

3 September 2008

Executive summary regarding work on delegation

1. Following the Francq recommendation that supervisors develop a framework for the delegation of supervisory tasks in the banking sector, CEBS has performed an in-depth analysis of current cases of delegation of tasks, and by doing so, identified practical and/or legal obstacles to delegation under the current framework. The work provides information about the current situation and indicates areas for further possible progress in the delegation of tasks in banking supervision.

In-depth analysis of current cases of delegation of tasks

2. Two particular areas have been identified in which delegation of tasks takes place: (i) on-site examinations including model validation and (ii) liquidity concessions. Specific cases have been reviewed using short questionnaires.
3. From the work performed it can be concluded that:
 - Regarding delegation of on-site examinations including model validation, where no legal or practical impediments are identified, more frequent use of these types of delegation may be expected in the future in both directions from home to host supervisors and vice versa, and regarding both subsidiaries and branches (in principle, delegating on-site examinations between supervisory authorities in the European Union seems feasible and legally sound as long as domestic laws foresee the possibility of entrusting to other supervisors or receiving from them the duty to carry out supervisory tasks).
 - Regarding liquidity concessions or delegation that includes waivers of quantitative requirements; national legal or regulatory frameworks have established the conditions for such waivers. CEBS recommends that CEBS members propose such steps to their national legislators when relevant.
4. The outcome of CEBS's work is to be regarded as work in progress. It is intended to provide information about the current situation and to identify areas for further possible progress in the delegation of tasks in banking supervision. It will provide input to the work on delegation being performed jointly by the 3 Level 3 Committees, which will commence its work in the second half of 2008. In addition, the paper is intended to

facilitate the use of delegation in banking supervision by providing guidance on the process of delegation and by clarifying legal obstacles.

1. INTRODUCTION

1. The Financial Services Committee in its Francq report recommended that supervisors develop a framework for delegation of supervisory tasks in the banking sector. Supervisors have been requested to explore the preconditions for the use of delegation mechanisms – especially through the use of guidelines – and where appropriate to test these arrangements.
2. This paper presents the outcome of an in-depth analysis of delegation of tasks based on practical cases. CEBS has identified two areas in which delegation already takes place: (i) on-site examinations including model validation and (ii) liquidity concession models. This paper elaborates on: (i) the definition of delegation of tasks, (ii) the current legal framework and reasons for delegation, (iii) possible trends for the future and (iv) general criteria for the processes of delegation. Two reports fleshing out current practices in the two areas studied are annexed to this paper.

2. DEFINITION

3. **Delegation of tasks** (or entrustment of tasks) means that tasks are carried out by another supervisory authority (the delegate) instead of the responsible authority, and the findings reported back to the delegating authority. The responsibility for supervisory decisions remains with the delegating authority. This definition is in line with the Francq report¹.
4. Adequate reporting by the delegate ensures that the delegating authority is able to take action where necessary. It also demonstrates that only the task has been delegated and not the responsibility.
5. The analysis shows that at the moment supervisors prefer the concept of joint working. Joint work between home and host authorities is considered to optimize resources and expertise and avoid redundant work by supervisors and unnecessary burdens on banking groups.

3. CURRENT SITUATION AND STATUS OF DELEGATION

Current regime under European legislation

6. **Branches** - the regime under European banking legislation allocates the responsibility for the supervision of a branch to the home supervisor.

¹ According to the Francq report delegation of tasks is where individual supervisors delegate specific pieces of supervisory work to one another. Where tasks are delegated, the decision-making responsibility remains with the delegating competent authority, but the other authority carries out processes on its behalf and reports the outcome back to the delegating authority or other interested authorities. In this case, the delegating authority retains full political responsibility for all decisions made. Another type of delegation is the delegation of responsibilities, where the delegating authority delegates the power to make decisions on its behalf to the other authority. Where responsibilities are delegated, the delegating authority would delegate the power to make decisions on its behalf to the other authority.

Exceptions to this principle are: (a) the supervision of liquidity which comes under the host supervisor “in cooperation” with the home supervisory authority (art 41 of CRD), (b) “general good” rules and (c) anti-money laundering and anti-terrorist financing.

7. **Subsidiaries** - the CRD applies on both consolidated and solo bases and takes into account the legal structure of the banking group: it allocates overall group supervision to the consolidating supervisor and solo and/or sub-consolidated supervision of subsidiaries/sub-groups to the host supervisors². Under Article 131 arrangements must be in place through which additional tasks may be entrusted to the competent authority responsible for supervision on a consolidated basis and procedures for joint decision-making and for cooperation with other competent authorities may be specified. In addition, Article 131 also permits the delegation of responsibilities from the host authority to the home authority (however this paper does not explore delegation of responsibilities). Finally, Article 129 (2) provides for full consultation with host supervisors and joint work on the validation of advanced models.

