

Legal & General Group's response to CESR'S advice on possible implementing measures of the Directive 2004/39/EC on Markets on Financial Instruments.

2nd Set of Mandates

Legal & General Plc is one of UK's top 50 FTSE companies. The core business of the group is the provision of a broad range of savings and protection products for individuals through our major retail channels. This product range includes term assurance, mortgage protection, household insurance, private medical insurance, saving for retirement, annuities, unit trusts and ISAs. Our corporate business (pensions, group life assurance, and group income protection) complements our individual business, drawing on our fund management, actuarial and administrative skills. We have over 5.2 million customers and employ over 8,500 staff.

Legal & General Investment Management Limited (LGIM) is a subsidiary of Legal & General Plc and provides fund management expertise to the Group's retail and corporate businesses as well as to trustees of pension schemes and other institutional clients. Total funds under management were £162 billion at 31 December 2004, of which pension fund assets exceeded £103 billion, underlining Legal & General's position as a major UK investment house and a leading provider of index tracking services.

Legal & General's primary focus is on UK business, but the Group has operations in the USA, the Netherlands and France. Some cross-border sales are also made in Germany. Our rapidly growing business in the USA is now the country's second largest brokerage channel writer of term assurance for high net worth customers. Business is transacted through two subsidiaries - Banner Life and William Penn. In the Netherlands, we concentrate on both annual and single premium business for higher income households distributed via independent intermediaries and through banks. Our French business sells primarily single premium investment based products through a direct sales organisation.

Please find below our responses in respect of your call for comment and your specific questions on your advice on Possible Implementing Measures of the second set of mandates from Directive 2004/39/EC on Markets in Financial Instruments. Please note that LGIM is continuing to contribute actively to the IMA and BBA working group that have also responded to this consultation.

Executive Summary

As we mentioned in our response to the first consultation on the first set of mandates, we reiterate that CESR should, in addressing the needs of retail and professional clients, clearly distinguish between these client types when drafting technical advice and therefore defining the appropriate level of regulatory intervention. It is important that the advice is proportionate to the relative protection needs for the client type. Moreover, it is important that professional clients are not placed at a commercial or competitive disadvantage by onerous and superfluous regulatory obligations that affect efficiency, liquidity or timely entry to markets.

SECTION I - DEFINITIONS

LGIM has no specific comments to make on this section.

SECTION II - INTERMEDIARIES

Definition of “Investment Advice” (Art. 4(1) No.4)

Question 1.1: Do you agree that advice on services, such as recommendation to use a particular broker, fund manager or custodian, should not be covered?

Article 4(1)(4) of the MiFID Directive defines investment advice in relation to transactions relating to financial instruments and does not refer to services. Therefore, we agree that advice on such services should not be covered.

Question 1.2: Do you agree with the approach that a personal recommendation has to be held out as being suited to, or based on a consideration of, the client’s personal situation or do you consider this criterion to be unnecessary or ambiguous and would like to refer to the bilateral nature of the relationships and bilateral contacts between the firm and its clients? In the latter case, which criteria would you use to differentiate between a “personal recommendation” or a “general recommendation” or a “marketing communication”?

It is our opinion that a personal recommendation has to be held out as being suited to, or based on a consideration of, the client’s personal situation.

We recommend to CESR that the definition of personal recommendation does not include implicit as well as explicit recommendations. We have concern that should the definition include such recommendations and as disclaimers cannot be relied on, clients could consider all communication regarding a specific financial instrument to be an implicit recommendation. The implications of this could have a detrimental effect on the industry, as firms may be less inclined to issue general recommendations or marketing communications as the firm maybe in no position to assess the individual circumstances of the customer.

Question 1.3: Do you think it is reasonable to restrict “investment advice” to recommendations of specific financial instruments or is it necessary to cover generic information including financial planning and asset allocation services for financial instruments?

