Financial Law Institute

Working Paper Series

WP 2007-04

Eddy WYMEERSCH

Delegation as an Instrument for Financial Supervision

February 2007

WP 2007-04

Eddy WYMEERSCH

Delegation as an Instrument for Financial Supervision

Abstract

As financial integration proceeds, new issues are coming up in the field of supervision of financial markets. Some have to do with better cooperation among supervisors whether in the same field or on a cross-sectoral basis. The possibility to cooperate is however restricted by the public nature of most supervisors: public authorities should exercise their powers themselves, and risks should be borne by the legally empowered supervisor. In order to make supervision more effective, cross border delegation is needed. However, it is unclear to what extent supervisors can delegate, tasks as well as competences or decisions. This paper aims to give a first overview of the issues to be tackled including an attempt to analyse the liability question.

12 December 2006

Delegation as an instrument for financial supervision

Eddy Wymeersch

1. As integration in Europe's financial markets progresses, questions relating to the efficient organisation of supervision have become more and more prominent. In the longer term, issues of coordination of the supervision, at present exercised by 54 financial supervisors in Europe, will be unavoidable[1]. The cost of supervision, the need to find increasingly rare expertise in the most advanced financial techniques, but also the regularly voiced concerns about the imposition of several layers of supervision are some of the arguments that plead for a more efficient supervisory pattern. Several schemes have been circulated: some dream of a big, single, European supervisor, in charge of all types of financial supervision[2]. This scheme is more a political symbol than a workable solution. It is generally thought as being unfeasible, vastly overdone and in any case premature. The official position of the European institutions, shared by most supervisors, is that the existing techniques of cooperation and attribution of competence have to be fully tested and explored and only if these would have failed to yield satisfactory solutions other avenues can be explored.

2. Some, especially in the European Parliament[3] have proposed a two-tier system, often dubbed the "26th regime" which would come on top of the existing 25 regimes. According to this line of thought, the largest European financial firms would be supervised by a single European supervisor, while the national, local supervisors would remain competent for the local market participants, creating an additional line of border conflicts. Objections speak for themselves: one will not simplify the existing system by adding an additional supervisory layer. Most firms will continue to function on a multi-state basis, calling for some involvement of the local supervisor. The argument that local supervisors will not be able to upkeep expertise is not entirely convincing as the most complex financial issues with sometimes considerable systemic consequences arise not only in large groups, but due to the significant interdependency in the most sophisticated segments of the markets, are present in niche players as well. This type of 26th regime would necessarily be more distant, more bureaucratic than the existing ones and therefore less efficient.

[1] For the precise count, see Wymeersch, The structure of financial supervision, SSRN 946695.

[2] Deutsche bank calls for a European System of Financial Supervisory Authorities (ESFSA) .AFG in France proposed to attribute to CESR the role of "supervisor of the supervisors", and put forward a single European supervisor in the longer term: AFG in La réponse de l'AGF au rapport Himalaya,February 15, 2005. In the same sense: Schoenmaker, D. and Oosterloo, S. The lead supervisor model, Financial regulator, vol. 9, nr. 3; comp. Lannoo, K., European Financial System Governance, CEP Policy Brief, nr. 106, June 2006, would allow full delegation for conduct of business rules, but proposes to rely on a centralised authority for prudential supervision.

[3] See Report by Ieke van den Burg Verslag over de stand van zaken bij de integratie van de financiële markten van de Europese Unie, Commissie economische en monetaire zaken van het EP¨, 2005/2026 (INI); European Parliamentary Financial Services Forum, Briefing paper for the meeting of 8 October 2002, http://www.epfsf.org/meetings/2002/briefings/briefing_8oct2002.pdf and Report on the current state of integration of EU financial market, by Ieke van den Burg, 18 Jan. 2005,
Van den Burg, I., Centraal Europees toezicht is efficienter dan lead supervision, NVB Bulletin, Juni 2005, 6-8, htpp://www.nvb.nl/scrivo/asset.php?id=11660; Van den Burg, I., Roep om een Europese toezichthouder op de financiële sector, 27 Juli 2006, www. Treasury.nl/NewsItem.aspx?ItemID=6815;

According to other proposals[4] the 26th regime would be a supervisory regime addressing the simpler financial products that could be distributed without any additional formalities all over Europe after having been approved by this central supervisor. The objective is laudable, the way to achieve it is confusing: in order to facilitate access to the different markets, regulators should not add to complexity, but address the existing barriers. By so confirming the existing barriers and indirectly subscribing to their justification, the proposal is at odds with the rest of the present integration efforts. Moreover it would add supervision for simple popular products, but these usually deserve least supervisory attention. Finally, the proposal is product oriented, but does not offer an answer for the institution-based supervision.

3. The existing directives contain a well-established pattern of coordination of supervisory activities that is rooted in the Treaty's basic freedom of establishment. It is based on mutual recognition, along with attribution of supervisory competence to the supervisor that has the strongest instruments to implement the policy. Normally this is also the supervisor with the strongest prudential interest. This regime results in attributing competence to the home state, being the state where the firm has its registered office, where its main place of business is located, and which legal system will be applicable to the entity supervised, its head office and its branches. Only that supervisor is able to address injunctions and insure their implementation. According to present regulations, subsidiaries being separate legal entities are not included in the home state's jurisdiction, but are supervised by their home supervisors. In, a cross border context, this not only leads to specific coordination questions – each subsidiary being supervised by a different national or sectoral supervisor, addressing the subsidiary from the angle of its own requirements - but does not fit with the integrated business model that these financial services groups have developed. In the not unlikely hypothesis that more and more subsidiaries would be converted into branches, the paradigm will shift towards a more centralised supervisory model, raising sovereignty issues in the states where substantial operations take place[5].

3. The issue of including subsidiaries in the overall home supervision is a complex one, and was not openly addressed in the older directives. Recently however, a change of opinions seems in the offing: both in the CRD directive[6] and in ECJ case law[7], there are sign of recognition that multinational financial services firms are managed as one single entity, and hence that supervision should address the overall firm, irrespective of the legal structure of the group. Within a single legal order, this division does not call for specific discussion, but in a cross border context it is resented as too radical, the more so as it raises very considerable questions of legal competence, enforcement and liability. Supervisory competences are indeed directly linked to the exercise of national sovereignty, and therefore cannot be exercised on a cross border basis, except on the basis of an agreement between the states concerned. In the absence of agreements to that effect, solutions have been developed that are based on cooperation among the supervisors, but without abandoning any part of national sovereignty.

---

[4] See the Commission 's White Paper on Financial Services policy (2005-2010)

[5] See Wymeersch, The future of financial regulation and supervision in Europe, Comm.M.L.R. 42, (2005) 1005 e.s.

[6] Recent the directive on capital adequacy of banks has introduced this group wide approach, fixing requirements on a group wide basis.

[7] The ECJ has adopted a similar reasoning in its recent Caixa case(Judgment of the Court of Justice of 5 October 2004 in Case C-442/02 (reference for a preliminary ruling from the Conseil d'État) where it considered that a subsidiary of a foreign group could avail itself of the privileges granted by article 43 EC Treaty. In the case at hand, a French subsidiary of the Spanish bank, making use of article 43, could offer remuneration on sight deposits, as the existing French prohibition to pay interest on sight deposits would be "serious obstacle" to the pursuit of its banking activity via a subsidiary in another Member state, gravely affecting its access to the market.

Part 1. Delegation according to the present directives

4. The directives in the field of financial supervision have always contained provisions calling national supervisors to cooperate. This has been the case in both the prudential directives and the directives relating to financial products (here: securities and insurance). These calls for cooperation were formulated in general terms, without specifically analysing the conditions or the consequences of such cooperation. In some fields, additional provisions have clarified the information obligations of national supervisors.

