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

Part II

Legal & General Investment Management Limited (LGIM) is a UK-based investment management firm. It is a subsidiary of Legal & General Plc, a large UK-quoted insurance company. LGIM manages funds valued at around £140 billion for a variety of clients, but predominantly pension funds and insurance companies.

Please find below the second part of our response in respect of your call for comment and your specific questions on your advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments. This paper focuses on the consultation regarding best execution and market transparency. Please note that LGIM has also actively contributed to the IMA and BBA working group that have also responded to this consultation.

Executive Summary

We recommend that CESR ensures that its advice is proportionate and appropriate. It is important that where costs will be incurred by firms complying with CESR advice, which are most likely to be passed onto the client, the benefits must sufficiently mitigate the costs. We feel that CESR should take into account the client categorisation in defining disclosures that have to be made, in order to avoid information overload. Moreover, CESR should consider whether market forces and commercial pressure would create efficient and effective markets rather than direct regulatory intervention.

SECTION II - INTERMEDIARIES

Best Execution (Art. 21)

Criteria for determining the relative importance of the differing factors to be taken into account for best execution. (Art. 21.1)

Question 1: Are the criteria described above relevant in determining the relative importance of the factors in Article 21 (1)? How do you think the advice should determine the relative importance of the factors included under Article 21 (1)?

We agree that the criteria are relevant in determining the relative importance of the factors in Article 21(1). However, we do not believe that the advice should determine the relative importance of these factors. The relative importance is based on variables, such as client objectives and the type of business being undertaken and therefore, cannot and should not be a set level of importance attributed to them. Thus, the relative importance of each factor may vary accordingly.

Question 2: Are there other factors that firms might wish to consider in determining the relative importance of the factors? Do you think that the explanatory text clearly explains the meaning of all different factors in respect of financial instruments?

We believe that the most important factors have already been identified and appropriately explained.

Question 3: How might appropriate criteria for determining the relative importance of the factors in Article 21.1 differ depending on the services, clients, instruments and markets in question? Please provide specific examples.

As mentioned in our answer to question 1, we do not believe that it is appropriate to assign levels of importance to particular factors due to the number of variables. For example, investors will have many different requirements, such as speed of execution or minimising market impact.

Question 4: Please provide specific examples of how firms apply the factors in Article 21(1) to determine the best possible results for their clients.

This is a complicated process that involves qualitative and quantitative measures. This is managed by centralised dealing desk and the process is overseen by senior management.

Trading Venues to be included in the order execution (Art. 21.2) and Obligation to monitor and update the order execution policy (Art. 21.3)

In this section, we understand trading venues to be an organisation or system that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers.

LGIM is not a member of an exchange, although we have the ability to input our trades onto the exchange order book by virtue of an agency agreement. We do not consider this to be direct access to a trading venue, in terms of this definition.

Review Requirements

Question 1: What investment services does your firm provide?

LGIM is a UK-based investment management firm. It is a subsidiary of Legal & General Plc, a large UK-quoted insurance company. LGIM manages funds valued at around £140 billion for a variety of clients, but predominantly pension funds and insurance companies. We refer you to the UK Financial Services Authority's Register for full details of our permission under the UK Financial Services and Markets Act 2000.

Question 2: How many venues does your firm access now? Does your firm expect to access more venues after the Directive becomes more effective?

For the majority of its trades, LGIM uses brokers and therefore, does not directly interact with trading venues. However, we do use some Alternative Trading Systems, such as E-Crossnet and Bloomberg Tradebook, which we directly access. In total, we currently directly access around five trading venues. We do not envisage that this Directive will directly affect the number of trading venues that we use.

Questions 3: What factors does your firm consider in selecting and reviewing venues?

Our centralised dealing desk is responsible for the selection and ongoing review of trading venues.

LGIM uses different trading venues as they offer different sources of liquidity or can provide better execution terms. We take into account many factors including the costs of accessing the venue. It is on this basis that they are selected for use and they are monitored on an ongoing basis. In reviewing venues, trades are analysed either at an individual level or as a basket of stocks, dependant on whether a single stock order or a programme trade was placed. They use a variety of different methods to measure impact, including both in-house and third party analysis. Additionally, the centralised dealing desk also undertakes transaction cost analysis in order to identify trends and costs over time. This undertaken using a stand alone internet based system.