We consider it reasonable to restrict investment advice to recommendations of specific financial instruments. Therefore, investment advice should not include generic advice. For example, advice on asset allocation should not be captured under MiFID. For clarity, we note that should a transaction into a specific financial instrument be entered into following such advice, then it is likely to have occurred either:

- a) as the consequence of subsequent investment advice relating specifically to that transaction and therefore covered by MiFID at this stage or*
- b) as the result of a separate series of actions by the recipient of the generic advice to identify and select specific securities in which to carry out a transaction, for which the individual concerned should take responsibility if acting without advice.*

List of Financial Instruments (Art. 4 – Annex 1 Section C)

Please note that no firm in the L&G group of firms undertakes trading in commodities.

Question 2.1: Should “commodities” for this purpose be limited to goods?

Yes, we believe that the category of commodities should be restricted to deliverable and fungible goods. We are of the opinion that this includes energy supplies, thus bringing electricity contracts into this definition.

Question 2.2: Alternatively, should an approach be taken that permits rights or property specifically mentioned in C (10) and other intangibles to be treated as “commodities” as well?

No, such intangible goods should not be treated as commodities.

Question 2.3: Should derivative instruments based on telecommunications bandwidth to be considered to be within the scope of the Directive?

Our opinion is that as it is possible for telecommunication bandwidth to be fungible and deliverable, then it should be considered to be a commodity and therefore, in the scope of the Directive.

Question 2.4: If it should be considered within the scope of the Directive, should it be considered to be within the scope of paragraph C (7) or of paragraph C (10) of Annex I?

Our view is that they should be considered to be in the scope of paragraph C (10) of Annex I.

Question 2.5: If the definition of “commodities” is restricted to goods, should a requirement be imposed that there must be a liquid market in the underlying?

Our opinion is that adding a requirement for the market in the underlying to be liquid would be unduly restrictive and therefore, we recommend that such a requirement is not applied.

Question 2.6: If not, should a requirement be imposed that, in addition to being capable of delivery, the underlying must be capable of being traded and if so, should there be a requirement for a liquid market?

Our opinion is that there should be no requirement for the underlying to be tradable.

Question 2.7: Should there be an initial filter to exclude contracts which are likely to be spot contracts? If so, do you agree with the proposed approach of excluding contracts whose settlement period does not exceed the lesser of two business days and the generally accepted settlement period in the relevant market?

We agree that there should be an initial filter so that transactions undertaken for a commercial purpose are excluded. However, we disagree with the proposed approach in that CESR should consider only excluding contract where the settlement period is the “greater” of the two periods, rather than the “lesser”.

Question 2.8: Should the status of the parties to the contract only be relevant for determining whether the exemptions in Articles 2(1)(i) and (k) or should it also be taken into consideration as an indicative factor for determining whether there is a commodity derivative as opposed to a commercial contract for the supply of commodities?

Our opinion is that the status of the parties should also be taken into account as an indicative factor in order to ensure that the Directive covers only appropriate persons.

Question 2.9: Should commercial merchants be required to rely on the intention to deliver test or should the producer and user indicating factor apply to them as well? If so, how can a commercial merchant be differentiated from a speculator?

Our opinion is that the producer and user indicating factor could be taken into account in order to differentiate between commercial merchants and speculators, but it is the intention to deliver test that is the principle factor.

Question 2.10: Do you agree with an approach under which the status of the contract for both parties is based on a consideration of the status and/or intent of either of the parties?

We consider that the statuses of both parties should be taken into consideration. However, each party cannot be responsible for the others regulatory status and therefore, CESR should ensure that their advice clearly states that they should only be responsible for the consideration of their own.

Question 2.11: If both elements of (2) are present should this be conclusive or indicative? If indicative, if only one is present is that still an indicator?

Our opinion is that we consider the presence of both elements to be conclusive. Should only one be present, then it is still an indicator.

