2002: p.45); a form of indirect participation in transactions on the capital market as a money deposit allowing the investor to participate in the fund’s assets (Mazur & Chróścicki, 1996: 18); as well as cumulative assets resulting from contributions in cash made by its participants (Kościelniak, 1998: 21).

An investment fund is a form of combining the funds of individual investors with highly qualified managers who, by definition, should give a guarantee of making appropriate investment decisions (Blicharz, 2006; Bojańczyk, 2005: p. 25).

The essence of investment funds is based on the assumption of combining the cash of individual investors in order to invest it jointly (Bojańczyk et al., 2005: 25). The fundamental rules on which investment funds operate are based include the diversification of the investment risk by diversifying the investment portfolio of a certain fund (Perez, 2011: p.8).

The rules on establishing and operating investment funds with their registered offices in the Republic of Poland, and the principles on which foreign funds conduct business in the Republic of Poland are set out in the Act on Investment Funds and Managing Alternative Investment Funds of 27 May 2004 (Journal of Laws of 2018, item 1546 as amended; Hereinafter: The Act on Investment Funds or the AIF).

Pursuant to Article 3 paragraph 1 of the Act on Investment Funds, an investment fund is a legal entity whose core business consists in investing funds raised by offering units or investment certificates to the public in securities, money market instruments and other property rights.

According to the current legal regulations, an investment fund may be established only by an investment

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fund company as an open-end investment fund or an alternative investment fund, i.e.: a specialist open-end investment fund or a closed-end investment fund. An investment fund conducts its business taking into account, in particular, the interests of its participants, while observing the principles of limiting the investment risk, as set out in the Act on Investment Funds.

The process of creating a fund involves meeting all the necessary requirements, including: adopting the fund's statutes, entering into an agreement with a depositary for the performance of the depositary's functions, receiving authorisation from the Polish Financial Supervision Authority, collecting payments into the fund in the amount specified in its statutes, as well as entering the fund into the register of investment funds.

An investment fund company creates an investment fund, manages and represents it in relations with third parties and is the primary governing body of the fund. It is the investment fund company who adopts the fund's statutes and enters into an agreement with a depositary. Only a joint-stock company with its registered office in the Republic of Poland who has obtained the relevant consent of the Polish Financial Supervision Authority can become an investment fund company.

As already mentioned, closed-end investment fund is one of the types of investment funds, alongside traditional investment funds.

III. Closed-End Investment Funds

Closed-end investment funds stand out against classic mutual investment institutions, with their object including the collection of assets from many investors in order to locate them in the interest of these investors in line with a certain investment policy, such as open-end investment funds (Cherkes, 2001; Banachowicz, 2008: p.107).

A closed-end investment fund issues investment certificates that are securities and may be sold both on the primary and the secondary markets (Dobosiewicz, 2008: p.49). They may also be the object of a public offering or admission to trading on a regulated market, or the introduction to an alternative trading system, if permitted under the statutes of the investment fund.

The legal nature of a closed-end investment fund assumes a fixed number of investment certificates and capital in a specified time unit. A closed-end investment fund is therefore intended for a smaller circle of investors compared to open-end funds (Deli & Varma R. 2002: pp.1–27; Perez et al., 2011: p.32; Brauer, 1984: pp. 491–507). The funds of this type do not issue investment certificates at each request of an investor, but on dates set out in the prospectus or memorandum of information, or in the terms issue. As a result, investment certificates of closed-end funds as securities are characterised by the possibility of repurchase and redemption at any request of investors, which at the same time has a stabilising effect on the investment portfolio of the fund.

The investment policy of a closed-end investment fund is less rigorous than that of traditional open-end funds and allows the gathered funds to be invested in assets with lower liquidity but a higher level of risk, such as: real estate, receivables, foreign currencies, shares in companies not admitted to public trading, etc. (Banachowicz, 2008 et al.: p,107). Closed-end investment funds may also conduct a location policy with an extended investment perspective (Close, 1951: pp.79–88; Kościelniak et al., 1998; Kropiwnicki, 2001; Michalski & Sobolewski et al., 1999).

IV. Private Closed-End Investment Fund

Despite the fact that the term private investment fund is used in practice, the legislator itself does not use such a term. The Act on Investment Funds uses the term public closed-end investment fund. A public closed-end investment fund is a closed-end investment fund with its investment certificates introduced to trading on the regulated market, or introduced in the alternative trading system, or where they have been subscribed for or acquired in a public offering, except for a public offering that does not require a prospectus to be prepared.

Therefore, given that the legislator does not introduce a normative construction of a private investment fund, we can assume that where an investment fund does not fall under the statutory definition of a public closed-end investment fund, it will not be a public fund. A private closed-end investment fund can therefore be defined as a fund that issues only investment certificates that, in line with the fund's statutes, are not introduced to trading on the regulated market, nor introduced in an alternative trading system, or will not be offered through a private offering that requires preparing a prospectus.

Lower legal requirements are stipulated for this type of fund by the legislator, both at the stage of creating such fund, when no consent of the Polish Financial Supervision Authority is required, but instead the Authority must be notified about this fact by the investment funds company, and during the operation of the fund, where some activities, such as amending the statutes, do not require the consent of the Polish Financial Supervision Authority, nor does changing its depositary.

