

AUTHORISATION MANUAL (AMENDMENT NO 5) INSTRUMENT 2002

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) of the Financial Services and Markets Act 2000 (Guidance).

Commencement

- B. This instrument comes into force on 1 October 2002.

Amendments to the Authorisation manual

- C. The Authorisation manual is amended:
- (1) by inserting, as AUTH App 2, the provisions in Annex A to this instrument; and
 - (2) in accordance with Annex B to this instrument.

Amendments to the Glossary

- D. The Glossary is amended in accordance with Annex C to this instrument.

Citation

- E. This instrument may be cited as the Authorisation Manual (Amendment No 5) Instrument 2002.

By order of the Board
19 September 2002

Annex A

AUTH Appendix 2

2 Meaning of open-ended investment company

2.1 Application and Purpose

Application

2.1.1 G This appendix applies to *persons* who need to know whether a *body corporate* is an *open-ended investment company* as defined in section 236 of the *Act* (Open-ended investment companies). This would mean that it is a *collective investment scheme*.

Purpose

2.1.2 G The purpose of this *guidance* is to outline the circumstances in which a *body corporate* will be an *open-ended investment company* and, in so doing, to:

- (1) give an overview of the definition (see *AUTH* App 2.3 (The definition)) and describe its three main elements:
 - (a) an *open-ended investment company* must be a *collective investment scheme* (see *AUTH* App 2.4 (Collective investment scheme (section 235 of the Act)));
 - (b) it must satisfy the ‘property’ condition in section 236(2) of the *Act* (see *AUTH* App 2.5 (The property condition (section 236(2) of the Act))); and
 - (c) it must satisfy the ‘investment’ condition in section 236(3) of the *Act* (see *AUTH* App 2.6 (The investment condition (section 236(3) of the Act): general) to *AUTH* App 2.9 (The investment condition: the ‘satisfaction test’ (section 236(3)(b) of the Act))); and
- (2) outline the implications for a *body corporate* if it does, or does not, fall within the definition of an *open-ended investment company* (see *AUTH* App 2.10 (Significance of being an open-ended investment company)).

Effect of guidance

2.1.3 G This *guidance* is issued under section 157 of the *Act* (Guidance). It is designed to throw light on particular aspects of regulatory requirements, not to be an exhaustive description of a *person’s* obligations. If a *person* acts in line with the *guidance* in the circumstances it contemplates, the *FSA* will proceed on the footing

that the *person* has complied with aspects of the requirement to which the *guidance* relates. Rights conferred on third parties cannot be affected by *guidance* given by the *FSA*. This *guidance* represents the *FSA*'s view, and does not bind the courts. For example, it would not bind the courts in relation to an action for damages brought by a *private person* for breach of a *rule* (see section 150 of the *Act* (Action for damages)), or in relation to the enforceability of a contract where there has been a breach of the *general prohibition* on carrying on a *regulated activity* in the *United Kingdom* without *authorisation* (see sections 26 to 29 of the *Act* (Enforceability of agreements)). A *person* may need to seek his own legal advice. Anyone reading this *guidance* should refer to the *Act* and to the various Orders that are referred to in this *guidance*. These should be used to find out the precise scope and effect of any particular provision referred to in this *guidance*.

Other guidance that may be relevant

- 2.1.4 G The only kind of *body corporate* of an open-ended kind that may currently be formed under the law of the *United Kingdom* is one that is authorised by the *FSA*. A *person* intending to form an open-ended *body corporate* that has its head office in Great Britain should refer to the Open-ended Investment Companies Regulations 2001 (SI 2001/1228). *Bodies corporate* formed under these Regulations are referred to in the *Handbook* as *investment companies with variable capital* (or '*ICVCs*'). *CIS 16* (Application and notification) contains *rules* and *guidance* on forming such *bodies corporate*. The Northern Ireland Assembly was in September 2002 considering a Bill to enable the establishment of open-ended *bodies corporate* whose head office is in Northern Ireland.
- 2.1.5 G *Open-ended investment companies* constituted in other *EEA States* which are seeking to exercise rights conferred by the *UCITS Directive* should refer to *CIS 17* (Recognised Schemes) for *guidance* on the requirements of section 264 of the *Act* (Schemes constituted in other *EEA States*).
- 2.1.6 G *Electronic commerce activities* carried on by, or in relation to, any *open-ended investment company* will be subject to the provisions of the *E-Commerce Directive*. *Guidance* on the carrying on of *electronic commerce activities* is contained in the *E-Commerce Directive sourcebook* (ECO).
- 2.2 Introduction
- 2.2.1 G The nature of many *bodies corporate* means that they will, in most if not all circumstances, come within the definition of *collective investment scheme* in section 235(1) to (3) of the *Act* (Collective investment schemes). The property concerned will generally be managed as a whole under the control of the directors of the *body*

corporate or some other *person* for the purpose of running its business. The idea underlying the investment is that the investors will participate in or receive profits or income arising from the operation of the *body corporate*'s business.

- 2.2.2 G However, there are a number of exclusions that apply to prevent certain arrangements from being a *collective investment scheme*. These are in the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062) (Arrangements not amounting to a collective investment scheme). The exclusion in paragraph 21 of the Schedule to that Order is of particular significance for *bodies corporate*. It excludes from being a *collective investment scheme* certain specified *bodies corporate* (such as *building societies* and *friendly societies*) as well as any other *body corporate* except a *limited liability partnership* or an *open-ended investment company*. This means that if a *body corporate* is an *open-ended investment company* it will not be excluded from the definition in section 235(1) to (3) of the *Act*. So it will be a *collective investment scheme*. Of course, it may be that other exclusions in the Schedule to the Order are available but this will depend on the circumstances of a particular *body corporate* (see *AUTH App 2.4.5G* (Collective investment scheme (section 235 of the Act))).
- 2.2.3 G Certain consequences flow according to whether or not a *body corporate* is an *open-ended investment company*. Different requirements apply to the marketing of the shares or securities issued by a *body corporate* which is an *open-ended investment company*, compared with one that is not (see *AUTH App 2.10.1G* to *AUTH App 2.10.6G* (Marketing of shares or securities issued by a *body corporate*)). In addition, the *regulated activities* that require *permission* may differ (see *AUTH App 2.10.7G* to *AUTH App 2.10.10G* (Implications for regulated activities)).
- 2.2.4 G *Guidance* on the application of the definition in particular circumstances is in *AUTH App 2.11* (Frequently asked questions)).
- 2.3 The definition
- 2.3.1 G For a *body corporate* to be an *open-ended investment company*, as defined in section 236(1) of the *Act*:
- (1) it must be a *collective investment scheme*;
 - (2) it must satisfy the property condition in section 236(2); and
 - (3) it must satisfy the investment condition in section 236(3).
- 2.3.2 G Each of these aspects of the definition is considered in greater detail in *AUTH App 2.4* (Collective investment scheme (section 235 of the Act)) to *AUTH App 2.9* (The investment condition: the