With several of the more recent directives however a further step has been taken: these directives contain express provisions about the possibility to delegate certain tasks or certain competences. The formulation is more explicit in the securities directives than in the prudential ones. This feature indicates that the two fields should not necessarily be treated the same way.

Recently a number of reports, especially of high-level European committees[8], have called attention to "delegation", which has been identified as an important tool for enhancing the coordination of financial supervision. Therefore it seems useful to first analyse the existing provisions of the directives that mention delegation as a supervisory tool and then to investigate how this tool could be further framed to make supervision more efficient. From the following analysis it will appear that the formulations used are very diverse and rather confusing. "Harmonisation of harmonisation" would be welcome, in this field as well[9].

The directives do not define "delegation": one can presume however, that the expression refers to cases where one supervisor charges another with certain tasks, to be executed on behalf of the former. These tasks may contain a certain number of minor matters or technical decisions, or may conversely amount to in substituting the decision of the former by a decision of the party to whom it has been delegated.

Most of the recent directives contain provisions on delegations. However their formulation differ significantly.

A. The securities directives.

5. In each of the four recent securities directives "delegation" has been expressly mentioned: securities regulation is one of the fields in which delegation has been referred to as a significant cooperation tool, but its precise meaning deserves further analysis.

In the *directive on market abuse*, delegation has been mentioned from a perspective of delegating supervisory duties to another body than the administrative agency in charge of supervision. The provision refers to the possibility – followed in several member states - to

[8] Franque Report, FSC 4159/06.

[9] See the Commission agenda on "better regulation"http://ec.europa.eu/enterprise/regulation/better_regulation/docs/en_689.pdf

confer to the stock exchanges[10] – increasingly private law bodies- certain tasks with respect to tracing market abuse[11]. This provision in fact ratifies the existing practice in some member states and was required to enable the administrative supervisor – the only one that is recognised as "competent authority" in a cross border context – to delegate some ancillary matters to private law bodies. It would be limited to ancillary matters, as the supervisor retain the final responsibility:

" The competent authority shall be given all supervisory and investigatory powers that are necessary for the exercise of its functions. It shall exercise such powers:
(a) directly; or
(b) in collaboration with other authorities or with the market undertakings; or
(c) under its responsibility by delegation to such authorities or to the market undertakings; or
(d) by application to the competent judicial authorities"[12].

The notion of "powers" may be misleading: as the analysis in the second paragraph shows, it was meant to refer to the "supervisory tools", such as the right to have access to any document, to demand information from any person, to carry on on-site inspections, etc. This delegation refers to "tasks" rather than to "decisions".

6. The *Prospectus directive* contains more explicit references to delegation.

According to art.13 (5)

"The competent authority of the home Member State may transfer the approval of a prospectus to the competent authority of another Member State, subject to the agreement of that authority."

Interesting is the provision of art 13 (6) as it clarifies that the directive will not affect the competent authority's liability, which shall continue to be governed solely by national law[13]. Furthermore

"Member states shall ensure that their national provisions on the liability of competent authorities apply only to approvals of prospectuses by their competent authority or authorities."

[10] See in Ireland, where the IFSRA has delegated its powers to the Stock exchange, which will be known as the "Delegate Authority" according to the Rules issued under section 51 of the of the Investment funds, companies and miscellaneous provisions Act 2005 and the Interim Provisions issued under section 34 of the same act, http://www.ifsra.ie/data/in_mark_abudir/MAD%20Interim%20Rules%20-%20Final%20Version.pdfhttp://www.ifsra.ie/data/in_mark_abudir/MAD%20Interim%20Rules%20-%20Final%20Version.pdf

[11] According to the preamble "A common minimum set of effective tools and powers for the competent authority of each Member State will guarantee supervisory effectiveness. Market undertakings and all economic actors should also contribute at their level to market integrity. In this sense, the designation of a single competent authority for market abuse does not exclude collaboration links or delegation under the responsibility of the competent authority, between that authority and market undertakings with a view to guaranteeing efficient supervision of compliance with the provisions adopted pursuant to this Directive."

[12] Art 12(1) littera c of the market Abuse Directive.

[13] It does not say that liability will not be affected by delegation.

The latter provisions should be read as meaning that the delegated approving authority will be liable for its approval, according to the liability rules to which it is subject. If the Luxembourg authority delegates the approval of a Eurobond prospectus to the German authority, responsible for the parent company of the Luxembourg bonds issuer, the German authority would incur liability according to German law.

This is the only provision according to which a formal legal decision could be delegated, provided the national law of that member state allows for such a delegation. The decision whether or not to delegate remains with the supervisor: there is no obligation to delegate. The directive states expressly that delegation can only take place in favour of "competent authorities", i.e. administrative agencies, and not to private law bodies, such as a stock exchange.
The provision relates to the case whereby a home member state, e.g. the state where the issuer is located is not the state where the securities are going to be traded. In these cases, the approval could be granted by the state of trading. Other cases may relate to transactions whereby the two states are competent: one of the supervisors involved could take the lead for vetting and approving the prospectus, without the delegating supervisor being formally involved. It could be called upon for bond issues that are guaranteed by the parent company, located in another state than that of the issuing vehicle. *The fact that the liability shall not be affected is likely to be an argument for not delegating the approval decision, but for exercising the power jointly with the host member state.*

The same directive contains another provisions on delegation. "Member States may allow their competent authority or authorities to delegate tasks". In light of the preamble this delegation should be analysed as a means for establishing cooperation between the administrative " authority and other entities with a view to guaranteeing efficient scrutiny and approval of prospectuses "[14]; Here the same reference should be made to the stock exchange and other similar bodies, who have in the past and might usefully also in the future intervene in the procedure of vetting the prospectuses. The powers under this clause should however expire after a given period of time[15]. It seems clear that the latter provision relates to a delegation of tasks, and not of decisions, as appears from the list of tools that is mentioned in the same article. Although not expressly excluded, one can presume that this type of delegation could also relate to conferring certain duties to non-domestic supervisors.

7.The *Transparency directive* contains a similar provision allowing a delegation of tasks, subject to a similar sunset clause as applicable according tot the prospectus directive[16]. Here again, delegation has been viewed as relating to calling on other especially private law bodies to implement specific tasks required by the directive, such as organising the disclosures the directive calls for. Similarly mention is made of conflicts of interest and illicit use of the information: this is likely to apply only in case of delegation to non-administrative bodies, as the administrative or "competent" supervisor is subject to professional secrecy on the basis of other directive provisions.

[14] Preamble nr. 37
[15] See art 21(2) Prospectus directive.
[16] Art 24(2); art 25 (1) extends secrecy obligations to delegated entities.

8. The *Mifid* contains several provisions relating to delegation. The directive allows multiple authorities to be put in charge of supervision: this arrangement should "not exclude delegation under the responsibility of the competent authority"[17] For the discharge of specific duties such as the authorisation of some investment firms, "Member States may allow the competent authority to delegate administrative, preparatory or ancillary tasks related to the granting of an authorisation, in accordance with the conditions
laid down in Article 48(2)"[18], the latter referring to **xxx** Similar to the provisions of the other directives, if delegation to a regulated market has taken place, specific attention should be paid to conflicts of interest[19]

In addition, the directives provides that "Any delegation of tasks … may not involve either the exercise of public authority or the use of discretionary powers of judgment." while "in any case, the final responsibility for supervising compliance with the Directive and with its implementing measures shall lie with the competent authority or authorities designated in accordance with paragraph 1" i.e. the public authorities[20].

Obviously the types of delegation in the *Mifid* concerns delegation of tasks only.

The directive on *investment funds*, of 1985 as modified in 2003 contains no provisions of delegation. It merely states the older formula that the supervisor have to cooperate.

