

Single Rulebook Q&A

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LEGAL ACT	Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876 – CRR2
TOPIC	Other topics
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PARAGRAPH	1
SUBPARAGRAPH	4
ARTICLE/PARAGRAPH	Not applicable
COM DELEGATED OR IMPLEMENTING ACTS/RTS/ITS/GLS	Not applicable
TYPE OF SUBMITTER	Investment firm
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SUBJECT MATTER	Definition of local firm under Article 4(1)(4)
QUESTION	Does the reference to “dealing for its own account” set-out in Article 4(1)(4) of the CRR include acting in the role of a “market maker” (as defined in Directive 2014/65/EU – MiFID II)?
BACKGROUND ON THE QUESTION	<p>As per Regulation (EU) No 575/2013 (CRR) Article 4(1)(4) - “‘local firm’ means a firm dealing for its own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets”.</p> <p>In practice this Article is interpreted differently by National Supervisory Authorities. For example, a National Supervisory Authority of one Member State does not permit a “local firm” to be involved in market making whereas this is permitted by a National Supervisory Authority of another Member State. This has important consequences for a level playing field for market participants and increases the risks of ‘regulatory arbitrage’.</p>
EBA ANSWER	<p>Based on a strict legal reading, dealing on own account by a local firm defined in Article 4(1)(4) of Regulation (EU) No 575/2013 (CRR) cannot be inferred to cover acting as a market maker. A local firm is exempt from the prudential requirements of the CRR and, as such, the permitted scope of its activities should be interpreted narrowly. Market making is not explicitly mentioned in this context, only dealing on own account and dealing for the accounts of other members of the markets they are present in.</p> <p>Further, Article 96(1)(b) of the CRR provides for a specific prudential treatment for investment firms which share some of the characteristics of local firms, but which fall outside its narrow definition. Together with the Article 95, Article 96(1)(b) is an example of one of the multiple categories of investment firm which are afforded special and more proportionate treatment under CRR. Article 96(1)(b) entails the application of CRR capital requirements but allows exemptions from e.g. liquidity and large exposures requirements, in order to address the risks of investment firms with</p>

the specific limited profile in its scope in a proportionate way. The existence of the multiple categories of investment firms in CRR, including Article 96(1)(b), which offer various degrees of proportionate application of its provisions, supports the case that any carve-outs from the CRR definition of an investment firm (e.g. local firms) should be treated very narrowly. Since the CRR local firm definition constitutes an exemption which should be interpreted narrowly and as market making is not explicitly included in this definition, Article 96(1)(b) appears purposefully to exist inter alia to cater for firms which fall outside this narrow definition. In other words, the existence of Article 96(1)(b) supports the strict legal reading mentioned in the first paragraph.

However, it is understood that some local firms in the EU have traditionally acted as market makers as a core feature of their activities. The local firm definition in CRR has evolved alongside this market practice, and is a result of several revisions of the concept of local firm, present in EU law since 1993 (ISD/MiFID, CAD). Indeed, some previous iterations of the concept of local firm in EU law have more loosely included market making in their permitted scope of activities by referring to local firms “making prices” for other members of the markets in which they trade in. Further, the forthcoming entry into force of the revised prudential framework for investment firms is set to delete both the definition of local firms and Article 96 in the CRR, and instead subject these firms to a tailored prudential regime alongside other investment firms. Therefore, because of the traditional function of some local firms as market makers, the partial ambiguity of the evolution of the concept of local firms in relation to the practice of market making, and the upcoming overhaul of the status quo, the possibility for local firms to act as market makers could be considered by competent authorities on a case-by-case basis. However, this should be mindful of the decision of the legislator to delete the local firms regime in the upcoming prudential framework for investment firms, with only a limited transitional period, specifically regarding the application of capital requirements but not its other provisions for these firms, before the new framework for investment firms is fully phased in (Article 57(6) of the Regulation on the prudential requirements of investment firms). Such a choice by a competent authority based on historical, transitional and proportionality arguments should only apply to the issue of market making and should not extend the permitted scope of activities of local firms under CRR in any other way.

Disclaimer:

This question goes beyond matters of consistent and effective application of the regulatory framework. A Directorate General of the Commission (Directorate General for Financial Stability, Financial services and Capital Markets Union) has prepared the answer, albeit that only the Court of Justice of the European Union can provide definitive interpretations of EU legislation. This is an unofficial opinion of that Directorate General, which the European Banking Authority publishes on its behalf. The answers are not binding on the European Commission as an institution. You should be aware that the European Commission could adopt a position different from the one expressed in such Q&As, for instance in infringement proceedings or after a detailed examination of a specific case or on the basis of any new legal or factual elements that may have been brought to its attention.

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