General Obligation to act fairly, honestly and professionally and in accordance with the best interests of the client (Art. 19.1)

Question 3.1: Do you agree with the proposals on portfolio management? Should any other issues be addressed under Article 19(1)?

We are pleased that CESR's proposal on Article 19(1) only applies to retail investors. However, we request that CESR provides clarity over some terms used in the provisions. Currently in the UK, portfolio management for a client would be undertaken in accordance with the client agreement. This agreement would include the client's investment objectives. In BOX 7, in addition to the client agreement, CESR makes reference to "investment strategies" and "management objectives". We therefore recommend that CESR revises their draft advice to refer only to the client agreement or to define clearly these terms.

Furthermore, the second provision in BOX 7, requires that investment firms' transactions are exclusively motivated by the interests of retail clients. We interpret this drafting as meaning where a firm undertakes portfolio management for both retail and professional customers, it must put the retail investors' interests over the interests of professional clients. We do not believe this is appropriate and recommend that CESR reconsiders the implications of their draft wording.

Suitability test (Art. 19.4))

Question 4.1: Do market participants think that adequate investment advice or portfolio management service is still possible on the basis of the assumption that the client has no knowledge and experience, the assets provided by the client are his only liquid assets and/or the financial instruments envisaged have the lowest level of risk if the client is not able to or refuses to provide any information either on his knowledge and experience, his financial situation or its investment objectives? Or would this assumption give a reasonable observer of the type of the client or potential client the impression that the recommendation is not suited to, or based on a consideration of his personal circumstances?

In answer to the first part of your question, we believe that adequate investment advice or portfolio management service can be given where the client as no established knowledge or experience, the assets provided by the client are his only liquid assets and/or the financial instruments envisaged have the lowest level of risk.

General Comments:

We ask that CESR clarifies that BOX 8 paragraph 1 can be interpreted as where a product is suitable for someone with no investment knowledge or experience, no information on this subject needs to be collated.

We feel strongly that CESR should differentiate between retail and professional clients. Therefore, the level of information necessary to be obtained by an investment firm prior to undertaking investment services will vary. If it can be ascertained that the client is professional, then the information provided in accordance with BOX 8 paragraph 2 b) should be considered to be adequate and therefore the requirements of Article 19(4) have been met. However, where it is not possible to assess categorically a client as professional, they should be treated as a non-professional client.

BOX 8 paragraph 4 appears to place the onus on the firm to ensure that information given by a client is accurate and complete. We believe that this place an inappropriate and impractical requirement on firms. Therefore, we request that CESR reconsiders their advice on this matter.

We do acknowledge that advice should not be given on out of date information .BOX 8 paragraph 5 requires a firm that provides portfolio management to keep their client profile under review. Portfolio management is undertaken in accordance with the formal, written agreement made with the client. For firms to maintain up to date, detailed knowledge of their clients would require a significant increase in client communication. Furthermore, we hold concern that should a client not be prepared to provide ongoing information, then firms may have to cease providing such services, at the likely detriment to the client. We suggest that CESR recognises that firms can update the information they hold in various ways. For example, firms could provide customers with a summary of the information they hold in relation to the advice they intend to give and request the client provide further information should there be a significant change in their relevant circumstances. We believe that the effect of this CESR advice could be unduly restrictive and create significant costs.

Furthermore, BOX 8 paragraph 5 states that a firm that provides investment advice or acts as a portfolio manager for a retail client on a continuing basis, must take reasonable care to keep the client profile under review. This includes taking into consideration any development of the relationship between the investment firm and the client. We are concerned that this requirement would require information to be passed between different entities in the a group, which is not always operationally or legally feasible (e.g., due to the Data Protection Act), where a range of different activities is carried out across a number of divisions of one firm or entities within a group.

Appropriateness Test (Art. 19(5))

General Comments:

We are pleased that CESR's proposal on Article 19(5) only applies to retail investors.