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V. Investment Fund Of Non-Public Assets

Based on the economics criterion of the specified investment policy, the assets allocation method and the level of investment risk, traditional and alternative funds can be distinguished (Perez et al., 2011: 35).

Alternative funds include closed-end investment funds that are organised for a certain purpose, namely, for instance, investing in a particular item, such as real property, shares, shares in certain non-listed companies from a certain sector (Banachowicz et al., 2008: pp.107-108). This type of dedicated fund is referred to by law as a fund of non-public assets. A fund of non-public assets is a particular type of investment fund characterised by the obligation to adhere to given statutory principles regarding the method of investing assets by the fund. The investment purpose and investment policy of a fund of non-public assets should be based on the standards set out in Article 196 paragraph 1 items 1 and 2 of the AIF, namely that such fund must invest at least 80% of the value of its assets in assets other than:

1) securities subject to a public offering or securities allowed for trading on the regulated market, unless the securities became subject to a public offering or were admitted to trading on the regulated market upon their acquisition by the fund,
2) money market instruments, unless they are issued by private companies whose shares form part of the fund's investment portfolio.

A fund that intends to operate as a fund of non-public assets must indicate this fact in its statutes.

There is a greater risk associated with the operation of investment funds of non-public assets than with other closed-end funds. This may be confirmed by the fact that a company managing only such funds (or closed-end investment funds established as securitisation funds) does not have to employ an investment advisor or ensure the operation of an internal control system. From an economic point of view, closed-end investment funds are more efficient than open-end funds and have lower operating costs and stable initial capital (Kościelniak et al., 1998: p.28).

The legislator's liberal approach to the legal regulations applicable to this special type of funds is also manifested in the possibility of allowing, in their case, income to be paid to participants from the sale of the fund's deposits, less the fund's operating costs related directly to the sold deposits and the part of the fund's operating costs assigned to these deposits in proportion to their value against the value of the fund's investment portfolio, which also makes it different from other closed-end funds (Krupa, 2008).

The need to modify the general rules concerning closed-end investment funds is dictated by the specific nature of funds of non-public assets. The statutory release of funds of non-public assets from certain provisions applicable to closed-end investment funds results in these funds being able to make more diversified decisions on locating the assets and their amounts, because the quantity limit of assets concentration at 20%, as specified in Article 145 paragraph 3 of the AIF, does not apply here. However, this is limited only until the date of offering investment certificates, which is stipulated in the fund's statutes. Therefore, the application of the limits from Article 145 paragraph 3 of the AIF refers to situations that occur after the date indicated in the statutes as the date of offering the investment certificates (Mroczkowski et al., 2014).

Similarly, the solutions regarding conditions and limitations do not apply when, according to the statutes, less than 36 months are left until the date of commencing the liquidation of the fund.

The liberalism of the legislator is also visible in the modification of certain terms concerning funds of non-public assets in relation to the basic regulation of a closed-end investment fund, whereby a preference is given to issues related to the functioning of funds of non-public assets, taking into account their specific nature.

In addition, in the case of an investment fund of non-public assets, the redemption price of investment certificates may be equal to the net asset value of the fund attributable to an investment certificate, according to the valuation of the assets on the date specified in the statutes. A condition for this simplification is an indication in the fund's statutes of provisions securing the interests of the fund's creditors in the event of new liabilities of the fund arising before the redemption date of the investment certificates, and of participants who have not requested the redemption of investment certificates (Malkiel, 1977: pp.47–58).

VI. Conclusion

As a rule, we describe an investment fund as a capital market participant being a collective investment entity that invests funds collected from investors. Private closed-end investment funds of non-public assets are a specific type of collective investment that, because of the possibility of creating such a fund for a specific purpose and for a specific investor (often one), does not always operate in line with the concept of a collective investment. The adoption of a liberal approach to this type of investment fund, whereby, in particular, there is no requirement to obtain a permit for its creation, and no need for consent to amend the statutes, allows for the relatively flexible establishment of such entities.

The introduction of the legal possibility to create a private closed-end investment fund of non-public assets

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is essentially an amalgam of three separate legal entities, namely: a closed-end investment fund, a closed-end investment fund other than a public (private) fund, and a fund of non-public assets. Each of these legal constructions was individually regulated by the legislator, and each of them has been given an independent operating basis. Nevertheless, in the case of a private closed-end investment fund of non-public assets, we are dealing with a kind of multiplication of the three separate legal regulations mentioned above, which allows a specific legal structure to be established with a non-standard object of activity that is significantly different from classic investment funds. Such a legislative measure can be considered a result of the expectations of trading practice, which sees alternative forms of allocation of surplus capital in the possibility of creating a specific fund for a selected investor.

The above analysis shows that private closed-end private investment funds constitute a mild form of economic development by allocating financial resources. On the one hand, investing funds are made to multiply the value of the deposited funds, but on the other hand, it may allow the investment fund to allocate the entrusted funds further. In the case of open-end investment funds, they usually place these funds in financial instruments listed on the stock exchange. On the other hand, closed-end investment funds invest the entrusted funds in less liquid assets, such as shares in limited liability companies or real estate. Such a structure of the legal regulation allows for expanding the possibilities of influencing the economy by using significant funds deposited in private investment funds of closed non-public assets.

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