Status of delegation

8. From the analysis performed it can be concluded that there are two general types of delegation commonly used in the EU at this time: (i) delegation of on-site examinations including model validation, and (ii) delegation of liquidity concessions including waivers.
9. Currently **delegation of on-site examinations including model validation** is the type of delegation which is most often used. This type of delegation usually covers specific tasks such as the review of credit risk management practices or internal governance in local subsidiaries and branches.
10. Another area in which delegation takes place is the assessment of the fitness and propriety of branch directors made by the host supervisor on behalf of the home supervisor.
11. With the implementation of the CRD, a new development is joint assessment of IRB models validation and their approval. In these cases the consolidated supervisor looks to the host supervisors to undertake the necessary review work of models used by subsidiaries and the host supervisors look to the home supervisor for the review of internal control and corporate governance issues and the assessment of models developed centrally. In some cases, this work has been conducted bilaterally; while in other cases the work has been conducted multilaterally (see Annex 1).

² The terminology used in this paper designates the home supervisor of a group as the ‘consolidating supervisor’, the supervisor that awarded a licence to a subsidiary as the ‘host subsidiary supervisor’ and the supervisor of a branch as the ‘host branch supervisor’. The term ‘host supervisor’ includes both host subsidiary supervisor and host branch supervisor. This terminology is not entirely in accordance with the wording of EU Directives, but it reflects the practical arrangements used in the supervision of a banking group.

12. **The only cases of delegation of liquidity concessions including waivers of quantitative requirements** cover the delegation of the supervision of the liquidity of branches to home supervisors. This delegation implies waiving certain quantitative requirements; in return, home supervisors assume certain reporting obligations in relation to the host supervisor (see Annex 2). Delegation of liquidity supervision of subsidiaries to home supervisors has not been reported by any supervisor.

4. POSSIBLE TRENDS FOR THE FUTURE REGARDING DELEGATION AND ISSUES TO BE ADRESSED

General framework

13. Since the implementation of the CRD into national legislation has been finalized, the work of supervisors is now focussing on the practical issues arising. This means that supervisors are becoming more familiar with the new CRD framework and are in the **process of building up trust** with respect to each other's work and developing closer supervisory cooperation.
14. It is possible that this increasing trust and close cooperation may result in more frequent use of delegation of both the types discussed in this paper and also in other areas. Some preliminary thoughts on the future development of on-site examinations or joint visits and certain aspects of liquidity supervision are set out below.
- Concerning the **delegation of on-site examinations including model validation**, it is important to mention that where no legal or practical impediments are identified, it may be expected that **this kind of delegation is used more frequently in the future** (in principle, delegating on-site examinations between supervisory authorities in the European Union seems feasible and legally sound as long as domestic laws foresee the possibility of entrusting to other supervisors or receiving from them the duty to carry out supervisory tasks). Such delegation already takes place both ways, from home to host supervisors and vice versa, and apply to both subsidiaries and branches as the delegation of tasks can be influenced by the functions and significance of the particular entities be they subsidiaries or branches regardless of the legal structure. Organization of these activities can also often encompass joint work between the supervisors involved.
 - The situation regarding the **delegation in form of liquidity concessions or delegation that includes waivers of quantitative requirements** is both more limited and complex. Firstly, it only operates in one direction: from host to home supervisor and only in relation to branches. Secondly, **it is also more complex because it needs a more elaborate legal or regulatory framework in the host country given the need to set the conditions under which such waivers are to be granted**:

- o As shown by the analysis, the conditions under which liquidity requirements may be waived for **branches** are clearly defined in the national legislation of the host countries which currently allow such waivers or concessions³. Such conditions may set the benchmark for those countries that have liquidity requirements in place for branches, and wish to consider waiving such requirements (relying on the supervision undertaken by the home supervisor) in the future.

Currently liquidity concessions/waivers do not apply to **subsidiaries**⁴. Bearing in mind the different legal nature of subsidiaries it should be noted that a number of important legal and practical considerations over and above those which arise in the case of branches may emerge when considering granting waivers for subsidiaries for example: (i) it may be more difficult to assess at which point the line between delegation of tasks or responsibilities is crossed given that EU insolvency law applies on a legal entity basis and (ii) in times of market stress there could be difficulties and pressures on the availability and transferability of funds between different legal entities. In addition, as with branches, certain conditions would have to be met although there are no current examples which could set the benchmark⁵.

Specific areas where delegation may be fostered

15. **In the cases of branches** there could be incentives from a local stability perspective to accept tasks delegated from the home supervisor when the branch is systemically relevant and/or in cases where additional deposit insurance (topping-up) applies to branches. Such tasks could encompass for example, a) the on-site review of internal controls and organizational procedures, and/or certain risk areas and b) information gathering.
16. Furthermore, there could be great incentives for banks to seek more liquidity concessions if they have centralized liquidity management and branches located in countries that impose quantitative and qualitative requirements on foreign branches' liquidity. A legal basis in the legislation of the host supervisor for liquidity concessions would need to be in place.

³ Some of these are being revisited as part of the wider CEBS liquidity review.

