Single Rulebook Q&A

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Article	26
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Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
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Disclose name of institution / entity	Yes
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Type of submitter	Investment firm
Subject matter	Defining the risk factor for third-country investment firms in K-TCD calculation
Question	Should the third-country investment firms be classified as investment firms or other counterparties for the purposes of defining the risk factor per counterparty type pursuant to Article 26 IFR?
Background on the question	Pursuant to Article 26 of the IFR, the risk factor, which is a part of a formula for K-TCD calculation, shall be defined per counterparty type as set out in Table 2 of the above mentioned provision. Accordingly, the risk factor for investment firms shall be 1,6%, while for other counterparties it shall amount to 8%. The definition of investment firm set out in Article 4 of the IFR refers to the MIFID definition, which states that investment firm means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis. However, the

MIFID contains also a distinct definition of third-country firm, which indicates that third-country firm means a firm that would be a credit institution providing investment services or performing investment activities or an investment firm if its head office or registered office were located within the Union. The IFR definition of investment firm seem not to encompass the third-country investment firms. In view of the above, it remains unclear how third-country investment firms should be treated for the purposes of defining the risk factor per counterparty type pursuant to Article 26 of the IFR. It is worth noting, that the risk factors in a formula for K-TCD calculation, originate from the CRR. According to the Annex to the EBA Opinion (EBA-OP-2017-11), the risk factors are derived from a simple calculation of capital requirements, within the context of CRR, with a 20% and 100% risk weight for credit institutions and investment firms (20%x8%=1,6%) and other counterparties (100%x8%=8%), respectively. At the same time, capital requirements for credit risk under the CRR allow, under certain circumstances, for the treatment of the exposures to third-country investment firms as exposures to an institution. Pursuant to Article 107 of the CRR, exposures to third-country investment firms and exposures to third country credit institutions and exposures to third country clearing houses and exchanges shall be treated as exposures to an institution only if the third country applies prudential and supervisory requirements to that entity that are at least equivalent to those applied in the Union. Given the above, it is reasonable to conclude, that third-country investment firms could be treated as investment firms for the purposes of K-TCD calculation under the IFR. Consequently, the appropriate risk factor shall be then 1,6%. Moreover, it is worth mentioning, that the provisions of Article 25 of the IFR allow the investment firms (subject to the approval of the competent authority) to calculate the credit counterparty own funds requirement by applying one of the methods set out under the CRR. Therefore, the different treatment of the third-country investment firms under two possible to be applied prudential regimes (third-country investment firms treated as other counterparties under the IFR, while as institutions under the CRR), could simply lead to regulatory arbitrage. Finally, it is important to note, that the credit counterparty risk estimation has an impact on the calculation of the concentration risk under the IFR (i.e. OFR calculation pursuant to Article 39). However, for the purposes of the Part Four of the IFR (Concentration Risk), according to Article 35 the terms ‘credit institution’ and ‘investment firm’ include private or public undertakings, including the branches of such undertakings, provided that those undertakings, if they were established in the Union, would be credit institutions or investment firms as defined in this Regulation, and provided that those undertakings have been authorized in a third country that applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union. Considering the above, it seems reasonable to follow the same approach for the treatment of the third-country investment firms (as investment firms, but under certain conditions) for both the credit counterparty risk, and the

	concentration risk calculation under the IFR. Even though, the provisions of the IFR in this subject are sufficiently clear only in the case of the concentration risk. In conclusion, taking into account the overall uncertainties resulting from the above mentioned provisions of the IFR, it seems reasonable to treat third-country investment firms as investment firms for the purposes of defining the risk factor per counterparty type pursuant to Article 26 of the IFR, rather than as other counterparties.
Final answer	In accordance with Article 24 of the IFR, investment firms that are dealing on own account, whether for themselves or on behalf of clients, are subject to an own funds requirement for trading counterparty default ("K-TCD"). In accordance with the formula set out in Article 26 of the IFR, the determination of such requirement depends on a risk factor that is defined per type of counterparty. Three types of counterparties are considered: a) Central governments, central banks and public sector entities, for which a risk factor of 1.6% applies. b) Credit institutions and investment firms, for which a risk factor of 1.6% applies. c) Other counterparties, for which a risk factor of 8% applies. In relation to point (b), the definition of an investment firm is provided in Article 4(1), point (22), of the IFR. It refers to the definition in Article 4(1), point (1), of Directive 2014/65/EU ("MiFID"). While additional conditions are imposed on natural persons, the definition of an investment firm is mainly based on the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis, but not on the location of the undertaking. As mentioned by the submitter, the MiFID specifically defines the notion of "third-country firm" in its Article 4(1), point (57). Such definition is based on the qualification of a "third country firm" as a credit institution performing investment services/activities or an investment firm based on services provided and activities performed as if such firm was established in the Union. While not replicated or referred to under the IFR, a similar approach could be used, noting that activities or services performed remain the main criteria of the definition. The same reasoning would be valid in the case of credit institutions. Based on the above, it can be concluded that a risk factor of 1.6% would equally apply to credit institutions and investment firms established in a third country as long as they would qualify as credit institutions or investment firms based on the services provided and the activities performed if they were established in the Union.

	In addition, by analogy to Regulation (EU) No 575/2013 (e.g. Article 107(3)), the prudential and supervisory requirements applicable in a third country may influence the treatment of risk under the K-TCD requirement and should therefore be assessed by investment firms and their supervisory authorities as part of the processes laid down in Articles 24 and 36 of Directive (EU) 2019/2034. *The answers clarify provisions already contained in the applicable legislation. They do not extend in any way the rights and obligations deriving from such legislation nor do they introduce any additional requirements for the concerned operators and competent authorities. The answers are merely intended to assist natural or legal persons, including competent authorities and Union institutions and bodies in clarifying the application or implementation of the relevant legal provisions. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law. The views expressed in the internal Commission Decision cannot prejudge the position that the European Commission might take before the Union and national courts.*
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