‘satisfaction test’ (section 236(3)(b) of the Act)). Although the definition has a number of elements, the *FSA* considers that it requires an overall view to be taken of the *body corporate*. This is of particular importance in relation to the investment condition (see *AUTH* App 2.6.3G and *AUTH* App 2.6.4G (The investment condition (section 236(3) of the Act: general))).

- 2.3.3 G An *open-ended investment company* may be described, in general terms, as a *body corporate*, most or all of the shares in, or securities of, which can be realised within a reasonable period. Realisation will typically involve the redemption or repurchase of shares in, or securities of, the *body corporate*. This realisation must be on the basis of the value of the property that the *body corporate* holds (that is, the net asset value).
- 2.3.4 G In the *FSA*’s view, all of the elements of the definition are clearly objective tests. In applying the definition to any particular case, a *person* would need to have regard to all the circumstances. This includes any changes in the way that the *body corporate* operates.
- 2.3.5 G The *FSA* understands that the aim of the definition in section 236 of the *Act* is to include any *body corporate* which, looked at as a whole, functions as an open-ended investment vehicle. The definition operates against a background that there is a wide range of different circumstances in which any particular *body corporate* can be established and operated. For example, the definition applies to *bodies corporate* wherever they are formed. So, in the application of the definition to different cases, the law applicable to, and the detailed corporate form of, particular *bodies corporate* may differ considerably.
- 2.3.6 G For a *body corporate* formed outside the *United Kingdom*, there is an additional issue as to how the applicable corporate law and the definition of *open-ended investment company* in the *Act* relate to one another. The *FSA* understands this to operate as follows. The term 'body corporate' is defined in section 417(1) of the *Act* (Interpretation) as including 'a body corporate constituted under the law of a country or territory outside the United Kingdom'. So, whether or not any particular overseas *person* is a *body corporate* will depend on the law applicable in the country or territory in which it is constituted. But if it is a *body corporate* under that law, the question whether it is an *open-ended investment company* is determined, as a matter of *United Kingdom* law, by the definition in section 236 of the *Act*. This is regardless of whether or not the *body corporate* would be considered to be open-ended under the laws of the country or territory in which it is constituted.
- 2.4 Collective investment scheme (section 235 of the Act)
- 2.4.1 G The first element of the definition is that *open-ended investment*

companies are a corporate form of *collective investment scheme*. This means that they must have the features in section 235 of the *Act*.

- 2.4.2 G Section 235(1) states that a *collective investment scheme* means any arrangements with respect to property of any description. The purpose or effect of the arrangements must be to enable the *persons* taking part in them to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income. The participants must not have day-to-day control over the management of the property (section 235(2)) and the arrangements must provide:
- (1) for the contributions of the participants and the profits or income to be pooled (section 235(3)(a)); or
 - (2) for the property to be managed as a whole by or on behalf of the operator of the scheme (section 235(3)(b)); or
 - (3) for both (1) and (2).
- 2.4.3 G In the *FSA*'s view, it is the very existence of the *body corporate* that is the *collective investment scheme*. There are a number of statutory references that support this view. For example, it is clear that paragraph 21 of the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062) (Arrangements not amounting to a collective investment scheme) is drafted on the basis that it is the *body corporate* itself that is (or would be) the *collective investment scheme*. This provision states that 'no body corporate ... other than an open-ended investment company, amounts to a collective investment scheme'. So, any particular *body corporate* is either an *open-ended investment company* or it is not. It cannot be both at the same time, although it may change from one to the other over time (see *AUTH* App 2.7.5G (The investment condition: the 'reasonable investor') for further *guidance* on this point).
- 2.4.4 G Analysing a typical corporate structure in terms of the definition of a *collective investment scheme*, money will be paid to the *body corporate* in exchange for shares or securities issued by it. The *body corporate* becomes the beneficial owner of that money in exchange for rights against the legal entity that is the *body corporate*. The *body corporate* then has its own duties and rights that are distinct from those of the holders of its shares or securities. Such arrangements will, in the *FSA*'s view, qualify as arrangements of the kind described in *AUTH* App 2.4.2G. The holders of the shares or securities in the *body corporate* do not have day-to-day control over the management of the property (as specified in section 235(2) of the *Act*) and the property is managed

as a whole by or on behalf of the *body corporate* (as specified in section 235(3) of the *Act*).

