<table>
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<th>Question ID</th>
<th>2017_3422</th>
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<tr>
<td>Status</td>
<td>Final Q&amp;A</td>
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<tr>
<td>Legal act</td>
<td>Regulation (EU) No 575/2013 (CRR) as amended</td>
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<td>Topic</td>
<td>Credit risk</td>
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<td>Article</td>
<td>119</td>
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**Paragraph**
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**Subparagraph**
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**COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations**
Not applicable

**Article/Paragraph**
not applicable

**Date of submission**
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**Disclose name of institution / entity**
No

**Type of submitter**
Competent authority

**Subject matter**
Investment firms’ exposures to credit institutions

**Question**
Should MIFID investment firms which are subject to the CRR calculate the credit risk requirement for the clients’ funds (i.e. cash) deposited in a credit institution?

**Background on the question**
The question is about investment firms, as defined in Article 4(2)(2) of Regulation (EU) No 575/2013 (CRR), which hold clients’ money. According to Article 16(9) of Directive 2014/65/EU (MIFID II) and Article 4 of Directive 2017/593/EU concerning the safeguard of funds belonging to clients and product governance rules, Investment Firms (IFs) are subject to an obligation to make adequate arrangements to safeguard investor’s ownership and rights in respect of funds entrusted to them. In particular, IFs should keep clients’ assets distinct from those of the firm and those of other clients; where it places client funds with a third party, the investment firm should exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for holding and safekeeping client funds, and should consider the need for diversification and mitigation of risks by placing client funds with more than one third party in order to safeguard clients’ rights and minimise the risk of loss and misuse. In addition to this, Article
44(2) of Directive 2014/59/EU (BRRD) provides that “Resolution authorities shall not exercise write down or conversion powers in relation to the following liabilities whether they are governed by the law of a Member State or of third country: [...] c) any liability that arises by virtue of the holding [...] of client assets or client money including client assets and client money held on behalf of UCITS [...] or AIFs [...] provided that such a client is protected under the applicable insolvency law”. Recently, with regard to UCITS Q&A 3023 clarified that Article 44(2)(c) BRRD concerns third-party-owned assets, while Q&A 3022 specified that clients’ assets or clients’ money held on behalf of UCITS are not “owned” by the institution, and therefore they cannot be bailed in provided that such a client is protected under the insolvency law; the protection would be the right of the owners to reclaim the assets in the insolvency proceeding. In Italy such protection is guaranteed by Article 22 of Legislative Decree on Finance No. 58/1998 also with regard to client assets and client money held on behalf of investment firms. In particular said provision states that “the financial instruments and funds of individual customers held in whatever capacity by an Italian investment company [...] and the financial instruments of individual customers held in whatever capacity by a bank shall be separate assets for all intents and purposes from those of the intermediary and from those of other customers” and that “actions in respect of such assets may not be brought by creditors of the intermediary or on behalf of such creditors, nor by creditors of the depositary or the sub-depositary, if any, or on behalf of such creditors”. Therefore, it seems debateable whether there would be an exposure towards the institution where client funds are deposited according to Article 119 CRR for the purposes of credit risk. In particular, for prudential purposes, the risks arising from the deposit (i.e. legal and reputational risk arising if the firms do not exercise all due skill, care and diligence in the selection of the depositary, concentration risks) would already be addressed by the operational risk requirements (under the CRR) and the Pillar II (CRDIV) framework.

**EBA answer**

Where an investment firm has deposited with a credit institution any cash or financial instrument belonging to a client, this constitutes a credit risk exposure to the credit institution according to Article 119 CRR to the extent that the investment firm needs to provide compensation to the client in case of not or not completely receiving back from the credit institution the cash or financial instrument that had been deposited.

Therefore, even if the cash or non-cash financial instruments deposited with a credit institution was treated as owned by the client rather than by the investment firm, an obligation to compensate the client in case of default of the credit institution would nevertheless constitute a credit risk exposure according to Article 119 CRR, as the separation of the deposited assets for all intents and purposes from those of the intermediary does not eliminate the risk that said cash or non-cash deposits would not be
available in case of failure of the credit institution. Said exposure represents a guarantee having the character of a credit substitute and, in case of an off-balance sheet item, is a full risk item according to Annex I(1)(a) of Regulation (EU) No 575/2013 (CRR).

Nevertheless, in case that specific provisions under national insolvency laws effectively eliminate the credit risk that investment firms have with institutions where they deposit their customers cash or non-cash financial instruments, these assets that have been deposited do not constitute an exposure to an institution according to Article 119 CRR.


European Banking Authority, 05/08/2020

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