Question 4: Please provide specific examples of costs you consider in evaluating venues.

There are both implicit and explicit costs. From an explicit perspective, costs include commission and the cost of accessing and using the trading venues. Implicit costs include market impact.

Question 5: How do costs affect your decisions about venue selection?

We do consider costs in selecting trading venues, as part of our overall evaluation in order to provide best execution.

Question 6: Do you take account of implicit costs such as market impact? Is the question of implicit costs only relevant to firms that act as portfolio managers?

It is our policy that we always try to minimise market impact when placing trades, and therefore, we always take it into account. It is our opinion that market impact could potentially affect all market players, it is dependant on many factors, such as the size of the trade, its liquidity and market conditions.

Question 7: What specific events have led your firm to re-evaluate venues in the past? Please provide examples of how your firm has changed the venues that it access as the firm, its clients, or markets have changed.

All trading venues are subject to periodic and ad hoc review. The reasons for changing the venues are usually where new venues are developed and we believe that they, rather than existing venues could provide better execution.

Question 8: Have we identified the key criteria?

Yes, we believe that the key elements in venue selection have been identified by CESR.

Question 9: What data is available to carry out these reviews? If no data is available, are market solutions likely to provide it?

As previously mentioned, we use both internal and third party data to undertake trading venue reviews. We access historic price and volume data from various suppliers, including, Bloomberg and Reuters. This facility is provided as part of our subscription to these services.

We believe that markets will ensure that appropriate data is available. Therefore, we do not feel it is necessary for detailed regulatory requirements in respect of data for trading venues, as this may result in service providers introducing charges, which are likely to be ultimately borne by the client.

Monitoring Requirements

Question 1: What kinds of monitoring arrangements do firms use now?

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Furthermore, periodic compliance monitoring includes monitoring best execution.

Question 2: How frequently do firms monitor execution quality?

Operationally, reviews are ongoing and continuous by the centralised dealing desk in LGIM. Formal compliance monitoring is undertaken periodically and on a risk based approach.

Question 3: What data is available to aid firms in their monitoring obligations? What does the data cost?

We access current and historic price and volume data from various suppliers, including, Bloomberg and Reuters. This facility is provided as part of our subscription to these services.

Question 4: In what respects does the frequency with which firms monitor execution quality depend on the types of instruments, clients, markets and investment services in question? Please provide specific examples.

In general, it is easier to ascertain best execution when undertaking transactions in equities rather than bonds. There is no central trading place for bonds so therefore, the establishment of comparison prices is more difficult.

Question 5: What, if any, market data do firms consult in order to monitor execution quality?

We refer you to our answer in question 3.

Question 6: What additional data do firms expect to use after the Directive's transparency requirements become effective?

We do not see any material changes in the data we expect to use.

The Timing of Venue Assessments

Question 1: How frequently do firms review the venues to which they direct orders on behalf of clients?

Operationally, reviews are ongoing and continuous by the centralised dealing desk in LGIM. Formal Compliance monitoring is undertaken on a periodic based and risk based approach.

Question 2: Do firms re-evaluate their trading venues:

- whenever there is a material change of any of the trading venues?
- whenever there is a material change at the firm that affects its execution arrangements?
- whenever the firm's monitoring indicates that it is not obtaining the best possible result for clients on a consistent basis?

Trading venues are continually review by the centralised dealing desk. Furthermore, we undertake ad hoc reviews.

Question 3: What difficulties would firms face in reviewing their execution arrangements in response to each of the forgoing events?

Where an execution venue is new, it is very difficult to evaluate its future liquidity and the quality of its execution. Furthermore, it is often possible to recognise that a change has occurred in the trading venue, but it may take a considerable length of time before it is clear whether it has a material impact on execution quality.

Question 4: Do venues make firms aware of material changes in their business?

Generally, we are aware of material changes in their business. Either we are formally notified, or we are made aware through informal discussions with market contacts.

Question 5: Please provide examples of instances in which firms have changed the venues that they use.