- 2.4.5 G Where a *body corporate* does come within the definition of a *collective investment scheme* in section 235(1) to (3), the only relevant issue is to determine whether or not it is excluded. As *AUTH* App 2.2.2G (Introduction) explains, the exclusions are in the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062) (Arrangements not amounting to a collective investment scheme). If a *body corporate* satisfies any of the exclusions in paragraphs 1 to 20 of the Schedule to the Order it will not be a *collective investment scheme*. This means that it will not then be necessary to consider whether or not it is an *open-ended investment company*. In any other case, it will be necessary to consider whether the *body corporate* is an *open-ended investment company* to see whether the exclusion in paragraph 21 of the Schedule to the Order (Bodies corporate) *for bodies corporate* other than *open-ended investment companies* and *limited liability partnerships* applies.
- 2.4.6 G In the *FSA*'s view, the question of what constitutes a single scheme in line with section 235(4) of the *Act* does not arise in relation to a *body corporate*. This is simply because the *body corporate* is itself a *collective investment scheme* (and so is a single scheme). Section 235(4) contemplates a 'separate' pooling of parts of the property that is subject to the arrangements referred to in section 235(1). But to analyse a *body corporate* in this way requires looking through its corporate personality and ignoring the legal entity that exists separately from the holders of shares or securities and their rights. As a corporate entity, it cannot be broken up into component parts in this way. This is so even though a *body corporate* may issue shares or securities of deferred classes or of classes carrying different rights.
- 2.5 The property condition (section 236(2) of the *Act*)
- 2.5.1 G If a particular *body corporate* ('BC') comes within the definition of a *collective investment scheme*, the second element in the definition is whether the property to which the scheme relates meets the property condition. This condition is that the property must belong beneficially to, and be managed by or on behalf of, BC. In addition, BC must have as its purpose the investment of its funds to:
- (1) spread investment risk; and
 - (2) give its members the benefit of the results of the management of those funds by or on behalf of BC.

- 2.5.2 G The property belonging to BC may be property of any description, including money. For example, the arrangements may relate to real estate, works of art or a particular enterprise or rural activity. It must, of course, be possible to value the property if the requirements of the investment condition concerned with the link to net asset value are to be met (see *AUTH* App 2.9 (The investment condition: the ‘satisfaction test’ (section 236(3)(b) of the Act))).
- 2.5.3 G The property of the *collective investment scheme* must belong beneficially to BC, although the legal title to it may be held by a third party. However, the holders of shares or securities issued by BC may not have a beneficial interest in that property. In exchange for their contributions, they will only have rights against BC.
- 2.5.4 G The purpose of BC will need to be determined bearing in mind its constitutional instruments and any other relevant material: for example, material in a prospectus or offer document or other promotional material. The prevailing law may also be relevant.
- 2.5.5 G In the *FSA*'s view, the question of whether funds are invested by BC with the aim of spreading investment risk is not affected by the levels of risk involved in particular investments. What matters for these purposes is that the aim is to spread the risk, whatever it may be. For example, the value of each of BC's investments, if taken separately, might be subject to a high level of risk. However, this would not itself result in BC failing to satisfy the property condition as long as it could be said that the range of different investments demonstrated that the aim was to spread investment risk.
- 2.6 The investment condition (section 236(3) of the Act): general
- 2.6.1 G If BC comes within the definition of a *collective investment scheme*, the third element in determining whether it is an *open-ended investment company* is whether the ‘investment condition’ is satisfied. This condition is that, in relation to BC, a reasonable investor would, if he were to participate in the scheme:
- (1) expect that he would be able to realise his investment in the scheme, within a period appearing to him to be reasonable; his investment would be represented, at any given time, by the value of the shares in, or securities of, BC held by him as a participant in the scheme; and
 - (2) be satisfied that his investment would be realised on a basis calculated wholly or mainly by reference to the value of the property for which the scheme makes arrangements.
- 2.6.2 G Under the investment condition, the reasonable investor is looking

to satisfy two criteria. Both of these are fundamental to his decision to invest. But the thresholds referred to in *AUTH* App 2.6.1G (1) and *AUTH* App 2.6.1G (2) are different. In the *FSA*'s view, a *person* expects something where he regards it as likely to happen or anticipates that events will turn out in a particular way. A *person* is satisfied of something where he has made up his mind or is persuaded that it is the case. The first of these criteria is referred to in this *guidance* as the 'expectation test' and the second as the 'satisfaction test'.

- 2.6.3 G Section 236(3) of the *Act* states clearly that the investment condition must be met 'in relation to BC'. In the *FSA*'s view, this means that the investment condition should not be applied rigidly in relation to specific events such as particular issues of shares or securities or in relation to particular points in time. The requirements of the investment condition must be satisfied in relation to the overall impression of the *body corporate* itself, having regard to all the circumstances.
- 2.6.4 G In the *FSA*'s view, and within limits, the investment condition allows for the possibility that a *body corporate* that is an *open-ended investment company* may issue shares or securities with different characteristics. Some shares or securities may clearly satisfy the condition whereas others may not. The *FSA* considers that a reasonable investor contemplating investment in such a *body corporate* may still take the view, looking at the *body corporate* overall, that the investment condition is satisfied. In the *FSA*'s view, a *body corporate* issuing a number of different classes of shares or securities on different terms might be expected to satisfy the investment condition where the overall balance between those that do and those that do not is strongly in favour of those that do satisfy the investment condition. The *FSA* considers that, in any case where there is a genuine and reasonable doubt as to where the balance between the different classes lies, it is very likely that the *body corporate* would not be an *open-ended investment company*. *AUTH* App 2.8.8G (Some relevant factors in applying the 'expectation test') comments further on this aspect of the investment condition in the specific context of the 'expectation test'.
- 2.6.5 G Certain matters are to be disregarded in determining whether the investment condition is satisfied. Section 236(4) of the *Act* states that, for these purposes, no account is to be taken of any actual or potential redemption or repurchase of shares or securities under:
- (1) Chapter VII of Part V of the Companies Act 1985; or
 - (2) Chapter VII of Part VI of the Companies (Northern Ireland) Order 1986; or

- (3) corresponding provisions in force in another *EEA State*; or
 - (4) provisions in force in a country or territory other than an *EEA State* which the Treasury has, by order, designated as corresponding provisions (no orders have yet been made).
- 2.6.6 G The *FSA* considers that the reference in *AUTH* App 2.6.5G (3) to corresponding provisions in force in another *EEA State* will include provisions that derive from the maintenance of capital requirements of the Second Council directive on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies (77/91/EEC).
- 2.6.7 G The *FSA*'s views on the following three elements of the investment condition are explained separately:
- (1) the 'reasonable investor' (see *AUTH* App 2.7 (The investment condition: the 'reasonable investor'));
 - (2) the 'expectation' test (see *AUTH* App 2.8 (The investment condition: the 'expectation test' (section 236(3)(a) of the Act))); and
 - (3) the 'satisfaction' test (see *AUTH* App 2.9 (The investment condition: the 'satisfaction test' (section 236(3)(b) of the Act))).
- 2.7 The investment condition: the 'reasonable investor'
- 2.7.1 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*.
- 2.7.2 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 *FSA*'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.

