

Chapter 9

Meaning of open-ended investment company

9.7 The investment condition: the 'reasonable investor'

9.7.1 **G** The investor is specifically a reasonable investor and not just a reasonable *person*. This simply means that the objective standard to be applied is that of the reasonable investor. In all other respects the test is the same as any other objective test applying the standards of the reasonable *person*.

9.7.2 **G** The characteristics that a reasonable investor can be expected to have will inform the use of judgment required by the 'expectation test' and the 'satisfaction test'. These tests relate to the investor's ability to realise an investment within a reasonable period and to do so on the basis of the net value of its assets. In the *FCA's* view, the characteristics of the reasonable investor include:

- (1) sound judgment based on good sense;
- (2) some knowledge of, and possibly experience in, the field of investment in property of the same kind as that in which the *body corporate* is to invest; and
- (3) some knowledge of the characteristic features of collective investment.

Where investment in a particular *body corporate* is clearly targeted at investors with certain characteristics, the reasonable investor can be assumed to have those characteristics.

9.7.3 **G** The reasonable investor is a hypothetical investor. The implications of this are that the test does not relate to actual investment by a particular *person* at a particular time or in relation to a particular issue of any class of shares or securities. In the *FCA's* view, what underlies the test is what a reasonable investor would think he was getting into if he were contemplating investment in a particular *body corporate*. In addition, because the investor is hypothetical, the investment condition is capable of operating on a rolling basis over time.

9.7.4 **G** In practice, the assessment of the nature of a particular *body corporate* will have to be made by applying the definition whenever an *authorised person* proposes to communicate an invitation or inducement to others for them to participate in the *body corporate* by buying shares or securities issued by it.

9.7.5 **G** After an initial assessment, however, the *FCA's* view is that subsequent applications of the investment condition could produce a different result, but only if there is a change to the constitution or practice of the *body corporate* which is significant and sustained. For example, this may happen if there is a change in the *body corporate's* published intentions or regular practices. As the Economic Secretary to the Treasury said in parliamentary debate when commenting on the definition, "It is a test that can be applied from time to time to allow for the possibility that a closed-ended company can become open-ended and vice versa, on account of significant changes to the way in which the operation of the company and its constitution are structured and which push the company over the boundary between the two types". (Hansard HC, 5 June 2000 Col 123).

9.7.6 **G** Section 236(3) uses the words "the investor would, if he were to participate in the scheme". This is consistent with the fact that the reasonable investor is hypothetical. But applying the test at this early stage makes it clear that there must be objectively justifiable grounds on which the reasonable investor could base the expectation in section 236(3)(a). And on which he could be satisfied on the matters in section 236(3)(b). In the *FCA's* view, this requires, for example, that there must be something in the nature of the *body corporate* or the law applicable to it to give rise to the required expectation or on which to satisfy the investor. The established practice of the *body corporate* may also provide the necessary grounds.