Normally, we would look to add additional trading venues. However, there has been an occasion where we ceased to use one, as we were not placing enough trades with them for the venue to find us a profitable client.

Information to the clients on the execution policy of the firm (Art. 21.2)

Question 1: At present, how many venues do firms access directly? Indirectly?

LGIM is an international investor and therefore has trades executed on many different venues, all over the world. For the majority of its trades, LGIM uses brokers and therefore, does not directly interact with trading venues. However, we do use some Alternative Trading Systems, such as E-Crossnet and Bloomberg Tradebook, which we directly access. In total, we currently directly access around five trading venues.

Question 2: Should an investment firm be required to provide clients and potential clients with information on the percentage of a firm's orders that have been directed to each venue?

We do not consider that this information is necessarily useful to all clients. It is important that CESR considers the client categorisation to ensure that any regulatory disclosure requirements are proportionate and appropriate for them.

Question 3. For example, should an investment firm be required to disclose to clients and potential clients what percentage of its client orders were executed in the trading venues to which the firm directed most if its client orders (to cover at least 75% of transactions executed)

We do not consider that this information is necessarily useful to all clients. It is important that CESR considers the client categorisation to ensure that any regulatory disclosure requirements are proportionate and appropriate for them.

Question 4: How frequently should investment firms make this information available to clients? On a quarterly basis for example?

Not applicable, in light of our answers to questions 2 and 3.

Question 5: Should firms be required to update the information to reflect recent usage? How frequently?

Not applicable, in light of our answers to questions 2 and 3.

Question 6: Are there any other categories of information that a client or potential client needs to be adequately informed about the execution services provided by the firms?

We do not believe that there are any further categories of information that a client or potential client requires. We are concerned that the information suggested by CESR is already excessive for most clients and costly to the firm. Ultimately, there is a risk that these costs will be borne by the client.

Question 7: Should the information provided by portfolio managers and firms that receive and transmit orders be different from that provided by brokers? What are the key differences?

Whilst we can see some merit in getting general agreement of clients to a firm's execution policy we do not think that express consent should be obtained for orders outside a regulated MTF or that clients should be notified of all material changes to execution venues. We feel those information requirements are excessive for both portfolio managers and brokers.

Question 8: Have all key conflicts of interest been identified?

Yes.

Question 9: When should firms be required to provide required disclosure to clients and potential clients?

We do not believe that there should be separate regulatory requirements for either the content or timing of information on execution venues and policy.

Question 10: Is there any reason to impose different timing requirements for disclosure under Article 21 than are required in the Level 2 measures under Article (19.3)

We do not believe that there should be separate regulatory requirements for either the content or timing of information on execution venues and policy.

SECTION III - MARKETS

Pre-trade transparency requirements for regulated markets (Art. 44) and MTFs (Art. 29)

Question 12.1: Do consultees agree with the specific proposals as presented or would they prefer to see more general proposals?

We suggest that CESR considers general and principle-based proposals. We feel that the current proposals are both too wide ranging specific. We are concerned that they are likely to result in heavy costs, ultimately borne by investors.

Question 12.2: Is the content of the pre-trade transparency information appropriate?

We do not believe that CESR's current proposals are appropriate. We consider them to be too detailed and prescriptive. It is important that pre-trade transparency requirements are flexible enough to permit market developments.

Question 12.3: Do consultees agree on the proposal regarding the depth of trading interest and access to pre-trade information?

We recommend that CESR undertakes a programme of full research and cost-benefit analysis to ensure that the costs of building new systems are mitigated by the gains in pre-trade transparency.

Question 12.4: Do consultees agree on the proposal exemptions to pre-trade transparency. Are there other market models which should be exempted?

We agree with CESR's proposals to exempt regulated markets and MTFs that determine their prices by reference to those displayed on other trading venues. We also welcome the exemptions proposed for iceberg orders and large trades.

Question 12.5: Do consultees support the waiver for "crossing systems" as defined in paragraph 13? Could pre-trade transparency for crossing systems have a negative impact on liquidity or create the potential of abusive behaviour?

We completely support a waiver for crossing systems. Crossing is beneficial to clients in that there are efficiency improvements and cost reductions.