- 2.7.3 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 *FSA'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.
- 2.7.4 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.
- 2.7.5 G After an initial assessment, however, the *FSA'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).
- 2.7.6 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 *FSA'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.
- 2.8 The investment condition : the 'expectation test' (section 236(3)(a) of the Act)
- 2.8.1 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 *FSA*'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 *AUTH* App 2.7.2G (The investment condition: the 'reasonable investor').

'Realisation' of investment

- 2.8.2 G In the *FSA*'s view, the 'realisation' of an investment means converting an asset into cash or money. The *FSA* 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 *FSA*'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.
- 2.8.3 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 *FSA* 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 *AUTH* App 2.9.4G to *AUTH* App 2.9.6G (Effect of realisation on a market).
- 2.8.4 G An investor in a *body corporate* may be able to realise part, but not all, of his investment. The *FSA* 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’

- 2.8.5 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 *FSA* 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 *FSA* 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 *FSA's* view, give rise to the expectation required by section 236(3)(a).
- 2.8.6 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’

- 2.8.7 G In the *FSA'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 *AUTH* App 2.6.3G (The investment condition (section 236(3) of the Act): general).

- 2.8.8 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 *AUTH* App 2.6.4G (The 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 *AUTH* App 2.8.9G).
- 2.8.9 G As indicated in *AUTH* App 2.3.5(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 *FSA* 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*.

- 2.9 The investment condition : the ‘satisfaction test’ (section 236(3)(b) of the Act)
- 2.9.1 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.
- 2.9.2 G In the *FSA*'s 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 *AUTH* App 2.6.3G (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.
- 2.9.3 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 *FSA* 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 *AUTH* App 2.9.4G (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 *AUTH* App 2.9.4G (Effect of realisation on a market)).

Effect of realisation on a market

- 2.9.4 G *AUTH* App 2.9.3G(2) and *AUTH* App 2.9.3G(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 *FSA* 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 *FSA* considers that the satisfaction test will not be met if the primary means for realising any investment in BC is on a market.
- 2.9.5 G However, where there is a market, the *FSA* 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 *FSA*'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 *FSA* takes the view that, subject to *AUTH* App 2.9.4G, 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*.
- 2.9.6 G The fact that the definition must be applied to BC as a whole (see *AUTH* App 2.6.3G (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 *FSA*'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'

- 2.9.7 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.

2.10 Significance of being an open-ended investment company

Marketing of shares or securities issued by body corporate

- 2.10.1 A number of controls apply under the *Act* to the promotion of *shares* or *securities* that are issued by any *body corporate*. These controls differ according to whether the *person* making the promotion is an *unauthorised person* (see *AUTH* App 2.10.2G) or an *authorised person* (see *AUTH* App 2.10.3G to *AUTH* App 2.10.6G). In addition, where a *body corporate* is not an *open-ended investment company*:
- (1) the requirements of the Public Offers of Securities Regulations 1995 will apply if its *securities* are offered to the public in the *United Kingdom*; and
 - (2) the listing requirements under Part VI of the *Act* (Official listing) will apply if its *securities* are to be *listed*.
- 2.10.2 G The controls under the *Act* that apply to promotions of *shares* or *securities* by *unauthorised persons* are in section 21 of the *Act* (Restrictions on financial promotion). These controls apply where an *unauthorised person* makes a *financial promotion* in, or from, the *United Kingdom* that relates to the *shares* in or *securities* of any *body corporate*. The same controls apply regardless of whether the *shares* or *securities* being promoted are issued by a *body corporate* that is an *open-ended investment company* or one that is not. There are a number of exemptions from the restriction in section 21 of the *Act*. These are explained in [AUTH App 1](#) (Financial promotion and related activities).
- 2.10.3 G Promotions made by *authorised persons* in the *United Kingdom* are generally subject to the controls in *COB* 3 (Financial Promotion). However, in the case of shares in, or securities of, a *body corporate* which is an *open-ended investment company*, additional controls are imposed by Chapter II of Part XVII of the *Act* (Restrictions on promotion of collective investment schemes) (see

[AUTH App 1.20](#)). Section 238 of the *Act* (Restrictions on promotion) prevents an *authorised person communicating* any invitation or inducement to buy shares or securities issued by an *open-ended investment company*. Section 240 of the *Act* (Restriction on approval of promotion) prevents an *authorised person approving* a *financial promotion* to be *communicated* by an *unauthorised person*. This is if the *authorised person* would not be able to promote the share or security himself.

- 2.10.4 G The restrictions mentioned in *AUTH App 2.10.3G* are subject to a number of exemptions. For example, the controls in sections 238 and 240 do not apply to *financial promotions* about certain kinds of *collective investment scheme*. These are:
- (1) *open-ended investment companies* formed in Great Britain and authorised by the *FSA* under the Open-ended Investment Companies Regulations 2001;
 - (2) *authorised unit trust schemes*; and
 - (3) *collective investment schemes* that are *recognised schemes* (see CIS 17 (Recognised schemes)).

The position with respect to the promotion by *authorised persons* of *open-ended investment companies* formed in Northern Ireland will be considered as part of the implementing process for the relevant Northern Ireland legislation (see *AUTH App 2.1.4G* (Other guidance that may be relevant)).

- 2.10.5 G There are a number of other exemptions in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060). In general terms, these exemptions are equivalent to the exemptions from section 21 of the *Act* that apply to *units*. There is *guidance* on those exemptions in [AUTH App 1.20.3G](#) (Additional restriction on the promotion of collective investment schemes).

- 2.10.6 G The *FSA* has also made *rules* under section 238(5) which allow *authorised persons* to *communicate* or *approve* a *financial promotion* for an *open-ended investment company* that is an *unregulated collective investment scheme* (that is, one that does not fall within *AUTH App 2.10.4G*). The circumstances in which such a communication or *approval* is allowed are explained in [COB 3](#) Annex 5 (which is introduced by [COB 3.11](#)).

