

Chapter 9

Meaning of open-ended investment company

9.9 The investment condition : the 'satisfaction test' (section 236(3)(b) of the Act)

9.9.1 **G** The test in section 236(3)(b) of the *Act* is whether the reasonable investor would, before he makes a decision to invest, be satisfied that the value of his investment would be realised on a basis calculated wholly or mainly by reference to the value of the property belonging to BC.

9.9.2 **G** In the *FCA* view, this means that the reasonable investor must be satisfied that what he will get when he realises his investment is his proportionate share in the value of BC's underlying assets, less any dealing costs. In other words, that he is satisfied he will get net asset value. The investment condition focuses on the way the *body corporate* operates over time, and not by reference to particular issues of shares or securities (see ■ PERG 9.6.3 G (The investment condition (section 236(3) of the Act): general)). This means that this part of the investment condition looks to the general method used to calculate the value of the investment.

9.9.3 **G** For the 'satisfaction test' to be met, there must be objectively justifiable grounds on which the reasonable investor could form a view. He must be satisfied that the value of BC's property will be the basis of a calculation used for the whole, or substantially the whole, of his investment. The *FCA* considers that the circumstances, or combination of circumstances, in which a reasonable investor would be in a position to form this view include:

- (1) where the basis of net asset valuation is stated in constitutional documents of BC;
- (2) where there is a separate agreement or arrangement made outside BC's constitution under which a *person* other than BC undertakes:
 - (a) to redeem or repurchase any shares or securities issued by BC; or
 - (b) to take steps to ensure that the market value of the shares or securities reflects the value of BC's property (see ■ PERG 9.9.4 G (Effect of realisation on a market)); and
- (3) where an undertaking to intervene in the market to support the price of the shares or securities at net asset value has been made publicly known by BC or by another *person* (see ■ PERG 9.9.4 G (Effect of realisation on a market)).

Effect of realisation on a market

9.9.4 **G** ■ PERG 9.9.3 G (2) and ■ PERG 9.9.3 G (3) refer to circumstances where the reasonable investor may be satisfied that he can realise his investment at net asset value because of arrangements made to ensure that the shares or securities trade at net asset value on a market. There may, for example, be cases of market dealing where the price of shares or securities will not depend on the market. An example is where BC or a third party undertakes to ensure that the market value reflects the value of BC's property. This includes taking steps such as intervening in the market. In this case, it seems to the FCA that such an undertaking will constitute the necessary objective grounds on which an investor can be satisfied as to the basis on which the value of his investment will be realised. Unless arrangements of this kind exist, the FCA considers that the satisfaction test will not be met if the primary means for realising any investment in BC is on a market.

9.9.5 **G** However, where there is a market, the FCA does not consider that the test in section 236(3)(b) would be met if the price the investor receives for his investment is wholly dependent on the market rather than specifically on net asset value. In the FCA's view, typical market pricing mechanisms introduce too many uncertainties to be able to form a basis for calculating the value of an investment (linked to net asset value) of the kind contemplated by the satisfaction test. As a result, the FCA takes the view that, subject to ■ PERG 9.9.4 G, market dealings or facilities relating to the shares in, or securities of, BC will generally not be relevant in assessing whether or not BC comes within the definition of an *open-ended investment company*.

9.9.6 **G** The fact that the definition must be applied to BC as a whole (see ■ PERG 9.6.3 G (The investment condition (section 236(3) of the Act): general)) is also relevant here. So, for example, in a take-over situation the fact that a bidder may be willing to provide an exit route for an investment at net asset value will be irrelevant within the context of the definition. This is so even if an investor invests in particular shares or securities in the knowledge or expectation or in anticipation of such an offer being made. In the FCA's opinion, this is not a typical situation and does not affect the nature of BC as a whole or the manner in which it functions characteristically.

'Wholly or mainly'

9.9.7 **G** The expression 'wholly or mainly' in section 236(3)(b) determines the extent of the permissible departure from the link between the price of BC's shares or securities and the value of its net assets. The word 'mainly' introduces some flexibility to the process to allow for limited account to be taken of factors other than the value of BC's assets that may result in the sum realised failing to reflect the true net asset value. Such factors may include:

- (1) the payment by the investor of charges; or
- (2) the payment by the investor of an early redemption penalty; or
- (3) a discount on a repayment or repurchase of the shares or securities to reflect the payment by or on behalf of BC of the charges required to fund payment from a source other than BC's assets; for example, this might be a loan that is to be repaid from BC's assets once they are available.