Article 19(5) clearly places lesser requirements on the firm that those of the suitability test. However, BOX 9 paragraph 4 appears to place the onus on the firm to ensure that information given by a client is accurate and complete. We believe that this place an inappropriate and impractical requirement on firms. Therefore, we request that CESR reconsiders their advice on this matter.

We recommend that BOX 9 Paragraph 5 is reconsidered. This advice requires a customer to assess their knowledge on an ongoing basis and different customers are most likely to apply this differently. Furthermore, the application of requirement is seemingly impossible to ensure. Additionally, should the client gain knowledge, it is uncertain that their assessment of risk would be altered and therefore, we question the benefit of this advice.

Execution only (Art. 19 (6))

Question 5.1: In determining criteria, should CESR pay more attention to the legal categorisation or the economic effect of the financial instrument?

We believe that more attention should be paid to the economic effect of financial instruments than their legal categorisation as it is this that impacts investor protection. We would like to remind CESR that it is the risk of the product that should be relevant, not, in isolation, its complexity.

Question 5.2: Do you think that it is reasonable to assume that a service is not provided “at the initiative of the client” if undue influence by or on behalf of the investment firm impairs the client’s or the potential client’s freedom of choice or is likely to significantly limit the client’s or potential client’s ability to make an informed decision? Alternatively, do you think that the consideration of this overarching principle is not necessary because the use of undue influence could be subject to the general regulation under the UCPD and that CESR should base its advice more strictly on Recital 30 or refer entirely to this Recital advising the Commission that it is unnecessary to adopt Level 2 measures in this area?

We do not consider it necessary for CESR to advise the Commission on Level 2 measures as Recital 30 is sufficiently clear.

Transactions executed with eligible counterparties (Art. 24)

Question 6.1: Do market participants agree that the quantitative thresholds for undertakings to request treatment as eligible counterparties should be the same as the thresholds for professional clients? Please provide the reasons for your position?

Yes, we consider this approach to be both appropriate and practical. We agree that professional customers should be able to opt-up to eligible counterparty status, should they meet the criteria.

SECTION III - MARKETS

Display of client limit orders (Art. 22.2)

Question 7.1: In your view, what types of arrangements other than RMs and MTFs could be considered as complying with Article 22.2?

We recommend that CESR considers that where a firm has published such order on their website, the requirements of Article 22.2 should be considered to have been met.

Question 7.2: Do you consider the proposal on publishing the client limit order in a quote-driven system appropriate?

We believed that the requirement to publish client limit orders using “...appropriate venues that achieves similar results” places an imposition on firms to display such orders on an exchange. This may be costly and difficult to implement, especially as there is an “immediate” requirement for disclosure and could be anti-competitive.

Pre-trade transparency – Systematic Internalisers (Art. 4 and 27)

Please note that LGIM does not operate a trading book.

1. Definition of Systematic Internaliser

Question 8.1: Do consultees agree with criteria for determining systematic internaliser? Should additional/other criteria be used and if so, what should these be?

We feel that the definition from the Level 1 text is very wide and therefore, difficult to apply. We suggest that CESR provides guidance on its interpretation of the expressions “organised”, “frequent” and “systematic”. It could be argued that most firms operate in an organised and systematic way, leaving only the criteria of frequency to ascertain whether a firm is a systematic internaliser. Moreover, the detail given in the draft Level 2 advice does not seem to provide further clarification. For example, we suggest that that no firms would undertake such an activity if it were no deliberate. Therefore, we suggest that the CESR reconsiders its interpretation of systematic internalisers. The criteria should be used to assess whether a firm does undertake such an activity, rather than proving that they do not. In respect of determining whether a firm is a systematic internaliser, we suggest that CESR bases its advice on whether client orders are automatically executed from the firm’s propriety book.

Question 8.2: Should the criteria be fulfilled collectively or used separately?

We recommend that CESR ensures that whatever the criteria are, they are sufficiently clear and interpretable to ensure their consistent application across the EU. Whether they should be fulfilled collectively or separately will depend on the criteria and any quantitative amount assigned to them.

