8th June 2005

CESR
11-13 avenue de Friedland
75008 PARIS
FRANCE

Dear Sir

CESR's Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS (CESR/05-064b March 2005)

M&G welcome the opportunity to respond to the proposed advice to the European Commission set out in the consultation paper.

M&G has been looking after savers since 1931 and now has £11bn of retail funds under management and more than 750,000 investors. Since May 1999 M&G has been part of the Prudential Group and now has responsibility for the management of all of Prudential's assets in the UK and Europe. Total assets managed by M&G are thus some £140bn covering Institutional, Retail and Life and Pension clients.

For retail clients we offer a comprehensive range of UCITS funds under both the Prudential and M&G brands. In 2001 M&G launched its International Business (M&G International Investments) and is now a major distributor of UK UCITS within the EU. In the year to 31st December 2004 cumulative sales in Europe (ex-UK) amounted to Euros 611.0m and assets under management of Euros 551.9m.

General

It has been difficult to respond to the consultation document in any definitive way because its purpose is not entirely clear. This is demonstrated in the lack of consistency in the text style (the application of principles in some cases and detailed advice in others). Our understanding from the published document was that the mandate was for CESR (acting within the narrow confines of comitology) to offer advice on the clarification of definitions. However, the paper provides a mixture of some limited advice on definitions and more text on guidance issues.
The explanation behind this approach was made public by CESR at the open hearing held on 9 May 2005 when it was stated that CESR wished to take a broader approach to the question of the scope of the definitions provided for by the UCITS directive. We therefore appear to be in consultation over two, albeit related, issues:

- Classification of existing definitions (to allow UCITS III to operate uniformly across the EU) and;

- Proposals for further Level 3 work on supervisory convergence.

M&G take the view that it would have been more constructive if the necessary legal analysis, which is needed to separate these issues, could have been done in advance of this consultation. This would illustrate what is legally permissible in terms of the application of existing definitions and would highlight those areas which remain to be resolved possibly through additional level 3 work which might be necessary to ensure a uniform application of the directive.

In general, we would argue that the advice as currently drafted represents unresolved issues of supervisory convergence and not matters that should have the effect of changing the provisions of the existing Directives (e.g. in posing new obligations on market operators, supervisory authorities and Member States).

In view of these concerns we have restricted our response to the following specific comments.

Detailed Comments

The proposed advice, if implemented as it stands, appears to claw back some agreed investment freedom to pre-UCITS III provisions in the case of the treatment of transferable securities and closed-end schemes. This would materially alter the scope of the original directive.

1. Transferable securities (Box 1)

The proposed re-definition of transferable securities would:

a) Effectively preclude the existing UCITS provision that allows up to 10% of the fund to be invested in "unapproved" (unlisted) securities because both transferability and 'other factors' must be taken into account in order to determine eligibility. We seek further clarification as to whether the intention of the advice is to restrict the freedom as set out in UCITS Art 19 (2) (a).

b) Place additional burdens on fund managers when selecting appropriate stocks when this should be left to their professional investment analysis and portfolio management practices (as overseen by the national competent authorities). Diversifying risk and return, together with liquidity, remain the driving principles on which stock selection, of any kind, is made for a UCITS and further prescription in the form of selection criteria is self-defeating.

We understand from comments made by CESR at the open hearing that the eligibility criteria should be considered as 'cumulative' and therefore <u>all</u> conditions including these additional ones will have to be met.

2. Closed-end funds (Box 2)

CESRs proposals take a too restrictive approach to the acquisition of closed end funds by UCITS because:

a. Structured products (including closed-ended funds) are legitimate ways of creating liquidity in otherwise illiquid assets (eg property) and provide greater opportunity for diversification (risk and return). M&G take the view that listed closed-funds should continue to be classified as transferable securities under Art 1(8) of UCITS with no further look-through requirements other than those which would naturally form the basis of stock selection for any transferable security.

b. For a listed investment company, the notion that there is generally a correlation between the underlying of the product and liquidity in the asset itself is an oversimplification. What is important for portfolio management is liquidity at the level of the share not the underlying asset. This approach also enables fund managers to introduce liquidity into areas where there is a lack of liquidity.

c. The terms “closed ended fund” and “transferable security” are not synonymous in all jurisdictions (a closed-ended unit trust under Financial Services Markets Act - FSMA - is defined as a collective investment scheme - CIS).

d. In (c) how would fund managers treat trading companies which specialise in property investment (companies aimed at maximising the returns from their investment portfolios)? Would they fall within the definition of a "closed fund"?

e. Investing in listed closed end funds for the purposes of "circumventing" the investment limits for UCITS would not ordinarily form the basis of prudential portfolio management and stock selection. A fund must be managed within its investment objectives and if these are, for example, the generation of growth and income from a portfolio of investment trusts (companies) then diversification potential should be absolute (within the guiding principles of a UCITS in terms of liquidity and risk diversification).

Conclusion

M&G support the general approach described by CESR at the open hearing. That it is to be principle based and to seek to determine the responsibilities of investment managers when determining what constitutes eligible assets. Therefore, there should not be prescriptive text listing every different asset which is considered eligible as such a list would become quickly outdated.

In terms of the primacy of **investor protection,** the increased responsibilities have been set out in the UCITS directive. The industry accepted that any broadening of investment powers made it necessary for UCITS III to introduce more sophisticated risk management arrangements and additional requirements for disclosures to potential investors. This is particularly detailed in the area of derivative use (see for instance how the UK industry has responded to its increased responsibilities[1]).

However, we believe that the proposed advice if adopted would have the effect of stifling innovation and reducing a fund manager's ability to diversify a fund both in terms of risk and opportunity for the benefit of investors. It represents an increase in the administrative burden and reduces the freedoms currently set out in the UCITS legislation. As such it would appear to go beyond what we understand the delegated powers permit.

CESR needs to consider whether problems with uniform application of the directive lie more at the level of implementation rather than trying to add obligations to the existing product definitions.

We would be very happy to discuss any of these issues with CESR in more detail.

Yours faithfully

Gary Shaughnessy
Chief Executive, UK Retail

[1] **RISK MANAGEMENT PROCESS: GUIDELINES FOR UCITS MANAGERS. July 2003**

As a response to the Product Directive and its implementation in the United Kingdom and in particular to the requirement that authorised fund managers "must use a risk management process enabling it to monitor and measure as frequently as appropriate the risk of a scheme's derivative positions and their contribution to the overall risk profile of the scheme", the Investment Management Association (IMA), the Depositary and Trustee Association (DATA) and the Futures and Options Association (FOA), established a joint working party to draft Guidelines to assist UCITS managers in developing appropriate mechanisms for managing the various risks generated by their use of derivatives.