

The Role of Name-Passing Brokers

Introduction

The Financial Services and Markets Act (Regulated Activities) Order 2001 included in Article 25 the activity of "arranging deals in investments" and this was defined as:

- 1) making arrangements for another person (whether as principal or agent) to buy, sell, subscribe for or underwrite a particular investment which is a Security or a contractually based investment, or an investment of the kind specified by article 86 or 89 so far as is relevant; or
- 2) making an arrangement with a view to a person who participates in the arrangement buying, selling, subscribing for or underwriting investments falling within 1) above "whether as principal or agent".

Hence it was clear that the name passing broker fell within this activity.

The above activity has not been clearly transposed into MiFID and the purpose of this note is to set out the activity performed by name passing brokers in relation to how this is to be treated under MiFID, with particular focus on whether they are deemed to be conducting the activity of Receivers and Transmitters of orders.

Legislation

According to Recital (20) of Level 1 Directive 2004/39/EC (the "Directive"), a party that brings together two or more investors, culminating in a transaction between those investors, qualifies as the business of reception and transmission of orders.

This would suggest, therefore, that brokers acting in a name passing capacity are receivers and transmitters of orders. However, in carrying out their activities they do not receive and transmit orders for execution. As receivers of orders, they are a sub-section of the "Receiving and Transmitting" grouping and not all rules relating to the Receiving and Transmitting Group are applicable to name-passing brokers.

Best Execution

Article 21 of MiFID requires "that investment firms take all reasonable steps to obtain, when executing client orders, the best possible results for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order".

Article 45 of MiFID Implementation Directive require, when providing the services of Receipt and Transmission of Orders, a firm must "take all reasonable steps to obtain the best possible results for their clients taking into account the factors referred to in article 21.1".

The role of a name passing broker is to provide quotes on request to counterparties in order that such counterparties may enter into a bilateral contract with each other. Therefore, as name passing brokers do not 'execute' transactions, or receive and transmit orders for execution, the WMBA understand that Best Execution is not applicable in these markets.

Furthermore, based on our analysis of the legislation and in accordance with Recital (33) of the Level 1 Directive which states that it is necessary to effect a 'best execution' obligation to ensure investment firms execute client orders on terms most favourable to the client, we do not believe that the name passing broker activity actually falls within the definition of "concluding agreements" as the final details of the trade are agreed between the two counterparts. Name passing brokers neither have contractual nor agency obligations to their clients in the performance of their role and quote prices rather than execute orders.

Furthermore, we would highlight the European Commission's response to CESR on the 19th March 2007. This states with regards to Best Execution, "questions of market practice will help determine whether it is legitimate for clients to rely on the firm". The paper cites, "For example, in the wholesale OTC derivatives and bond markets buyers conventionally **"shop around"** by approaching several dealers for a quote, and in these circumstances there is no expectation between the parties that the dealer chosen by the client will owe best execution".

As name give-up brokers firstly operate in the wholesale markets, secondly provide access to pools of liquidity to allow clients to "shop around" and thirdly, arrange as opposed to execute or transmit transactions for execution, they should not be subject to the Best Execution requirement.

Conclusion

Based on the role of the name passing broker (See Annex 2, Role of an IDB), it is the WMBA's understanding that whilst name passing brokers fall into the generic definition of 'receiver and transmitter of order', they are merely arrangers of transactions and under MiFID do not execute transactions or transmit orders for execution and therefore are not subject to the best execution requirements in article 21 of MiFID.