Implications for regulated activities

- 2.10.7 G In the *Regulated Activities Order*, shares in or securities of an *open-ended investment company* are treated differently from *shares* in other *bodies corporate*. They are treated as *units* in a *collective*

investment scheme under article 81 of the *Regulated Activities Order* (Units in a collective investment scheme) rather than *shares* under article 76 (Shares etc).

- 2.10.8 G A person who carries on in the *United Kingdom* the business of engaging in any *regulated activity* that relates to *units* or *shares* will need to be an *authorised person* (see [AUTH 2.7](#) and [AUTH 2.8](#)) (Authorisation and regulated activities).
- 2.10.9 G In order to be *authorised*, a person must have *permission* to carry on the *regulated activities* in question. What the *permission* needs to cover may differ according to whether the *regulated activity* being carried on relates to *units* or *shares*. So, for example, a *body corporate* that is an *open-ended investment company* will need *permission* if it carries on the *regulated activity* of *dealing as principal* or *agent, arranging (bringing about) or making arrangements with a view to transactions* in its own shares or securities in the *United Kingdom*. This applies also to a *body corporate* that is not an *open-ended investment company* except that it will not need *permission* to issue or arrange for the issue of its own *shares* or *securities*.
- 2.10.10 G A person carrying on the *regulated activity* of *establishing, operating or winding up a collective investment scheme* that is constituted by an *open-ended investment company* will need *permission* for those activities. In line with section 237(2) of the *Act* (Other definitions), the *operator* of a *collective investment scheme* that is an *open-ended investment company* is the *company* itself. But where the *open-ended investment company* is incorporated outside the *United Kingdom*, it will only require *permission* if its operation takes place in the *United Kingdom*.
- 2.11 Frequently Asked Questions
- 2.11.1 G There are some frequently asked questions about the application of the definition of an *open-ended investment company* in the following table. This table belongs to *AUTH* App 2.2.4G (Introduction).

Question	Answer
1 Can a <i>body corporate</i> be both open-ended and closed-ended at the same time?	In the <i>FSA's</i> view, the answer to this question is 'no'. The fact that the investment condition is applied to BC (rather than to particular shares in, or securities of, BC) means that a <i>body corporate</i> is either an <i>open-ended investment company</i> as defined in section 236 of the <i>Act</i> or it is not. Where BC is an <i>open-ended investment company</i> , all of its securities would be

Question

Answer

- treated as *units* of a *collective investment scheme* for the purpose of the *Act*. A *body corporate* formed in another jurisdiction may, however, be regarded as open-ended under the laws of that jurisdiction but not come within the definition of an *open-ended investment company* in section 236 (and vice versa).
- 2 Can an *open-ended investment company* become closed-ended (or a closed-ended body become open-ended)?
- In the *FSA's* view, the answer to this question is 'yes'. A *body corporate* may change from open-ended to closed-ended (and vice versa) if, taking an overall view, circumstances change so that a hypothetical reasonable investor would consider that the investment condition is no longer met (or vice versa). This might happen where, for example, an *open-ended investment company* stops its policy of redeeming shares or securities at regular intervals (so removing the expectation that a reasonable investor would be able to realise his investment within a period appearing to him to be reasonable). See also *AUTH App 2.7.5G*.
- 3 Does the liquidation of a *body corporate* affect the assessment of whether or not the body is an *open-ended investment company*?
- The *FSA* considers that the possibility that a *body corporate* that would otherwise be regarded as closed-ended may be wound up has no effect at all on the nature of the *body corporate* before the winding up. The fact that, on a winding up, the shares or securities of any investor in the *body corporate* may be converted into cash or money on the winding up (and so 'realised') would not, in the *FSA's* view, affect the outcome of applying the expectation test to the *body corporate* when looked at as a whole. The answer to Question 4 explains that investment in a closed-ended fixed term *company* shortly before its winding up does not, in the *FSA's* view, change the closed-ended nature of the *company*. For *companies* with no fixed term, the theoretical

Question

Answer

- possibility of a winding up at some uncertain future point is not, in the *FSA's* view, a matter that would generally carry weight with a reasonable investor in assessing whether he could expect to be able to realise his investment within a reasonable period.
- 4 Does a fixed term closed-ended investment *company* become an *open-ended investment company* simply because the fixed term will expire?
- In the *FSA's* view, the answer to this is 'no'. The termination of the *body corporate* is an event that has always been contemplated (and it will appear in the *company's* constitution). Even as the date of the expiry of the fixed term approaches, there is nothing about the *body corporate* itself that changes so as to cause a fundamental reassessment of its nature as something other than closed-ended. Addressing this very point in parliamentary debate, the Economic Secretary to the Treasury stated that the "aim and effect [of the definition] is to cover companies that look, to a reasonable investor, like open-ended investment companies". The Minister added that "A reasonable investor's overall expectations of potential investment in a company when its status with respect to the definition is being judged will determine whether it meets the definition. The matter is therefore, definitional rather than one of proximity to liquidation". (Hansard HC, 5 June 2000 col 124).
- 5 In what circumstances will a *body corporate* that issues a mixture of redeemable and non-redeemable shares or securities be an *open-ended investment company*?
- In the *FSA's* view, the existence of non-redeemable shares or securities will not, of itself, rule out the possibility of a *body corporate* falling within the definition of an *open-ended investment company*. All the relevant circumstances will need to be considered (see *AUTH* App 2.6.4, *AUTH* App 2.8.8G and *AUTH* App 2.8.9G). So the following points need to be taken into account.

