The term "the public" in the Collective Investment Act

Statute
- **Act No 189/2004 Coll., on Collective Investment, as amended (the Collective Investment Act, CIA)**
- **Act No. 256/2004 Coll., on Business Activities on the Capital Market, as amended (the Capital Market Undertakings Act, CMUA)**

Provisions
- **Articles 2a, 24, 44, 56 and 58 of the CIA**
- **Articles 34 and 35 of the CMUA**

Question

According to what criteria is the term "the public" assessed in the field of collective investment?

Answer

I. Summary regarding the term "the public" for the purposes of defining collective investment

Based on the arguments below, it can be stated that in the field of collective investment the term "the public" applies in cases:

1. where the group of offerees is not merely very small, not exceeding about 10 persons.

2. where there is no clear link between the offeror and the offerees justifying above-average trust as regards access to information and handling of investments. However, if the group of offerees is wide, each link is necessarily very loose and an offer to such persons constitutes an offer to the public; this situation arises, regardless of the link, for groups of approximately 150 persons.

3. where not only qualified investors are targeted (qualified investors are not included in the group of persons specified in (1) and (2) either).

It should be added that the material criterion of a link or of qualifiedness is more important than the definition in terms of a specific number. It is clear that the higher is the number of offerees, the less probable it is that the link to the offeror or pooler will be sufficient. The term "the public" must always be interpreted with respect to the specific circumstances of the case in question.

II. Introduction

Czech law does not contain a generally applicable definition of "the public". For example, Article 117 of the Criminal Code stipulates that a crime is committed in public if it is committed among other things before at least three persons present at the same time. By contrast, Article 276(1) of the Commercial Code considers as public an offer addressed to unspecified persons.

An older Supreme Administrative Court (NSS) judgement states, among other things, that *"The term 'publicity' would imply that only an auction that is open to the public, i.e. open to anyone – at least to anyone who is seriously interested in it, being thus the opposite of an auction open only to certain persons, can be considered public".* It goes on to specify that non-public auctions are those *"open only to a certain group of persons. It does not matter how wide that group is."* (SAC 845/1923). Another definition stated that *"The term 'publicity' is therefore presented as the opposite of 'secrecy'."* (NSS 1729/1925, ÚS Pl. 28/04). However, the following decision of the NSS seems generally valid: *"The term 'public', variously employed, occurs frequently in legal rules and is undoubtedly used in multiple meanings.…A guide to interpreting what was meant by this expression must first be sought in the regulation itself."* (NSS 7925/1924).

III. Starting points and basic definitions of the term "the public" in the field of collective investment

The law and the European legislation contain no direct guides for defining "the public" in the field of collective investment. It is appropriate to start by considering the purpose of the collective investment regulation, which, in the words of the NSS, is *"to protect retail investors against undesirable practices in pooling funds from the public."* (7 A 131/2001). In addition to the traditional understanding[1] another guidance stems from the definition of "the public" in the nearest legal rule, namely the CMUA.

Under Article 34(1) of the CMUA, *"any communication to a wider group of persons"* is an offer of securities to the public. It is therefore clear that the public is not merely an unlimited group of persons. The CIA does not contain any exemptions for offers intended for, say, less than 150 persons (unlike the regulation applying to prospectuses – Article 35(2)(b) of the CMUA). The number of persons is therefore not the deciding factor, even though obviously an offer to only a few persons cannot qualify as an offer to a wider group of persons or to the public, and, conversely, an offer to a large number of persons always involves a very loose and wide group of persons.[2]
For collective investment purposes, "wider group" refers to all cases where the nature of the offerees or the link between the offeror and the offerees cannot be assumed to ensure sufficient access to information and offset the requirements for professionalism of the manager, be it a management company or an autonomous investment fund.