The *takeover bid directive,* without mentioning delegation*,* urges member states to designate their competent authorities and specifies that these can be public bodies, associations or private bodies recognised by national law or by public authorities especially empowered for that purpose by national law[21].

B. The banking directives

9. Other directives are rather scant on delegation provisions.
The directive on financial conglomerates merely alludes to the delegation hypothesis, without organising it: " without prejudice to the possibility of delegating specific supervisory competences and responsibilities as provided by Community legislation, the presence of a coordinator entrusted with specific tasks concerning the supplementary supervision of regulated entities in a financial conglomerate shall not affect the tasks and responsibilities of the competent authorities as provided for by the sectoral rules[22].

The CRD should merely be mentioned here, as it is rather timid in this respect. Art 141 mentions inspections and verification that can be undertaken whether by the requesting supervisor or the

[17] Art 64 (3) Mifid.
[18] Art 5(5) Mifid; art 16(3) art 17 (2); art 23 (4).
[19] Art 39 Mifid.
[20] Art 48 (2) Mifid.
[21] Art 4 (1) Take-over directive
[22] Art. 13 (3) Conglomerates directive

supervisors, or by a third party, an auditor or an inspector. In any case the requesting supervisor can attend the inspection. There is no mention of further delegation.

However one should mention art 129 according to which the lead supervisor is entitled to determine the rules applicable to the group including its subsidiaries, and which have to be respected by the host supervisors as far as the subjects have been referred to in said article. This is not a delegation provision sensu proprio, but allows the lead member state to decide on certain matters in the case they have not been able to agree with the host or the subsidiary supervisors. One could analyse this provision as obliging the host supervisor to leave the decision to its home colleague, in which case it is close to a mandatory delegation.

C. The insurance directives.

10 . Directives in the insurance field contain general provisions about cooperation, but none on delegation[23]

D. Short summary of the delegation provisions.

11. Looking at the provisions on delegation in the present financial services directives, one could summarize the situation as far as delegation is concerned as follows.

Delegation has obviously received more attention in the securities field, than in prudential matters. This is the more astonishing as one would obviously expect the strongest need for cooperation in prudential matters that are characterized by a long term relationship between the supervisor and the supervised entity and where cooperation between supervisors has been practised since a long time. Also, the home state rule has been more clearly affirmed in several directives in the securities field, making cooperation between supervisors less of a priority**.** Securities directives being more recent, the rules on delegation are more elaborate.

A second observation relates to the organisational objective: does delegation exclusively relate to cooperation among state supervisors, and does it include cross border cooperation? From the wording in most of the securities directives, one can deduct that delegation was meant to relate to delegation to private bodies that intervene – or have intervened - in the supervisory process. As stated in the directives the relationship with the supervisory tools and with matters like conflicts of interest and illicit use of information obviously do not view delegation among administrative supervisors that are held by equivalent secrecy obligation, but rather to the domestic private law bodies that may be involved in the supervisory process at the national level. In all these cases, the rules on delegation have a very limited and almost specific meaning that comprises specific domestic forms of delegation. No reference is made to cross border delegation of tasks, but this type could be considered included in the general provisions on cross border cooperation. All in all, these provisions are not of a great help in defining the "delegation" figure.

The distinction between delegation of tasks and delegation of decisions is essential Except for the prospectus directive, most reference to delegation concern delegation of tasks.

The liability for delegation has been mentioned only once: it is in the case where the prospectus approval can be delegated.

[23] See e.g. Directive 2002/92 of 9 December 2002, art 7.

Not explicit mention was made of a number of important cases of delegation: cross border delegation, delegation among state authorities, cross sector delegation, e.g. between banking and insurance supervision, subdelegation have not been considered[24]

To conclude the present rules on delegation do not contain the building blocks for a more general chapter on delegation for the purposes of financial supervision. They can be considered as specific provisions solving problems that existed in a few of the member states. Furthermore, it is unclear what has been the intention of the draftsmen of the prospectus directive by including the provisions of art 13(5) especially as they added the clause on the home state's continuing full liability.

Part II Delegation in the future

12. Looking at all the statements that have been made, both in Europe and outside, it is likely that delegation will received much attention in the coming years[25]. Therefore it is important to situate the formula in perspective, and to describe the different forms and conditions that could be developed as part of a delegation formula.

A. Delegation, outsourcing, mutual recognition.

13. What is the difference between the three notions mentioned in the caption? As obviously there are some common elements, it is worthwhile to attempt to differentiate. One will suppose that the three cases relate to supervisory issues amongst administrative supervisors.

Outsourcing could be defined as a contractual technique, whereby certain material acts will be accomplished by another party, acting as a subcontractor for the outsourcing entity. Although the distinction between material and intellectual acts is well known, but difficult to make, it is assumed that supervisory outsourcing will not necessarily comprise a certain number of intellectual acts and decisions, and essentially not be confined to material acts. In order to find a criterion, one could state that in the case of outsourcing, the activity outsourced would be a well defined series of the acts, in which the material aspect will dominate, while decisions, although not totally absent, will be subordinate. In contrast, delegation could be defined as relating to a larger coherent series of tasks that form a domain in supervisory terms, composed of material but also and perhaps dominantly intellectual acts, and in which intermediary or final decisions will have to be made. The intensity will be greater – stronger, more ample – than in outsourcing. The mentioned example of the stock exchange tracing insider transactions on behalf of the supervisor could be analysed as delegation, while the outsourcing of the computer infrastructure by e.g. an exchange would rather be considered outsourcing. But the dividing line will often been a fine one, as even technical matters may require a certain, albeit limited number of decisions to be made.

Mutual recognition could be analysed as a technique whereby, on the basis of the applicable law – and not of an agreements between the supervisors – the supervisory competence

[24] Although in terms of secrecy, the directive provisions put both sector on the same footing.

[25] See Council conclusions on Financial supervision, 2726th Economic and Financial Affair Council meeting, Brussels May 5th, 2006, underlines the importance of delegation along with mediation and other convergence instruments, "taking into account the diverse state of progress in each financial sectors".

has been "transferred" or ascribed to another (the home), eliminating more or less fully the supervisory competence of the first supervisor (host). The consequence is that by virtue of the applicable law, the supervisor will exclusively – or almost exclusively - be exercised by the home. Differences relate to the legal basis (by virtue of law v. agreement), the remit (full competence) and the duration (indefinite and irrevocable competence). The remaining powers of the home will usually be very limited (e.g. only marketing of investment funds) or nil. Other policy objectives may however correct this distribution of competences and introduce a different balance (e.g. on the basis of the host's major interest). But looking at it from a distance there is no fundamental difference, at least no contradiction between the mutual recognition technique and the delegation formula. One could also present it as an increasing scale between outsourcing, delegation and mutual recognition, the latter culminating in the "lead supervisor".

B. Forms of delegation

14. In the absence of any more elaborate definition in the directives or in other legislative sources, one has to further investigate what forms and characteristics delegation as a supervisory tool could adopt. The different forms in which delegation could be put to work will therefore be analysed. The analysis will clearly distinguish between delegation of tasks and delegation of decisions. The latter will briefly be commented on as it raises considerable issues of liability, so that the analysis should first address the delegation of tasks.

Delegation could take on many forms: it could be delegation of tasks or delegation of decisions, it will usually be of a contractual - quasi contractual nature[26] - nature it will be more or less specific, relate to more or less material matters, bi- or multilateral, more or less voluntary; the agreement could be for a definite or indefinite period of time, while the delegating authority may, or may not retain certain supervisory powers, e.g. as a "second line" supervisors, merely overlooking how the delegation has been performed. Also, third party and subdelegation may be mentioned.