Question

Answer

- (1) The precise terms of the issue of all the shares or securities will be relevant to the question whether the investment condition is met, as will any arrangements that may exist to allow the investor to realise his investment by other means.
- (2) The proportions of the different share classes will be relevant to the impression the reasonable investor forms of the *body corporate*. A *body corporate* that issues only a minimal amount of redeemable shares or securities will not, in the *FSA's* view, be an *open-ended investment company*. A *body corporate* that issues a minimal amount of non-redeemable shares or securities will be likely to be an *open-ended investment company*. A *body corporate* that falls within the definition of an *open-ended investment company* is likely to have (and to be marketed as having) mainly redeemable shares or securities. However, whether or not the *body corporate* does fall within the definition in any particular case will be subject to any contrary indications there may be in its constitutional documents or otherwise.
- (3) Where shares or securities are only redeemable after the end of a stated period, this factor will make it more likely that the *body corporate* is open-ended than if the shares or securities are never redeemable.
- 6 Does "realised on a basis calculated wholly or mainly by reference to..." in section 236(3)(b) apply to an investor buying investment trust company shares traded on a *recognised investment exchange* because of usual market practice that the

In the *FSA's* view, the answer is 'no' (for the reasons set out in *AUTH* App 2.9.4G to *AUTH* App 2.9.6G).

Question	Answer
shares trade at a discount to asset value?	
7 Does the practice of UK investment trust companies buying back shares result in them becoming <i>open-ended investment companies</i> ?	In the <i>FSA's</i> view, it does not, because its actions will comply with company law: see section 236(4) of the Act and <i>AUTH</i> App 2.6.5G.
8 Would a <i>body corporate</i> holding out redemption or repurchase of its shares or securities every six months be an <i>open-ended investment company</i> ?	In the <i>FSA's</i> view a period of six months would generally be too long to be a reasonable period for a liquid securities fund. A shorter period affording more scope for an investor to take advantage of any profits caused by fluctuations in the market would be more likely to be a reasonable period for the purpose of the realisation of the investment (in the context of the 'expectation' test, see <i>AUTH</i> App 2.8 and, in particular, <i>AUTH</i> App 2.8.9G which sets out the kind of factors that may need to be considered in applying the test).
9 Would an initial period during which it is not possible to realise investment in a <i>body corporate</i> mean that the <i>body corporate</i> could not satisfy the investment condition?	In the <i>FSA's</i> view, the answer to that question is 'no'. In applying the investment condition, the <i>body corporate</i> must be considered as a whole (see <i>AUTH</i> App 2.6.3G). At the time that the shares or securities in a <i>body corporate</i> are issued, a reasonable investor may expect that he will be able to realise his investment within a reasonable period notwithstanding that there will first be a short-term delay before he can do so. Whether or not the 'expectation test' is satisfied will depend on all the circumstances (see <i>AUTH</i> App 2.8.9G).

Annex B

Amendments to the Authorisation manual

In this Annex, underlining indicates new text and striking through indicates deleted text.

- 1.8.4 G As well as being included as an appendix to *AUTH*, copies of all current guidance issued by Authorisation Enquiries are available separately from the FSA website at www.fsa.gov.uk or through the FSA's Publication Enquiries department on 020 7676 3298. The Authorisation Enquiries team will be pleased to clarify or discuss any aspects of the guidance in more detail. Enquiries about the scope of the Act may be made to the Authorisation Enquiries helpline by telephone on 020 7676 0082 or by e-mail to authorisationenquiries@fsa.gov.uk.
- 2.3.2 G (4) ... This applies to the activities of *effecting* or *carrying out contracts of insurance*, certain activities relating to the Lloyd's market ~~and, in the future~~, entering as provider into a funeral plan contract and, in the future, activities relating to regulated mortgage contracts (see ~~AUTH 2.7.18G~~ and AUTH 2.7.20G respectively).
- 2.5.5 G ...Article 4(4) of the *Regulated Activities Order* (Specified activities: general) ~~identifies four~~ lists a number of exclusions that must be disregarded. These relate to the exclusions concerned with:
- (1) the absence of holding out (see *AUTH 2.8.4G(1)*);
 - (2) transactions or arrangements with or through certain persons (see *AUTH 2.8.4G (2)*, *AUTH 2.8.5G(1)* and *AUTH 2.8.6G(4)*);
 - (3) risk management (see *AUTH 2.8.4G(5)* and *AUTH 2.8.5G(2)*);
 - (4) persons acting under powers of attorney (see *AUTH 2.8.7G*);
 - (5) sale of goods (see *AUTH 2.9.7G*);
 - (6) groups and joint enterprises (see *AUTH 2.9.9G*); and
 - (7) sale of a *body corporate* (see *AUTH 2.9.11G*).

- 2.6.3 G ... The circumstances in which payments are excluded from the definition itself are exhaustively stated in article 5(3) of the *Regulated Activities Order (Accepting deposits)*. In addition, there is a separate exclusion in article 9 of the Order (Sums received in consideration for the issue of debt securities) for ~~sums that are received as consideration for the issue of specified debt securities~~ and another in article 9A (Sums received in exchange for electronic money). *AUTH App 3.2.15G to AUTH App 3.2.19G* contain *guidance* on the exclusion relating to *electronic money*.
- 2.6.4A G ... Further *guidance* is given in *AUTH 2 App 3 (Guidance on the scope of the regulated activity of issuing e-money)*.
- 2.6.27 G Regulated mortgage contracts will be *specified investments* with effect from ~~a future~~ the date ~~nine months following the date on which section 19 of the Act comes into force~~. The Treasury has indicated that it expects this date to be in 2004.
- 2.7.2A G *Guidance* on the *regulated activity of issuing e-money* is given in *AUTH 2 App 3*.
- 2.7.7A G The Treasury has announced that it intends to bring within the scope of regulated activities the arranging of deals in regulated mortgage contracts. It has also announced that it intends to regulate the activities of insurance intermediaries. (The activity of arranging deals in contracts of insurance that are contractually based investments is already a regulated activity under article 25 of the Regulated Activities Order). These changes are expected to take effect in 2004.
- 2.7.11 G The *regulated activities* relating to *sending dematerialised instructions* relate to the operation of the system for electronic transfer of title to ~~certain securities~~ securities or contractually based investments. This is the system maintained under set up by the Uncertificated Securities Regulations 1995-2001 (and currently operated by CREST). ...
- 2.7.16A G The Treasury has announced that it intends to bring within the scope of regulated activities advising a borrower on the merits of his entering into or varying the terms of a regulated mortgage contract. It has also announced that it intends to regulate the sale of insurance by insurance intermediaries. (Advising on contracts of insurance that are contractually based investments is already a regulated activity under article 53 of the Regulated Activities Order). These changes are expected to take effect in 2004.
- 2.7.18 G ... This ~~will be~~ became a *regulated activity* on ~~with effect from~~ 1 January 2002.