The following must be ascertained for every offer:

- the link between the offeror and the offerees. A relationship within a family or between close friends is close link justifying a regime not regulated by the CIA. For example, a previous long-standing business relationship (but a not standardised business relationship linked, say, with deposit account or insurance) would qualify. Relationships between the members of a holding have the nature of a close link.[3]

  An important factor is that the link must not be a purpose-made one connected with the intended collective investment. In the case of a higher number of persons, the link will by nature always be loose and insufficient.

  or

- the qualification of the offerees. The purpose of the collective investment regulation is offset if qualified investors are targeted (Article 56(1) of the CIA). This group consists mainly of financial institutions – banks, insurance companies, investment firms, collective investment funds, etc. – and large businesses. Also those specified in the CMUA (Article 34(3)) can be considered qualified, i.e. professional clients of investment firms (targeted typically through such firms). Where other persons are targeted, it is not clear in advance whether they are qualified investors – the definition of the

[1] The Czech Securities Commission Opinions *Pooling funds from the public under the CIA* (STAN/6/2005) and *On the issue of offering securities of a foreign special fund to the public under the CIA* (STAN/7/2004), available at www.cnb.cz.
[2] See SAC Judgement 7925/24: *"A performance does not become public by the mere fact that more than three persons take part (as spectators or listeners)…; if this were the case, the term private performances (entertainment) would be deprived of any practical meaning…, as even performances limited, for example, to the family circle would have to be considered public if the family had more members.…In principle it cannot be ruled out that a performance with 50 participants might retain the nature of a private performance."*
[3] As to the employer-employee relationship, the Supreme Court stated in Decision 5 Tz 1/2006 that *"the company accepted deposits only…from its employees, not the public"* and that *"employees…had a closer relationship with the company arising from the existence of an employment relationship and hence from the trust regarding the handling of the deposited funds*." Nevertheless, it should be taken into account in the area of securities offers and investment opportunities that the CMUA (pursuant to EU law) lays down a special exemption from the obligation to publish a prospectus when securities are offered to employees, i.e. such an offer is also considered an offer to the public, where the condition of a wider group of persons is satisfied.

qualification in the CIA includes a written affirmation of experience of investing in securities and also the ability and willingness to invest at least CZK 1 million. The offeror must therefore make sure that these conditions have in all probability been met.[4]

In cases of doubt, a higher degree of qualification may outweigh the intensity of the mutual link.

Other restrictions regarding the group of offerees, for example the minimum investment amount, are not relevant to the definition of "the public" in the CIA. It is also irrelevant whether or not the offer is made formally as a targeted offer. An untargeted offer will typically be considered as public, but even a targeted offer to a wider group of persons will constitute an offer to the public if there is no clear link between the offeror and the offerees or the offerees are not qualified within the meaning referred to above (for example a targeted offer to all the inhabitants of a town will undoubtedly be an offer to the public even though it involves a pre-specified and limited group of persons).

IV. Offering and pooling

In the field of collective investment, there is no reason to distinguish between the group of people representing the public for the purposes of "pooling from the public" and an "offer to the public".

- In the case of an "offer to the public", there is no doubt that the group of offerees must be taken into account (regardless of how many of them decide to invest).
- In the case of "pooling from the public", the same group must be taken into account. This is due to the imperfective aspect of the word "pooling", which implies that legislators had in mind the process whereby funds are being acquired from the public. The meaning of the prohibition of "pooling funds" is different from that of the prohibition "to pool funds".

V. Final remarks

Persons wishing to pool funds in order to collectively invest them without the relevant authorisation must therefore proceed in such a way that the group of offerees is smaller than the size of the public defined herein. The same applies to foreign funds wishing to offer securities in the Czech Republic without authorisation or notification.

Moreover, standard collective investment funds, whose defining feature is that they offer securities to the public, may not limit the number of investors in their statute to a narrow group of personal acquaintances, linked persons, etc. Such a fund cannot be considered a public fund. This does not rule out the typical investor being defined more specifically not only in terms of knowledge, experience, etc.,[5] but also using other criteria, such as membership of a particular professional group or local community, or a similar limiting criterion.

Importance of answer for those to whom it is addressed	This answer expresses the opinion of the employees of the CNB. The courts and/or the CNB Bank Board may take a different opinion. However, when performing financial market supervision, the CNB will, within the constraints of the reply and its starting points, consider acting in accordance with the answer to constitute acting in accordance with the law unless circumstances render the answer inapplicable to the case in question.
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[4] In respect of the same issue, a Czech Capital Market Association Recommendation of 25 June 2010 on the Provision of Information about Collective Investment Funds states that *"In the case of new clients, a [non-public] offering of funds for qualified investors to a new client must be preceded by an expert assessment of the client's experience of investing in securities." (www.akatcr.cz)*

[5] Article 6(3) of Decree No. 193/2011 Coll., on the minimum requisites of the statute of a collective investment fund and the conditions for the use of the name "short-term money market fund" and "money market fund".