1. Delegation of tasks v. delegation of decisions.

15. The distinction between delegation of tasks and delegation of decisions is essential. The first form is a technique for outsourcing certain supervisory activity, mostly preparatory or ancillary. Even today, delegation of tasks would probably not raise major questions of responsibility, as the delegating authority should be able to intervene and check the quality of the service performed. Whether the delegating authority remains fully liable and whether the authority to which delegated tasks have been charged, will be analysed infra. Delegating tasks is already today laid down in the law of certain member states: several states call on the auditor to perform crucial verifications to be used within the prudential supervision. The depository function for an investment fund must be entrusted to a party different from the portfolio manager, who must perform certain supervisory tasks. Surveyors may be called upon to value the real estate that is held by a real estate investment fund. These delegations are part of the law, but nothing prevents the formula to be used by the supervisor designating the party that could perform certain supervisory functions on the basis of the supervisor's delegation.

A clear example of delegation of tasks can be found in the intervention of the stock exchange for the tracing of suspect transactions, whereby the official supervisor will analyse the result of the screening by the exchange, decide upon further proceedings and eventually imposing

[26] Due to the fact that most of the time public authorities will be involved, the nature of the agreement will not be qualified as a mere contract.

sanctions. There is little doubt that the last-mentioned activities should belong to the supervisors' reserved competences[27].

Delegation of decisions in only found in the prospectus directive. The provision of the directive is not very explicit and is confusing to the extent that delegation will not affect legal liability. The rule has been framed in such a way that only the home supervisor can delegate, and that its liability will remain unchanged. It is clear that in these circumstances, home supervisors are not likely to be willing to delegate the supervisory review: being liable for a process that you do not master is not an attractive proposition. It seems doubtful whether this provision will be frequently used.

2. Common features

1. Prerequisites

16. In some national legislations, delegation at the national level has already been provided for.[2829] These exceptions to the basic rule that supervisors exercise their competences autonomously are in practise specific forms of supervisory cooperation. Cross border delegation raising issues of sovereignty and shifting of risks will require an express legal provision whereby both legislations should contain provisions allowing for cross border delegation, most of the time along with an authorisation by the competent minister. Moreover both legislations should be effectively tuned to the approach followed in the other legislation, and allow the supervisor to which the request for delegation is addressed to dispose at least of the tools sufficient to implement the request. Very often this will in practice imply that both supervisors will need to have comparable, if not identical powers[30]. The latter condition is an essential prerequisite supporting the mutual confidence on which delegation is ultimately based. This element has been repeatedly underlined in recent statements of the European supervisory committees. It will mainly intervene between supervisory bodies that are subject to the same legal regime, in fact between administrative agencies[31]. Cross sectoral deals will be more difficult to achieve: if remit, objectives or methodology are substantially different, an additional effort will have to be made to find a common understanding. As between banking and insurance supervision, the tools are increasingly being harmonised, it is worthwhile to eventually consider including bank-insurance delegation in future regulations. More complex issues would arise between institutions with widely different remits: between e.g. market supervision and "central banks 'oversight", could not a common approach be found for specific issues under the heading of financial stability? The supervisor with the most widely defined ambit could delegate to his colleague with a more restricted field of action. Vice-versa seems more unlikely.

In many case the mere reference that delegation may take place will not be sufficient: supervisors will want to have guidelines about the way they can make use of this power. It would be useful if the legislator give a series of legal choices among which the supervisors could choose while leaving the exact choice to the supervisor's decision and his analyse of the concrete case. A few of these clauses or issues will be reviewed later. In a future legislation, these elements should

[27] In some jurisdictions, even private bodies can impose fines, e.g. the NYSE Regulation Inc. impose fines on member according to the NYSE rules.
[28] See the rules on the Belgian Fond des Rentes.
[29] Comp the rule of art 77 of the L. 2 August 2002.
[30] See art 12, MAD; Art 24(4), transparency directive.
[31] The legal status of the "competent authorities" may present some interesting differences: so the FSA, a private company limited; also the Dutch AFM, as these are acting on delegated powers from the minister of finance. These features may not be change the qualification of bodies acting in the general interest.

be introduced all over Europe in a largely equivalent way. A European instruments setting the common framework would therefore be helpful.

17. As a rule, a delegation provision should leave the national supervisors free to delegate or not. This contractual freedom could strongly contribute to flexibility, innovation and experimentation necessary in the first years of application of the new technique. In some fields however, it will be necessary to urge parties to reach an agreement: therefore it might be envisaged to identify fields in which there would be an obligation to enter into delegation negotiations at the request of another supervisor, taking into account a certain number of well defined circumstances (e.g. for some aspects of the previously mentioned home-host relationship). A better knowledge of the cost of supervision in its respective components, along with a transparent cost structure may motivate some supervisors to look for less costly or for more efficient services. One might also look for financial incentives to enter into delegation mechanisms: it seems logical to services to be rendered among supervisors will have to be remunerated, thereby creating a market for supervisory services. These will have to be billed at cost, as most supervisors being public authorities are not supposed to make profit. Ultimately, one could point to art. 129 CRD as a technique where decisions are being reached, even if the negotiation fails. A more general principle, in strictly defined areas could create strong incentives for parties to find workable solutions.

18. National provisions on delegation would have to respond to certain conditions. It is likely that in several states the use of the delegation formula, to the extent that it engages the state's responsibility, will have to be approved by the persons politically responsible, usually the minister in charge of the subject matter. In addition the provisions on delegation will probably have to contain rules characterising the delegation power, as to time, conditions, subject matters, liability, cross border aspects etc. Although it might be advisable to take a prudent start, one could plead for leaving most of the subjects to the decision of the supervisor, who is best placed to determine the needs and responses to be given.

19. The actual use of delegated powers would usually be laid down in an "agreement" between the supervisors concerned. Under most of the legal systems, this would not be a private law agreement, as the parties involved are imbedded in public law. Nevertheless, as a reference point, the standard contractual framework could usefully be followed for determining the involvement of both parties, one in an executing, the other in a supervising capacity. Many of the usual contract clauses would have to be considered: termination clauses, with or without damages, liability for deficient implementation and related insurance requirements, fees or other forms of remuneration in exchange for the supervisory services rendered, etc.

2. Analysis of some delegation clauses

20. As a rule delegation would be temporary: if it is permanent one almost reaches the result aimed at by mutual recognition. Normally, the delegating supervisor will want to keep the supervisory process under his close control, and if needed, be able to decide to intervene directly, and eventually to stop the process and invite his colleague to explain. This control remains

indispensable as the delegating authority will remain responsible and legally liable. How much control the delegating authority should retain is a subject of discussion and negotiation: one can imagine that in certain cases he will be content to limiting himself to second line supervision, in others that a more hands on approach will be required.

Delegation will always be for a limited period of time: a public authority cannot renounce its legal powers, but can be entitled by the law to negotiate about the way to exercise them. Therefore delegation can be stipulated for a limited period of time, for a specific task, or even for an undetermined period of time[32] in which case a clause allowing for early termination should be considered, thereby taking into account the interests of the other authority that may have invested in the delegated supervisory task. The delegating supervisor should keep a certain, albeit limited monitoring role, although one may wonder whether, in some cases, this residual monitoring might not also be delegated.

Delegation may relate to a series of subjects or to one single transaction: the supervision of a number of issues relating to UCITS (e.g. the role of the depository) or of certain approvals in a take-over bid case could be cited as examples. Also, parties may agree to a delegation framework whereby the delegation clause could be activated each time an individual case, or an individual supervisory action needs to be dealt with.

21. Delegation could be bi-lateral, or multilateral. The former raises no additional issues, while the latter opens interesting perspectives for multilateral supervision, especially in the context of the increasing use of regulatory colleges for the supervision of multinational financial institutions. Within the latter hypothesis, certain investigation duties could be discharged by a smaller group of supervisors acting on behalf of the entire college. Here delegation would contribute to the efficiency of supervision, especially as the specialised skills for supervising the increasingly complicated business activities will not necessarily be available in each of the supervisory bodies involved. As delegation feeds on trust, the call on multinational teams will further enhance the mutual confidence among the supervisors, and allow, in its turn, to take the delegation to further fields.