Question 8.3: Should CESR set criteria for the term “frequent”? If so, do consultees support the setting of numeric criteria or do they believe that a more flexible approach would be useful? What should these criteria be?

We feel that it is right for guidance to be given as to the term frequent in order that only appropriate firms are identified and to ensure that the criteria are consistently applied across the EU. However, it is important that the guidance is flexible in order to ensure it is not too restrictive and remains current.

Question 8.4: Do you agree with the proposed obligation to disclose the intention to cease systematic internalisation? Should CESR propose more detailed proposals on this and if so, what should be the appropriate notice period?

We agree that this should be disclosed. We think a little further guidance from CESR would be useful to ensure consistency and recommend that the notice period should be aligned to the underlying financial instruments.

2. Scope of the Rule (Art. 27.1)

Question 8.5: Should liquidity be measured on an EU-wide or national basis?

We believe that liquidity should be measured on an EU-wide basis. This is to ensure that there is consistency. By measuring liquidity on a national basis, the inherent different levels of liquidity across the EU markets would mean that some member states would categorise a stock as being liquid whilst in others, it would not meet the criteria, and so be categorised as illiquid.

Question 8.6: Do consultees have a preference in favour of setting pre-determined criteria or using a proxy approach?

We think that pre-determined criteria may be the most practical approach. We fully support the recommendation made by the British Bankers Association to this question in their response and duly refer CESR to their response to this Consultation Paper

Question 8.7: Regarding the different criteria described above, do consultees agree with the analysis of each of them, and are there other methods which should be evaluated?

We agree and do not see that any other methods need evaluating.

Question 8.8: Is it possible and/or appropriate to use for the purposes of Article 27, a combination of absolute and relative criteria to define shares as liquid?

We do consider this to be possible and could be appropriate if certain member states have no home based stocks in an EU-wide index. For example, irrespective of whether they met the liquidity requirements, CESR Level 2 advice could suggest that a set and pre-defined number of the most liquid stock from each member state are included in the list of liquid stocks, thereby ensuring each member state has representation in the liquidity list.

Question 8.9: Do consultees consider the proposed figures (i.e. 480 trades per day and 95% of total trading) as appropriate? If not, and where no figures are suggested what are the appropriate figures in your opinion?

We do not feel in a position to make an assessment of the appropriateness of these figures.

Question 8.10: Do consultees agree with the analysis of the relative merits and drawbacks of using proxies such as indices?

We have no specific comments to make.

Question 8.11: Which criteria would best accommodate the needs of different markets within the EU?

We have no specific comments to make.

3. The determination of the Standard Market Size/Classes of shares (Art. 27.1 and 27.2)

Question 9.1: Do you agree with CESR's approach of proposing a unified block regime for the relevant provisions in the Directive or do you see reasons why a differentiation between Art 27 MiFID on the one hand and Art.29, 30, 44, 45 MiFID on the other hand would be advisable?

We agree that in the interest of consistency and simplicity, CESR uses a unified block regime.

Question 9.2: Would you consider a large number of SMS classes, each comprising a relatively small bandwidth of arithmetic average value of orders executed, as problematic for systematic internalisers?

We believe that either a very small or a very large number of SMS classes could be problematic.

Question 9.3: In your opinion, would it be more appropriate to fix the SMS as monetary value or convert it into number of shares?

Our opinion is that the SMS should be converted into a number shares to take into account moving share prices.

Question 9.4: Do you consider subsequent annual revisions of the grouping of shares as sufficient or would you prefer them to be more frequent? Should CESR make more concrete proposals on revision? In particular, should the time of revisions be fixed a level 2?

Annual revisions seem reasonable. CESR should clearly detail the process of revisions. CESR should not only define the frequency, but also the date and time on which they should take place to ensure consistency across the EU.