Question 12.6: Do consultees support the same minimum size of trade for the waiver to transparency pre-trade and delayed publication post-trade? Are there circumstances in which the two should be different?

In order to provide a comprehensive answer to this question, we would welcome further details on CESR's evaluation work.

Question 12.7: Do consultees have a preference for one of the options proposed for defining the block size, are there other methods which should be evaluated?

At this stage, we do not wish to nominate a preference.

Post-trade transparency requirements for regulated markets (Art. 45) and MTFs (Art. 30) and for investment firms (Art. 28)

Question 13.1: Do consultees support the method of post-trade transparency (trade by trade information), should some other method be chosen (which)?

LGIM considers that the post-trade transparency requirements detailed by CESR to be costly and time consuming for some firms to implement. This will be particularly the case where there are currently no mechanisms for reporting to an exchange. We therefore strongly recommend that interim solutions and transitional arrangements are considered.

Question .13.2: Do consultees support the inclusion of "aggregated information" in paragraph 22 or should it be left for market forces to provide on the basis of the information disclosed under paragraph 21. If it is included what should the content be?

We believe that aggregated information should be left to market forces, which are likely to provide the most cost-effective, innovative and flexible solution.

Question 13.3: Do consultees support the two week period for which the post-trade information should be available?

This timescale does not seem unreasonable, but CESR may wish to consider whether it is appropriate in very liquid or illiquid markets.

Question 13.4: Should some minor trades be excluded from publication (and if so, what should be the determining factor?

We agree that minor trades should be excluded from publication. The determining factor should be whether these trades have an influence on the price formation mechanism.

Question 13.5: Do consultees agree on the method of defining the time limit in paragraph 24 and is the one minute limit capable of meeting the needs of occasional off-market trades?

We do not believe that CESR should set a specific time. Instead, CESR should require that the time limit should be appropriate given the nature of the asset traded, the execution venue and the nature of the trading and reporting systems in operation.

Question 13.6: Do consultees support the view that only intermediaries who have created a risk position to facilitate the trade of a third party should benefit from deferred publication or should all trades which are above the block size be eligible for deferred publication?

We agree that only companies that have created a risk position should be exempted from the immediate reporting requirements.

Question 13.7: Should the identifier of a security be harmonised and if so to what extent? What should be the applicable standards (ISIN code, other?)

We support initiatives that promote the harmonisation of the security identifier. We consider that this should be on a global basis, not just at a European level. It is important that complete cost-benefit analysis is undertaken, taking into account any system changes that would be required.

Question 13.8: Should more information be available on stock lending? If so, which should be the content? Are there other similar types of activities which should be covered?

We consider that for transparent markets, there should be symmetry between both long and short transactions.

Question 13.9: Should CESR initiate work, in collaboration with the industry and data publishers, to determine how best to ensure that post-trade transparency data be disseminated on a pan-European basis?

We welcome any initiative that improves beneficial disclosure of information. However, such initiatives should be subject to full consultation and cost-benefit analysis.

Admission of financial instruments to trading (Art. 40))

Question 14.1: Do consultees agree on the requirements for admission to trading? Should more (qualitative and/or quantitative) criteria for admission to regulated markets be specified in the level 2 measures? If yes, which?

The minimum conditions for admission to trading in respect of derivatives are too detailed, in our opinion. Whilst we completely agree that the price of a derivatives contract should be unambiguous, for certain complex and exotic derivatives, it would be almost impossible to establish publicly available and reliable prices. We would therefore suggest deletion of Box 14, paragraph 3b.

We do not consider that it is appropriate for more criteria for admission to trading be specified in Level 2 measures.

Question 14.2: Do consultees agree on the role proposed for RMs in order to ensure that the issuers fulfil their disclosure requirements?

We do not consider that it is the responsibility of a RM to ensure that issuers fulfil their disclosure requirements. We are of the view that the primary responsibility of ensuring compliance with disclosure requirements lies with the relevant competent authority. Obviously, this is notwithstanding a RM being required to inform competent authorities of any breaches of which they become aware. Therefore, the heading in Box 14, paragraph 6 should be amended to remove the expression, 'RM's obligation to verify issuer's compliance with disclosure obligations'.