22. The issue of delegation is of particular importance in the context of the ongoing home-host discussion, as this is presently laid down in the applicable directives[33]. Delegation could be used as an interesting technique for making the supervisory scheme simpler and more efficient, while respecting the supervisory competences of each of the supervisors involved. Different hypotheses could be analysed: the home supervisor delegating specific tasks to the host; the host conferring most of the supervisory tasks to the home, while keeping some sort of second line supervision. Within a group context, where each supervisor maintains full responsibility for the legal entities under his jurisdiction, cooperation could take the form of delegation, whether up- or downstream.

In principle, the home supervisor is in charge of the head office, and the branches, whether domestic or abroad. Delegation could allow the home supervisor to entrust specific supervisory tasks relating to the branches to the host state supervisor even if the latter is not directly competent in legal terms but e.g. has a major interest in keeping an eye on these branches on the basis of their relative importance in the host state. But other motives will do

[32] Without amounting to home country control, as it can always be stopped.
[33] This is also the starting point in the analysis of the European Financial Services Roundtable, On the lead supervision model and the future of financial supervision in the EU, June 2005 p. 32 nr. 39

as well: proximity, language barriers, local banking traditions, or supervisory usages are cases in which delegation may offer an effective solution to the home supervisor. This is what is already practiced on a de facto today in some cases in which inspections are undertaken with – and sometimes even without - the assistance of the local supervisor's staff. Linked to home country control and designation of a coordinator such as provided for in the conglomerates directive, this formula would enable the supervisors that are directly involved in the supervision of a multinational group to act efficiently, in close cooperation, while at the same time maintaining the necessary coherence that flows from the home country principle

23. The reverse situation – from host to home - presents itself with respect to the supervision of subsidiaries. According to the present scheme, the supervisor for each of the subsidiaries is obliged to exercise its competences in full. As mentioned before, this state of the regulation does not correspond to the economic and financial realities in the groups today. A financial services group is managed as an integrated entity, along the business lines that its management has defined, and not along the lines of the legal structures. Supervision remains national, based on the national entities, although the latter often have but limited decision autonomy. Injunctions relating to a subsidiary often should not be addressed to the management of that subsidiary, composed of employees of the parent, but to the management of the group, to which the subsidiary's supervisor has no access at least in legal terms.

Delegation in a home-host context may contribute to bridging the gap between legal and factual structures. Although delegation of the subsidiary's supervision to the parent's supervisor may be incompatible with the subsidiary's supervisor's legal mission, intermediate solutions could be worked out, whereby the latter relies, more or less heavily on the work and investigations that have been undertaken by the former. Here again, supervision could be simplified, made more coherent and in many cases stick better to the realities of to-day. In fact, this integrated approach has now been recognized in the CRD and in prudent terms, in at least one decision of the European Court of Justice[34].

24. Objections are likely to be raised against this approach. The persistence of separate legal entities will result in the local supervisor remaining fully responsible for whatever happens in its jurisdiction. Indeed one is dealing only with delegation of tasks, not of competences, or decisions. Therefore the local supervisor has to remain the dominus in the relationship, he defines the subjects that will be the subject of the delegation, decides about the continuation of the relationship and finally decides upon the supervisory action to be undertaken. As trust and expertise build up, it is likely that the local supervisor will allow more freedom, and will extend the scope of the delegation. But in the beginning of the delegation relationship, parties will not delegate the supervision of an entire institution. They will probably prefer to delegate specific matters, such as IT inspections, on site missions, and so on. In the longer term, gradual extension should be allowed.

25. A second series of objections will be raised in the context of the supervision of institutions with systemic relevance. There are good arguments for rendering, at varying degrees, both home and host responsible as both jurisdictions are likely to be severally affected if the institution fails. According to the present directives the line is clear, but the solution is cloudy: the home is in charge of the parent plus its branches, the host of the subsidiaries. Both solutions may not be satisfactory: in case of financial crisis, the difference between branches and subsidiaries is less relevant here.

[34] See note 6.

In these cases delegation techniques may prove to be particularly useful as they will allow both supervisors to agree, starting from their respective legal positions, to negotiations about common concerns and about aspects that are of primary importance to the other, but not necessary within his reach. Agreements among supervisors have attempted to solve the problem on the basis of a wide exchange of information and intense cooperation. It could be a valid alternative that the supervisors agree to run certain specific supervisory programmes by delegation: why split group IT supervision, as the platform is common to the whole group? Delegation allows extending cooperation to investigations and analyses, but without modifying the ultimate responsibility.

For systemically not relevant subsidiaries, why could the entire supervisory activity not be delegated, in fact integrated in the supervision of the parent company? This is what already happens today in some cases, but on an implicit basis. The host supervisor would than only have to verify whether the supervision of the home authority is adequately effectuated, reserving his right to step in case supervisory measures have to be taken. Looking at it more closely, it will strike that delegation in this case can be considered a valid alternative to the "lead regulator" technique. However, even in this case, delegation would refrain from having one supervisor being substituted to another: the competent authority would remain fully in charge of supervision, receive all reports, could request any further investigation, and remain the only authority in charge of taking the ultimate measures. But over time, that supervisor could consider that in a risk-based perspective, it can better devote its means to other priorities, and limit itself to marginally verify whether the other supervisor has implemented the contract in an adequate way.

26. In the previous cases, delegation related to supervisors that were "naturally" involved. But could certain matters be delegated to a third supervisor? Could certain tasks not be entrusted to an unrelated supervisor with no direct involvement with any of the group's members, but who has developed an expertise that is so advanced that it would be more efficient to delegate him the supervision of the delegated subject matter, rather than developing the same skills in the delegating entity. In fact, one could refer once more to the validation of risk models in the CRD[35]; could this validation not be delegated not only to one of the group members (the parent, in the hypothesis of article 129 CRD) but also to a third supervisor?

(A) 3 - Structural consequences

27. Putting into place a efficient network of cooperating supervisors in Europe, with ample use of delegation and other techniques of supervisory cooperation, may have considerable effect on the evolution versus a new supervisory structure[36]. One could imagine a number of supervisors agreeing on of the ambit of their activities on the basis not of their legal powers but on the economic realities, some supervisors increasing specialising in specific fields, other withdrawing from certain sector for which there is not sufficient density of activity in their jurisdiction. Finally this may result in concentrating supervision in a more limited number of supervisors than today, but maintaining their sovereign right as delegating supervisors, often exercising second line supervision.

[35] According to art 129 CRD the decision reached by the home state supervisor will be "determinative" and applied by the host states' supervisors at least as far as the specific fields viewed by this article. This passage illustrates that the provision goes further than delegation but obliges all supervisors concerned to follow the decisions that have been reached by the home state.

[36] Financial supervision of Monaco has been widely delegated to French authorities.

4 - ***Delegation of decisions***

27. The difference between delegation of tasks and delegation of decisions has already been mentioned as being crucial, and a clear understanding about the difference may help to avoid considerable misgivings. While the former is limited to specific fields, with a significant component of material acts, and implies reporting to the delegating party for further decision, the latter would allow the decision to be taken by the party to whom the competence has been delegated. The decisions delegated would be binding on both parties. It would be useful to further distinguish between agreements that delegate supervision in full, from those that only contain a partial delegation, e.g. specific tasks (the approval of a prospectus), or specific specialised fields (e.g. IT inspections) from decisions whereby all supervisory tasks are being delegated. In the former case, the difference with delegation of tasks may often appear to be a very thin one.