Question 9.5: Do you support the determination of an initial SMS by grouping the share into a class, once a newly issued share is traded for three months, or do you consider it reasonable to fix an initial SMS from the first day of trading of a share by using a proxy based on peer stocks?

We agree with this. Then the initial SMS could be reviewed after a defined period.

Question 9.6: Do you consider a two week period from publication as sufficient for systematic internalisers to adapt to new SMSs?

We consider that this is too rigid and CESR should take into account the share and market on which it is traded.

Question 9.7: Do you agree on the proposal on publication of the classification of shares? Would you prefer the establishment of a single contact point (at level 2)?

We believe that it would be benefit to the pan-European market to have this information in one place, such as the CESR website. We also consider that national regulators should disclose the information on the classification of shares.

4. Obligations of the Systematic Internaliser

Question 10.1: Do consultees consider that there might be specific regulatory issues and specific provisions needed where a systematic internaliser is the trading venue with the largest turnover in a particular share falling within the scope of Article 27?

We have not identified any specific regulatory issues or specific provisions for such firms.

Question 10.2: Do consultees agree that the availability of quotes during 100% of normal trading hours of the firm is a reasonable and workable requirement for “on a continuous basis”?

CESR should consider the different time zones and public holidays across the EU and how this affects the above requirements.

Question 10.3: Do consultees think that publication of quotes solely on the firm’s own website meets the “easily accessible test”?

Yes, agree that this meets the easily accessible test.

Question 10.4: Do you agree with the proposed general criteria for determining when a price or prices reflect market conditions or do you think that more specific criteria should be added? In the latter case; which criteria do you think should be added?

We agree with this qualitative approach.

Question 10.5: Do you prefer either of the criteria defining exceptional market conditions, and should those criteria be supplemented by an open list of exceptional market conditions?

We recommend that CESR provides example of conditions it considers to be exceptional.

Question 10.6: Are there exceptional market circumstances where a systematic internaliser should be able to withdraw its quotes even though a trading suspension has not been called by the regulated market. In the latter case, which market conditions should be added to an open list?

We agree that firms should be able to withdraw their quotes due to exceptional circumstances without a trading suspension being made by a regulated market.

Question 10.7: Do you agree that the proposed approach to the updating of quotes is acceptable or would you prefer more specific criteria? In the latter case, which criteria should be added?

We agree with CESR's draft Level 2 advice on the updating of quotes.

Handling of client orders and executing the orders?

Question 11.1: Do consultees agree that it is unnecessary for CESR to provide additional advice in respect of the handling of client orders where a systematic internaliser publishes multiple quotes?

We believe that Article 22 placed sufficient obligations on firms and therefore, CESR does not need to provide further advice.

Question 11.2: Would there be any benefit to CESR making more detailed recommendations concerning how a firm should set the number and/or volume of orders that represents the norm? If so, what form should they take?

We do not consider it necessary for CESR to make recommendations that are more detailed on this matter.

Question 11.3: Do consultees agree with the definition of a transaction where execution in several securities is part of one transaction? In particular, is there a need to specify a minimum number of securities and if so, what should the number be?

We agree with the definition but do not feel that it is either necessary or appropriate to specify a minimum number of securities that make up a portfolio trade.

Question 11.4: Do consultees agree with the approach to "orders subject to conditions other than current market price"?

CESR's approach seems reasonable.

Question 11.5: Should the size be based on an EU-wide criteria or would national approaches be preferred?

We agree that the EU-wide approach is preferable.

Question 11.6: Do consultees prefer having a fixed threshold for all shares, or should the size be linked to the grouping of shares (and subsequently to the SMS of each class) or to some other factor? If so, which?

For reasons of practicality, we believe that the order size should be related to the classes of shares. This should be a fixed threshold, with periodic reviews.

Question 11.7: If a threshold is set, how should it reflect the different sizes around the EU, i.e. should it be the highest retail size, the lowest or something in between?

Our opinion is that it should be aligned to the average retail size across the EU.