- 2.7.20 G Entering into as lender, and administering, a regulated mortgage contract will become *regulated activities* from ~~the date nine months following the date on which section 19 of the Act comes into force~~ a future date. The Treasury has announced that it expects this date to be in 2004. These activities have not been included in Table 1 of *AUTH 2 Ann 2G*.
- 2.7.21 G ...But this is not the case if the underlying activities to which the agreement relates are those of *accepting deposits*, *issuing e-money*, *effecting* or *carrying out contracts of insurance*...
- 2.8.4 G (4) *A company does not deal as principal by issuing ~~certain securities in itself~~ its own shares or share warrants and a person does not deal as principal by issuing his own debentures or debenture warrants.*
- 2.8.6 G (9) *A company's ~~is not carrying on a regulated activity under arrangements for issuing specified securities in itself~~ are excluded from both article 25(1) or (2) of the Regulated Activities Order (Arranging deals in investments) by arranging for the issue of its own shares or share warrants and a person is not doing so by arranging for the issue of his own debentures or debenture warrants.*
- 2.8.9 G Exclusions for the *regulated activity* of *sending dematerialised instructions* apply in relation to certain types of instructions sent in the operation of the system set up by maintained under the Uncertificated Securities Regulations ~~1995-2001~~. ...
- 2.9.1 G (1) ...They have no effect in relation to the separate *regulated activities* of *accepting deposits*, *issuing e-money*, *effecting* or *carrying out contracts of insurance*...
- 2.9.17 G (2) ...The exemptions to the *financial promotion* restrictions made by the Treasury under section 21 of the *Act* (Restrictions on financial promotion) will be relevant to the question of whether those restrictions have been contravened (see separate *guidance on financial promotion* in *AUTH App 1 AUTH App X* ~~[to be added later]~~ (Financial promotion and related activities)).

2 Ann 2 G
2

Table

Table 1 : Regulated Activities [See note 1 to Table 1]

Regulated Activity

Specified Investment

in relation to which the regulated activity

(in the corresponding section of column one) may be carried on

...
(k) sending dematerialised instructions (article 45(1))
...
security and contractually based investment
[Expanded in Table 3]

Note 1...
Permission to carry on the activity of agreeing to carry on a regulated activity will be given automatically by the FSA in relation to those other regulated activities for which an applicant is given permission (other than those activities detailed in articles 5, 9B, 10, 51 and 52 detailed above).

- App1.1.2 G (1) to outline the restriction on financial promotion in section 21 of the *Act* (~~*Restrictions on financial promotion*~~ Restrictions on financial promotion) and the main exemptions from this restriction; and
...
- App 1.7.2 G ...but find that the restriction in section 21 applies to his communications. It should also be noted that e-money is not a controlled investment. This means that the restriction in section 21 does not apply to the communication of an invitation or inducement that concerns e-money. This is unless the communication is a financial promotion for some other reason.
- App 1.8.3 G ...For example, the ~~Electronic Commerce Directive~~ E-Commerce Directive (2000/31/EC) will, with limited exceptions, prevent the *United Kingdom* from imposing restrictions on incoming *financial promotions* in information society services. The Treasury has given effect to this through changes made in the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (Electronic Commerce Directive) Order 2002 (SI 2002/2157). This is explained more fully in AUTH App 1.12.38G. ~~The Treasury has stated in its consultative document 'Implementation of the E-Commerce Directive in Financial Services : a Second Consultation document' issued in March 2002 that it intends to amend the Financial Promotion Order to give effect to this.~~ Other potentially relevant directives include the Television Without Frontiers Directive (89/552/EEC)...
- App 1.9.5 G (2) The Financial Services and Markets Act 2000 (Miscellaneous Provisions) Order 2001 (SI 2001/3650); and
(3) The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment No2) Order 2001 (SI 2001/3800);

- (4) The Financial Services and Markets Act 2000 (Financial Promotion and Miscellaneous Amendments) Order 2002 (SI 2002/1310); and
- (5) The Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (Electronic Commerce Directive) Order 2002 (SI 2002/2157).

A consolidated version of the *Financial Promotion Order* is available on the Treasury website www.hm-treasury.gov.uk under 'consultations/ Documents/Financial Services/Regulating Financial Services/FSMA/ Secondary legislation ordered by date of laying.'

App 1.10.3 G (2) If the interactive dialogue takes place by means of the exchange of letters or e-mails or in a publication, the communication will be deemed to be non-real time. ~~(that is, a In this case, publications include newspapers, journals, magazines or other periodical publications, a websites or similar systems for the electronic display of information, a television or radio programmes and a teletext services) the communication will be deemed to be non-real time.~~

App 1.12.1 G ... These are summarised in *AUTH* App 1.12.2G to ~~AUTH App 1.12.37G~~ *AUTH* App 1.12.38G.

App 1.12.4 G The exemption ~~presently~~ applies whether or not the *financial promotion* is made from the *United Kingdom*. However, there is the exception that, if it is an *unsolicited real time financial promotion*, it must be made from a place outside the *United Kingdom* and be for the purposes of a business carried on entirely outside the *United Kingdom*. ~~The exemption as currently drafted conflicts with the requirements of the Electronic Commerce Directive (2000/31/EEC). The Treasury has indicated in its consultative document 'Implementation of the E-Commerce Directive in Financial Services: A Second Consultative Document' issued in March 2002 that it intends to amend the *Financial Promotion Order*. The Treasury plans to ensure that section 21 does not restrict persons in other *EEA States* who wish to make *financial promotions* in the *United Kingdom* through an information society service. The Treasury document also states that amendments will be made to ensure that section 21 applies to outgoing *financial promotions* of that kind, in order to ensure that the principle of Home State regulation of information society services is sustained. To give effect to the principle of *country of origin* regulation of *information society services* as required by the *E-Commerce Directive*, article 12(7) of the *Financial Promotion Order* prevents the exemption applying to an *outgoing electronic commerce communication*.~~

App 1.12.11G This exemption applies only to a real time financial promotions which are that is made with a view to or for the purposes of introducing persons the recipient to certain kinds of person. These are an authorised persons who carry on the controlled activity to which the financial promotion relates, or exempt persons where the financial promotion relates to whose authorisation or exemption covers the a controlled activity to which the financial promotion relates that is also a regulated activity in relation to which he is an exempt person. This is subject ...