In many jurisdictions, delegating decisions would affect constitutional or other public law principles, as it would allow public bodies to discharge themselves of their legal duties by designating somebody else to do so. Unless the law itself allows so, it seems likely that this would run contrary to constitutional or other legal principles applicable in many state. There are very few fields where a delegation of this kind has been accepted: in the field of financial regulation, art 129 CRD can be mentioned to the extent that it would apply in case the supervisors have not been able to unanimously adopt a common view. Another case refers to the delegation of the approval of the prospectus. One could also recall along the same line, the home country principle, although here the "delegation" – rather attribution of competence- is mandatory. In the case of art 129, the pre-emptive effect will be considerable, as it will urge supervisors to exert maximal efforts to reach an agreement.

Unfortunately, the question of the liability of the supervisor is likely to cause difficulties: in the case of art 129, it would seem that the coordinator, who has adopted the model, could ultimately be held liable if he had adopted a model that was grossly inadequate. This question has not been solved in the directive. In case of home supervision, the answer is easier: the home supervisor will be liable according to its own standards of civil liability. The UK supervisor e.g. could not be held liable for failure to exercise adequate supervision on a foreign branch of a UK bank, unless the plaintiff - creditor of the branch - proves gross negligence, this being the standard of liability adopted in the UK act on the FSA. Depending on the applicable conflicts of law system, this approach would also apply in case the damage was suffered by a creditor located in another state, as the place where the damaging act has been posed would decide on which legal system to apply. If in the latter state a stricter standard would apply – e.g. liability for mere negligence – creditors will be surprised to find out that their claims will be governed by the law of the home state.

The same objections cannot be raised against the delegation of tasks. Not only are these practical arrangements for exercising specific supervisory competences, but they do not modify the delegating authority's decision making power and hence its responsibility or accountability.

To sum up: European initiatives on delegation tread on uncharted territory and therefore a gradual approach is indicated. The needs for delegation are stronger among certain states, e.g. those that have already well developed cooperation agreements relating to the supervision of banks that operate on each of their territories. Initially, delegation will be rooted in the respective national laws but with the increasing integration of the European financial markets, a pan-European

instrument becomes increasingly necessary. Initially however, member states that feel strong needs of delegation, could suffice by conferring delegation powers to their national supervisors.

5 - The liability issue.

28. One the critical elements in the delegation debate relates undoubtedly to the question of the liability in case the delegated tasks are not adequately performed: who will be liable for what? what rules have to be applied? How can this risk be mitigated? The prospectus directive recalls this question by stating that the party delegating the decision to approve the prospectus remains liable[37].

29. The liability question is a complex one that has prevented supervisors to make progress in the delegation debate. The main issue relates to identifying the party that is going to foot the bill in case of inadequate supervision. But beyond that there are some interesting legal questions, such as: could the delegation agreement contain clauses about liability, there where the liability of supervisors is most of the time determined by express statutory provision? Hence can parties exonerate themselves in the agreement, and if not can their liability be covered by insurance? In case of differences of opinion who is going to decide about allocating liability or determine damages. A tribunal,? Or could this be determined by the mediation mechanism[38] that has now been introduced, at least among CESR members? What about divergent liability standards among the different jurisdictions: in some states, supervisors can only be held liable for gross negligence or for wilful misconduct,[39] while in others it has been decided that there will be no liability to investors as the rules are not considered to specifically protect investors[40]. For a third group, liability even for mere negligence would be the yardstick. In a given context of delegation, two different criteria might be applicable: if a supervisor who is only liable for gross negligence delegates to a supervisor liable for mere negligence what will be the liability regime if a creditor sues the latter supervisor? And conversely, would delegation to a supervisor with a stricter liability regime protect the delegating party that is held to more extensive liability rules? These and other complexities, as well as the potentially onerous effects on the willingness of supervisors to enter into delegation agreements are likely to prevent this formula to be used, unless some solution is worked out in a common legislative instrument.

30. Along which lines could the liability question be solved? As delegation is a rather exceptional technique, even at the national level, one will not find ready made answers. Public law is unlikely to yield workable solutions. A comparison with the private law parallel case might guide the analysis.

---

[37] See art 13 (6).

[38] see about mediation: CESR, Protocol on mediation mechanism of the Committee of European Securities Regulators, August 2006: comp. AMF, La charte de la médiation, http://www.amf-france.org/documents/general/3822_1.pdf

[39] This is the case on the basis of a statutory provision in the UK(e.g. s. 102, Financial Services and Markets Act 2000) , Belgium (art.68, L. 2 August 2002) and in the basis of applicable case law in France .

[40] see for the German legal order Tison,M., Do not attack the watchdog! Banking supervisor's liability after Peter Paul, Common Market L. Rev., 2005, 48. Rossi, F., Tort liability of financial regulators, A comparative study of Italian and English law in a European context, EBLR, 2003, 643; Proctor, C., Financial regulators, risks and liabilities, Butterworths Journal of International Banking and Financial law, 2002, 71; Andenas, M., and Fairgrieve, D., To supervise or to compensate? *in* Andenas and Fairgrieve (Eds.) Liber Amicorum Lord Slynn of Hadley: Judicial Review in an international perspective, Kluwer, 2000.

If the transaction would have been submitted to private law rules, it probably would have been qualified as "subcontracting", the liability regime of which is well known. Therefore it is proposed to follow the subcontracting rules to determine the legal position of the parties in case of delegation among public law supervisors. It is however not possible within the context of this paper to give an extensive overview of the applicable rules, and therefore the analysis will be limited to outlining some general principles.

At least according to some legal systems, subcontracting does not change the legal position of the main contractor. He remains liable towards the principal in contract, and towards all creditors, whether in contract or in tort and eventual liability of the subcontractor will not discharge him of his duty. Among the principal and the main contractor, liability in contract is freely determined by the contract, and exoneration or penalty clauses may reduce or increase the risk of the parties. Usually the contract will stipulate that the main contractor has a right of recourse against the subcontractor in case his liability is due to deficient performance by the subcontractor, or conversely may exclude the latter's recourse against the main contractor for liability suits brought by third parties against the subcontractor. Creditors of the subcontractor have, in principle, no recourse against the main contractor or the principal. In order to protect these creditors – often the employees of the subcontractors – specific laws in many jurisdictions offer a direct right of action against whether the principal, the main contractor, or both.

The subcontracting arrangement does not result in rendering the subcontractor liable as this would be a windfall for the creditors. Creditors have in principle no recourse against the subcontractor for deficient implementation of the contract, but he may be held in tort against third parties that have suffered damage due to his tortuous conduct, and then provided the action has not occurred within the mere implementation of the contract. The main contractor will remain fully liable: otherwise subcontracting would lead to a premium for the main contractor.

31. Starting from the hypothesis that these are the rules applicable to subcontracting could these also be applied to delegation, and what would be the legal position in case of delegation among administrative authorities? The relationship is limited to the one between main contractor and subcontractor: the position of the principal, ultimately the state, is beyond the discussion here.

Among main and subcontractor, the delegation agreement applies. Provided the law allows sufficient freedom in drawing up this agreement, the outcome would be quite similar to the private law subcontracting agreement: parties should identify the obligation of the subcontractor, define his remuneration, clarify his liability if needed by adding exoneration clauses, mention whether the main contractor could take recourse against the subcontractor and vice versa. All this could be determined in a binding contract between the two supervisors.

32. This agreement would not be binding on third parties such as creditors of the supervised institution suing on the basis of negligence or tort against whether the main contactor, or the subcontractor.

The main contractor could not escape liability on the basis that it has outsourced certain supervisory tasks. His liability will be determined according to the liability regime applicable to him.

