Chapter 9

Meaning of open-ended investment company

9.8 The investment condition : the 'expectation test' (section 236(3)(a) of the Act)

9.8.1 G The test in section 236(3)(a) of the *Act* is whether the reasonable investor would expect that, were he to invest, he would be in a position to realise his investment within a period appearing to him to be reasonable. In the *FCA's* view, this is an objective test with the appropriate objective judgment to be applied being that of the hypothetical reasonable investor with qualities such as those mentioned in PERG 9.7.2 G (The investment condition: the 'reasonable investor').

9

'Realisation' of investment

9.8.2 G In the *FCA's* view, the 'realisation' of an investment means converting an asset into cash or money. The *FCA* does not consider that 'in specie' redemptions (in the sense of exchanging shares or securities of BC with other shares or securities) will generally count as realisation. Section 236(3)(a) refers to the realisation of an investment, the investment being represented by the 'value' of shares or securities held in BC. In the *FCA's* view, there is no realisation of value where shares or securities are simply replaced by other shares or securities. However, an 'in specie' redemption might, in limited circumstances, satisfy the expectation test. This is where shares or securities are exchanged for other shares or securities in the same *body corporate* and those replacement shares or securities can be converted into cash or money within a period which, for both transactions taken together, can be said to be 'reasonable'. This involves looking through the series of transactions and considering whether their overall effect would satisfy the expectation test.

9.8.3 G The most typical means of realising BC's shares or securities will be by their being redeemed or repurchased, whether by BC or otherwise. There are, of course, other ways in which a realisation may occur. However, the *FCA* considers that these will often not satisfy all the elements of the definition of an *open-ended investment company* considered together. For example, the mere fact that shares or securities may be realised on a market will not meet the requirements of the 'satisfaction test' for the reasons given in PERG 9.9.4 G to PERG 9.9.6 G (Effect of realisation on a market).

9.8.4 G An investor in a *body corporate* may be able to realise part, but not all, of his investment. The *FCA* considers that the fact that partial realisations may take place at different times does not prevent the *body corporate* coming within the definition of an *open-ended investment company*. But, in any particular case, the 'expectation test' will only be met if the overall period for realising the whole of the investment can be considered to be reasonable. Apart from this, the simple fact that an investor has the opportunity to realise part of his investment at pre-determined times would not itself make a *body corporate* open-ended.

Illustrations of 'expectation'

9.8.5 G The use of an expectation test ensures that the definition of an *open-ended investment company* is not limited to a situation where a holder of shares in, or securities of, a *body corporate* has an entitlement or an option to realise his investment. It is enough if, on the facts of any particular case, the reasonable investor would expect that he would be able to realise the investment. The following are examples of circumstances in which the *FCA* considers that a reasonable investor may have such an expectation.

(1) Where a *body corporate*, in practice, regularly redeems or repurchases its shares or securities.

(2) Where a *body corporate* has a declared policy of redeeming or repurchasing its shares or securities; even if it is possible for the *body corporate* to change its policy, the *FCA* takes the view that the *body corporate* is open-ended unless and until it does so. In such cases it would, however, be necessary for the change of policy to be documented and for there to be a public statement or other public evidence of the change.

(3) Where a *body corporate* makes a public announcement that it will redeem or repurchase its shares or securities on a number of pre-arranged occasions that are identified at the time of the announcement. The issue here is whether there is a demonstrable intention to redeem or repurchase the whole of a *person*'s investment. If there is, then a *body corporate* may be an *open-ended investment company* even before it has carried out any actual redemption or repurchase. This is provided that the redemption or repurchase can take place within a reasonable period. In contrast, a *body corporate* that simply offers the possibility that it may, at some stage, decide to offer redemption, or partial redemption, at certain specified times would not, in the *FCA*'s view, give rise to the expectation required by section 236(3)(a).

9.8.6 G However, a reasonable investor's expectation of being able to realise his investment is not displaced simply because, in certain circumstances, no active steps need to be taken to realise the investment. This might happen where a redemption or repurchase of shares or securities may become compulsory as a result of some aspect of the applicable law.

Some relevant factors in applying the 'expectation test'

9.8.7 G In the *FCA*'s view, the fact that a *person* may invest in the period shortly before a redemption date would not cause a *body corporate*, that would not otherwise be regarded as such, to be open-ended. This is because the investment condition must be applied in relation to BC as a whole (see PERG 9.6.3 G (The investment condition (section 236(3) of the Act): general).

9.8.8 G Similarly, if BC issues shares or securities on different terms as to the period within which they are to be redeemed or repurchased (see PERG 9.6.4 G (The

9

investment condition (section 236(3) of the Act): general), BC must be considered as a whole. Whether or not the expectation test is satisfied in relation to a particular *body corporate* is bound to involve taking account of the terms on which its shares or securities, or classes of shares or securities, are issued. But this is only one of a number of factors to be taken into account. It is subject to any indications there may be in the other relevant factors (such as those in ■ PERG 9.8.9 G).

9.8.9 G As indicated in ■ PERG 9.3.5 G (The definition), the potential for variation in the form and operation of a *body corporate* is considerable. So, it is only possible in general *guidance* to give examples of the factors that the *FCA* considers may affect any particular judgment. These should be read bearing in mind any specific points considered elsewhere in the *guidance*. Such factors include:

(1) the terms of the *body corporate*'s constitution;

(2) the applicable law;

(3) any public representations that have been made by or on behalf of the *body corporate*;

(4) the actual behaviour of the *body corporate* or of a *person* acting on its behalf in relation to investors seeking to realise their investment in it;

(5) whether investors in the *body corporate* are in a position to take advantage of fluctuations in property value in the particular market in which the *body corporate* invests;

(6) the existence of a guarantee, which may mean that a longer period may appear reasonable than would be the case without the guarantee;

(7) where the underlying property in which the *body corporate* invests is relatively illiquid; in this case, the period within which realisation of an investment may be regarded as reasonable may be longer than it would be for property which has greater liquidity;

(8) the levels of disclosure of the terms on which investment is made;

(9) the nature of the investment objectives or policy of the *body corporate*; and

(10) the appropriateness of the name of the *body corporate*.