Mere conduits (articles 18 and 18A)

App 1.12.18 G ...*AUTH* App 1.6.5G explains that such persons may not be regarded as communicating a financial promotion simply because they have distributed it. Article 18 (Mere conduits) does not apply where the financial promotion is an outgoing electronic commerce communication. A person acting as a mere conduit for financial promotions of this kind will, however, be able to use article 18A (Outgoing electronic commerce communications : mere conduits, caching and hosting). Article 18A is not subject to the conditions that apply to other forms of mere conduit (as referred to in *AUTH* App 1.12.19G and *AUTH* App 1.12.20G). However, it does require compliance with the conditions in articles 12(1), 13(1) and 14(1) of the *E-Commerce Directive* that relate to the liability of intermediary service providers.

App 1.12.27 G (2) ...
(b) the Programme Guide of the Radio Authority; or

(c) the Producers' Guidelines issued by the British Broadcasting Corporation ; or

(d) the Programme Code of the Independent Television Commission.

App 1.12.32 G Promotion broadcast by company director etc (article 20A)

(Title)

Article 20A...

Incoming electronic commerce communications (article 20B)

App 1.12.38 G Article 20B gives effect to the provisions of the *E- Commerce Directive* by exempting incoming electronic commerce communications. However, article 20B does not apply to the following communications:

(1) an advertisement by the operator of a UCITS of units in that scheme;

(2) An invitation or inducement to enter into a *contract of insurance* where :

(a) it is made by an undertaking which has received official authorisation in line with article 6 of the *First Life Directive* or the *First Non-life Directive*; and

(b) the insurance falls within the scope of any of the *Insurance Directives*; or

(3) An unsolicited communication made by electronic mail.

For the purposes of (3), a communication is unsolicited unless it is made in response to an express request from its recipient.

App 1.14.22 G ...throughout the financial year before the date of the certificate. Where the *financial promotion* is an *outgoing electronic commerce communication*, the earnings or net assets may be of an equivalent amount in another currency. ~~In order to~~ To be current...

App 1.14.27 G ...the description of investment to which the *financial promotion* relates. Where the *financial promotion* is an *outgoing electronic commerce communication*, the certificate may be signed by a *person* who is entitled, under the law of an *EEA State* other than the *United Kingdom*, to carry on *regulated activities* in that *EEA State*. The FSA considers that a 'description of investment'...

App 1.14.31 G (4) ...
(b) any *person* considering investing in the *company* should regard his subscription as helping the *company* to meet its non-financial objectives and only secondarily, if at all, as an investment.

Where the *financial promotion* is an *outgoing electronic commerce communication*, the reference in (3) to an *authorised person* includes a *person* who is entitled, under the law of an *EEA State* other than the *United Kingdom*, to carry on *regulated activities* in that *EEA State*.

App 1.20.3 G The Treasury has made an order under section 238(6). This is the Financial Services and Markets Act 2000 (Promotion of Collective Investment Services) (Exemptions) Order 2001 (as amended by article 3 of the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2001, SI 2001/2633 and by articles 7 to 10 of the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) (Electronic Commerce Directive) Order 2002, SI 2002/2157)('the CIS Financial Promotion Order'). The overall effect of the CIS Financial Promotion Order is to ensure that *authorised persons* ...

App 1.21.13 G ... This includes *recognised investment exchanges* and *EEA regulated markets* ~~which that~~ are *exempt persons* under article 36 of the *Exemption Order*, together with various other markets (including OFEX(UK)). The *financial promotion* must...

App 1.21.16 G (1) which, if it were to be included in a prospectus issued in line with Part II of the Public Offers of Securities Regulations 1995 (or where it is an *outgoing electronic commerce communication*, provisions corresponding to that Part under the law of another *EEA State*), would be required to be *communicated* by those Regulations (or other provisions); and
...

App 1.29.3 G ... advice for the purposes of ~~section~~ article 53. This is because ...

App 1.36.6 G Table Application of Exemptions to Forms of Promotions

Financial Promotion Order		Applies to		
Article No	Title and AUTH App 1 reference (where applicable)	Unsolicited real time	Solicited real time	Non-real time (solicited or unsolicited)
18	Mere conduits (1.12.18G)	*	*	*
<u>18A</u>	<u>Outgoing electronic commerce communications: mere conduits, caching and hosting</u>	<u>*</u>	<u>*</u>	<u>*</u>
19	Investment professionals (1.12.21G and 1.21.5G)	*	*	*
20	Communications by journalists (1.12.23G)			*
20A	Promotion broadcast by company director etc (1.12.23G and 1.21.6G)	*	*	*

<u>20B</u>	<u>Incoming electronic commerce communications (1.12.38G)</u>	<u>*</u>	<u>*</u>	<u>*</u>
22	Deposits : non-real time communications (1.13)			*

App 3 (Title)

Guidance on the scope of the ~~regulatory~~ regulated activity of issuing e-money

Annex C

Amendments to the Glossary

Insert the following new definitions in the appropriate alphabetical position:

<i>electronic commerce communication</i>	(in accordance with article 6 of the <i>Financial Promotion Order</i>) a communication, the making of which constitutes the provision of an <i>information society service</i> .
<i>incoming electronic commerce communication</i>	(in accordance with article 6 of the <i>Financial Promotion Order</i>) an <i>electronic commerce communication</i> made from an <i>establishment</i> in an <i>EEA State</i> other than the <i>United Kingdom</i> .
<i>outgoing electronic commerce communication</i>	(in accordance with article 6 of the <i>Financial Promotion Order</i>) an <i>electronic commerce communication</i> made from an <i>establishment</i> in the <i>United Kingdom</i> to a <i>person</i> in an <i>EEA State</i> other than the <i>United Kingdom</i> .