The subcontractor could be sued by the creditor of the supervised entity – or by that entity itself - on the basis of his own tortuous conduct, e.g. if it has caused damages to this creditor other than flowing from the performance of the delegation contract. Indeed, liability for deficient performance would only weigh on the main contractor. However the subcontractor may act negligently and cause damage, e.g. by divulging data about account of individual clients. This

violation would not constitute a breach of the delegation contract but constitutes a breach of the general duty of care in its own right. For negligent conduct of this kind, not only the parties that could claim in negligence against the main contractor, but all other parties that were harmed by the subcontractor's illegal conduct would be entitled to claim.

33. More complex cases will present themselves which will cause the rules to be refined. If the delegation relates to duties that are imposed on both parties to the delegation relationship – e.g. the delegation has been resulted in supervision of the subsidiary companies being wholly attributed to the parent's supervisor– each party will be held liable for his own negligence. If the subsidiary's supervisor has relied on the parent's supervisor, this will as a rule reduce his liability, but he could take recourse against the parent's supervisor. In this recourse, contractual clauses stemming from the delegation agreement could come into play, but these could not be invoked against third parties.

One should question whether the latter regime is very different from the existing one in the context of group supervision, where one supervisor relies on the data and other information gathered by another. Here also, each supervisor will be liable for his own duties, but recourse could be based on the liability standard governing the relationship between financial supervisors. In the absence of explicit clauses in the agreement, the criterion for liability might be that of the "professional expert supervisor" .

34. How should delegation of decisions be dealt with in terms of liability? As mentioned above, delegation of decisions cannot be decided upon by the supervisors themselves in the absence of a clear authorisation in the law. The laws of both jurisdictions would have to provide for delegation and indicate what regime of liability will be applicable. One can assume, as said delegation may ultimately affect the state's finances, that at least in an initial phase, decisions to delegate decision making, even if based on the law, will need to be approved by the government, or by the competent minister.

In case of delegation of decision making, the first issue to be clarified will be what subjects are delegated for decision. As mentioned supra, delegation of tasks will usually also include some elements of decision, even if the final decisions remain in the hands of the delegating party. Therefore, delegation could refer to partial decisions, whereby a determination made by the supervisor to whom the matter has been delegated will be binding on the other supervisors involved. In case of multiple supervisors acting in common, this may be an appropriate technique for dealing with common issues in an efficient way. The partial determination on a specific issue would than not be challenged by the other supervisors, preventing them from doing the job over again. If one supervisor would not satisfied, he should terminate the delegation agreement.

In a stronger form, delegation would refer to the decision as a whole. This is the case to which the prospectus directive refers to be allowing the approval of the prospectus to be delegated. In the securities field, several other examples may be identified: approval of take-over bids and related prospectuses, delegation of market manipulation decisions, of Mifid procedures, and so on. In the prudential field, it would refer to cases whereby the entire supervision of a branch, or of a subsidiary is delegated to the other supervisor in a home-host relationship. In all these cases, the ambit of the delegation will depend on the agreement between the supervisors: they should have ample freedom to restructure their relationship and include elements of delegation of decisions, if considered feasible. Among the elements on which the parties could freely negotiate is the allocation of responsibility – or should one say: of risk – and the possibility to have this risk mitigated, among others by insurance.

35. The question of the liability is in the centre of the discussion about the feasibility of delegation of decisions. An analysis should be attempted to allow to investigate to what extent the liability issue blocks any progress in this matter or whether alternative avenues could be explored.

It is useful to distinguish between the internal relationship between the two supervisors involved and their liability against third parties.

Internally their legal position will be determined by their respective laws authorizing delegation, and by the agreement they have reached. This agreement would normally contain clauses relating to the liability of each of the parties involved, or in their absence, liability would be proportionate to their contractual obligations. One could also admit that a disclaimer of liability be included, whereby one of the parties – mostly the delegating authority - will exonerate, in whole or in part, the other party, and support the residual liability for his shortcomings. Comparable to the general rules applicable to private contracts, these liability clauses cannot be invoked against third parties.

Liability is only one side of the coin: one can expect that the parties will in their contract clearly specify what are the duties and standards of care that have to be respected. Violations of these more detailed provisions would lead whether to the immediate termination of the contract, or other types of corrective action by the delegating party. The contract therefore would normally call for a certain monitoring action by the delegating party, affecting the distribution of risks and liabilities among them. The liability for deficient monitoring would reinforce the delegating party's ultimate liability.

36. External liability may arise essentially v.à.v. the creditors of the supervised entity[41], holding the supervisor liable for deficient supervision. In addition, one should wonder what is the liability of the other supervisor, who has merely acted as a business partner to the former. At this stage of the analysis, it seems useful to distinguish between disclosed and undisclosed delegation: if the creditors were aware of the delegation and relied on it, the situation might be different from the case where delegation was merely a matter among supervisors, without third parties being informed, and even less being able to rely on it.

If the participating authorities would have decided to reallocate supervisory competences, e.g. declaring the parent company's supervisor to be in charge of supervising a subsidiary in another jurisdiction, it seems logical that informed creditors could rely on it, and hence sue the parent's supervisor for shortcomings even at the level of a subsidiary. Logically, the local supervisor would not further incur any liability for the supervision of that subsidiary[42]. However third parties may have continued to rely on the local supervisor remaining in charge: therefore it is up to the parties – and especially to the local supervisor - to decide whether their agreement will have external effects, and by disclosing it, rendering the parent's supervisor liable for both parent and subsidiary. If no such information is given, the local supervisor will remain liable, while the parent's supervisor will eventually be called to account by the local supervisor. Non disclosure would essentially protect the local supervisor, without substantially changing the other party's role.

[41] Relates to tort creditors, not contractual creditors.

[42] The situation is comparable to the mutual recognition and home state rule that also boils down to redistributing supervisory competence among authorities with external effect against creditors and other third parties. Different would be that the reallocation of the supervisory competences would not be mandatory – as is the designation of the home state supervision in case of mutual recognition – but would result from an agreement among supervisors.

37. If the delegation agreements were not known to the creditors and other outside parties, the delegating authority would continue to be liable according to the applicable legal provisions, and could not invoke to his defence that its responsibilities had been delegated. Undisclosed delegation of decisions may only be feasible for partial delegation, where the overall responsibility remains with the delegating party, but specific tasks are assigned to another. This formula could be used e.g. for delegation to a third party, as mentioned above, whereby the responsibility of the delegating party would not be affected.

Undisclosed delegation is not likely to affect the distribution of the risks. Third parties could rely on the apparent situation and if the delegating supervisors would be declared liable, he course take recourse on the delegatee supervisor.

If the delegation was well known to the outside world, e.g. because the supervisors have expressly referred to it, this would not suffice to give creditors an additional right of action against the delegatee. The law could of course provide otherwise: in a private law context, this result is achieved by virtue of an express clause granting rights to the third party. In public law, the law could impose and express liability on the delegatee but this looks a rather remote hypothesis. In the absence of a provision to that effect, the external liability of parties would not be effected by the delegation agreement. This means in practice that the supervisors who has delegated its powers to another supervisor would remain liable[43], even if the mistakes have been committed by the delegatee. It is clear that this outcome is unacceptable to the delegator, and therefore will effectively prevent delegation of decisions to take place. However, one could imagine that intermediate arrangements may be devised: the delegator may retain certain control rights allowing him to check the way the delegatee has implemented, including the decisions he has made, and allowing the agreement to be terminated at once if implementation appears unsatisfactory. This arrangement would not prevent the delegator to be held liable, but allows him to better control the damage.

In the hypothesis that a legal provision would be adopted, extending the liability of the delegatee, this might have considerable consequences on other related fields, such as the deposit protection schemes and the lender of last resort position. Therefore solving the liability issue presupposes that better arrangements are in place on these two topics as well.

Another question relates to the right of third parties, creditors of the delegator to sue the delegatee on the mere fact of their knowledge of the delegation. There might be circumstances where such liability might arise especially if the delegatee has committed torts for which he would be directly liable against any victim. In this case the delegatee would have no recourse against the delegator in the internal relationship either. The "additional" liability of the delegatee is not the consequence of delegation, but of the acts posed by the delegatee whether or not within a delegation context. But these case excepted, one does not see how the delegatee could be held directly against these creditors.

.

38. In the absence of an express statement in the law, it would seem that even after publication of the arrangement, the delegating party, being usually a public authority, will not be able to claim that it has contracted away it supervisory powers or at least that this will not affect its liability against third parties.

To conclude:

[43] This is in fact the solution formulated in the prospectus directive, art. 13 (6).

1. delegation of tasks do not give rise to specific liability issues, except in the internal relationship; here the agreement should prevail;
2. delegation of decisions may be practiced provided it relates to specific well defined actions that are part of a wider supervisory activity;
3. delegating the entire supervisory assignments leads to unwarranted liability questions and hence needs a reform of the law.

6. Exoneration and penalty clauses, Insurance, fees

39. Several times the need for flexibility in delegation agreement has been mentioned. It should be allowed for parties to include certain clauses limiting their liability, fixing pre-established amounts for specific shortcomings, but also imposing certain sanctions in case of defective implementation.

In addition, the importance of insurance should be mentioned. Already today, some supervisors have insured their liability, allowing for creditors to obtain more ready redress. In delegation cases, insurance coverage might be key to the willingness of the parties to engage in delegation. This topic needs further investigation.

Delegation will requires supervisors to affect scarce resources to tasks that are not necessarily within their statutory remit. Therefore, the issue of remuneration should be discussed. As most supervisors have increasingly detailed accounting systems, there should be no major hurdle in invoicing delegated tasks to the delegator, at cost. Whether in addition to cost an additional fee can be invoiced, seems doubtful, as these agreements will be entered into among public authorities, that according to the laws in many jurisdictions, would not be allowed to make profit. A certain element of competition could be introduced if delegation could also take place in favour of not directly involved supervisors.

7. Confidentiality

40. Among supervisors several provisions of the European directives and the national provisions implementing these govern confidentiality. These provisions most of the time relate to supervisors in the same line of business. Harmonisation may be needed for supervisors that are involved in different lines of business, e.g. for delegations among banking and insurance supervisors. This issue is not specifically related to delegation.

8. Supervisory tools

41. The effectiveness of the delegation technique is linked to the availability of the same or comparable supervisory tools in the different jurisdictions. Feasibility of delegation schemes but also liability issues may be insolvable if one supervisor is entitled to use a certain tool that another cannot put to work. Supervisors have repeatedly called for introducing the same supervisory tools by EU measure. Some of the securities directives contain a requirement to develop the same tools for all supervisors[44]. Similar provisions should be introduced in all financial services directives.

[44] See market abuse directive, art 12; comp. art. 24(4) Transparency directive.

9. Disclosure

42. Are delegation agreements to be disclosed? A full disclosure may lead to additional liability concerns. Therefore disclosure is strictly not required for a delegation of tasks, as it also would have no effect on the position of the authorities involved in terms of liability. As mentioned above, the situation would not be different for delegation of decisions as disclosure normally will not extend the liability of the delegatee. Also disclosure may have an effect on the market valuation of supervised entities. More generally, and as part of a general transparency policy, it sees preferable that delegation agreements be known to the public, without necessarily disclosing all the fine details. This is the actual practice for many of the existing MOU's. It would be for the supervisors involved to decide whether they want to proceed to disclosure and under what terms.

Conclusion

43. Supervisory delegation is undoubtedly an interesting formula that should be further analysed and tested in practice[45]. It can be considered as an original answer to the many questions that face European financial supervisors confronted with the needs of an integrating European financial markets, including the "market for supervisory services". Supervisors are bound to cooperate, but it remains unclear how this cooperation has to be structured. Delegation, if conceived in sufficiently flexible terms, allows to formulate a valid response, along with the existing techniques of supervisory coordination, especially the home country rule, the designation of a "coordinator" or even of a "lead regulator". It could also be usefully applied in cases where none of the existing European schemes apply, such as the supervision of regulated markets, or of financial services that are not covered by the directives. Delegation does not modify the existing schemes but allows optimalizing the existing cooperation among supervisors.

Delegation should remain flexible and hence voluntary. Room should be left to the initiatives of the supervisors to experiment with different formulas. It is the task of the supervisors that are directly involved to structure their cooperation in the most efficient way.

Delegation allows for specialisation so that some supervisors could develop into centres of excellence and take over some of the tasks of their colleagues. It seems likely that over time, not all 54 European supervisors will be willing to maintain all lines of supervision: delegation could allow a minimal involvement. Delegation of tasks to non-supervisors might even been considered.

---

[45] Delegation has been advocated in Canada to ensure the coordination among the provincial securities commission: see David Brown, former OSC chairman, Keynote address, Nov 20, 2001 "We are exploring Transparency directive asking the legislatures to permit securities regulators to delegate to each other the authority to make specified types of decisions. For example, all non-principal jurisdictions could delegate to the principal jurisdiction the authority to receipt a prospectus on behalf of all. Similar authority could be delegated for granting discretionary relief or other decision-making functions".
http://www.securitiescanada.org/2004_0930_action_plan_english.pdf; see also the Proposal blueprint for uniform securities laws for Canada, stating the the project "proposes mutual recognition and delegation of authority between securities regulators. These "would facilitate one stop-shopping (or a "passport system") for capital market participants across Canada". http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/csan_20030731_11-304_usl-proposal.pdf

44. There is a fear that delegation will only lead to few winners and many losers, but this fear will become stronger if no efficient cooperation scheme is put in place. It is not unlikely that regulatory competition will increase pressure on the present supervisory scheme, especially by converting subsidiaries into branches. Delegation could offer an answer allowing for parent company's supervisors to delegate tasks to local colleagues. Solutions could be found for the supervision by the host state of the systemically important branches. Also delegation will support the need to coordinate and concentrate supervision in the hands of the supervisors that are directly in charge of supervision of a multinational entity. If third party delegation of tasks would be accepted, this might start a developed towards more specialisation and competition on the quality of the service.

45. The European Commission could usefully table a directive on delegation of supervision. Without a directive delegation would be left to the – already existing – provisions in the states national laws, creating confusion and loopholes; The need for uniformity is quite string in this field.

Provisions should relate to the power to delegate, the freedom to frame delegation agreements, allowing parties to decide on delegating a wide range of issues depending on their individual needs. Delegation of tasks does not give rise to significant problems, and hence could be freely allowed. Delegation of decisions could also be accepted for partial decisions, especially in a multiparty context. However, delegation of full decisions raises difficult liability issues, for which there is not ready answer, unless some prerequisites have been met in terms of liability. At least provisionally, a directive should better leave these matters to the initiative of the member states.

It is important that ancillary matters such as confidentiality, fees, publication, and so on should be dealt with.

If a more intense use of delegation could be introduced in Europe an original model of supervision could be developed that would allow for a combination of subsidiarity and proximity along with efficiency and specialisation**.** May the present study contribute to that objective.

Financial Law Institute

The **Financial Law Institute** is a research and teaching unit within the Law School of the University of Ghent, Belgium. The research activities undertaken within the Institute focus on various issues of company and financial law, including private and public law of banking, capital markets regulation, company law and corporate governance.

The **Working Paper Series**, launched in 1999, aims at promoting the dissemination of the research output of the Financial Law Institute's researchers to the broader academic community. The use and further distribution of the Working Papers is allowed for scientific purposes only. Working papers are published in their original language (Dutch, French, English or German) and are provisional.

More information about the Financial Law Institute and a full list of working papers are available at:
http://www.law.UGent.be/fli