⁴ Article 69 applies only to domestic subsidiaries of domestic banking groups.

⁵ As a result of the analysis performed, some elements have been identified that may be taken into account when setting the conditions: (i) the arrangement should be consensual, and not obligatory, (ii) proportionality should be observed with respect to the requirement to be waived in relation to the systemic relevance of the subsidiary, (iii) the arrangement should not limit the host supervisor from receiving information from the subsidiary, including regular reports, (iv) the host supervisor should be kept well informed by the home supervisor as regards risk management at the local and group levels, (v) in the case of stress at the subsidiary level, supervisory action can be triggered by the host supervisor, and (vi) additional guarantees should be provided by the parent bank.

17. **In the case of subsidiaries** practical work on Pillar 2 has just started and is becoming a very relevant issue within the colleges of supervisors. This practical work requires a very close working relationship and may include delegation and joint work (e.g. on-site examinations) to obtain information for supervisory risk assessments and understand features of the internal models used by banks. The work on Pillar 2 issues can also benefit from the input of host branch supervisors.
18. The work in the **colleges** may follow different paths e.g.:
- i. The organisation of on-site examinations including model validation may follow banks' business lines where the supervisors in charge of units (branches/subsidiaries) involved in a significant amount of activity in the same business line coordinate the work.
 - ii. Horizontal on-site examinations across banking groups where the supervisors in charge of the work are chosen on the basis of their expertise and not just on the inclusion of the unit within their responsibility in the scope of the examination⁶. The scope of the work may be undertaken on a more permanent basis, rather than on an ad-hoc basis, and may incorporate several supervisory activities.
 - iii. The scope of the work may incorporate several activities and the delegation to a particular supervisor may be more permanent.

⁶ There is limited but positive experience of this kind of examination. There may be some legal obstacles to this form of cooperation which will need to be analyzed further.

5. GUIDANCE ON THE PROCESS ON DELEGATION

19. This section sets out some practical issues that need to be considered when entering into a delegation arrangement and which can facilitate the use of delegation. The coordination of activities and the division of tasks between supervisors may be agreed within the college of supervisors.

Introduction

- o The delegation of tasks is a voluntary agreement between supervisory authorities. Supervisors can rely on each other to perform supervisory tasks. Therefore, supervisors can share and delegate tasks to each other to the extent and under the terms and conditions agreed bilaterally or multilaterally.
- o The delegation may reflect the organisation of the banking group (centralized/decentralized risk management processes) and may take into account the importance and significance of the unit (branch and/or subsidiary) for the supervisors involved.
- o There should be a defined benefit derived from/as a result of the delegation. The benefit may be for the supervisory authorities in terms of optimising resources⁷ and expertise, avoiding duplication of work or avoiding unnecessary burdens for the banking group. Networking, learning opportunities and improved information sharing may also provide incentives to consider delegation.
- o One of the criteria that is considered when delegating is which authority will be best placed to conduct the specific task in terms of e.g. technical skills, business lines, expertise on local markets or other factors, and the availability and technical skill of the staff members who will undertake the work. Examples of supervisory tasks which could be delegated are aspects of SREP and model validation, joint on-site examinations and branches' liquidity supervision.

Legal setting

- o Before entering into a delegation arrangement, supervisory authorities should be aware of each other's legal and regulatory frameworks. In particular, the delegating authority should ascertain whether delegation of supervisory tasks is permissible under the national legal or regulatory frameworks. In the event that the delegation covers a regulatory exemption for a branch or subsidiary operating in that country, specific provisions need to be included in the legal framework.
- o While Article 44ff of the CRD ensures confidentiality in the exchange of information among EU supervisors, some supervisory authorities may want to specify in writing the conditions under which members of other

⁷ This document does not discuss economic compensation.

supervisory authorities working in the context of an arrangement of delegation or sharing of tasks, will have access to confidential information of the institutions under its supervision. Such confidentiality conditions could be agreed upon among the members of the college to ensure consistency.

Processes

o When planning their supervisory activities for the year ahead, the authorities may consider which tasks they wish to undertake jointly or to delegate. Delegation may also take place at any time at the request of the potential delegating or delegate authority. If the home authority is not involved in the delegation arrangement it should be kept adequately informed.

o Initial contacts can be used to discuss practical issues such as language, means of communication/reporting and the timetable for completion.

o There is mutual understanding between the delegating and delegate Authorities of each other's supervisory procedures and processes to arrive at the agreed outcome as well as the legal framework that applies to the specific task. In the event that the delegating authority wishes its own methodologies and procedures to be applied or certain own legal requirements to be looked after, then this needs to be arranged and agreed upon beforehand.

o Any information relevant for the proper execution of the task is communicated. This may include areas of interest and supervisory concerns that may have an important bearing on the other supervisor's work or significant differences in legal frameworks.

o Supervisors understand that in principle and unless otherwise stated, the delegation is outcome oriented (instead of process oriented) and that the laws and regulations of the delegate authority apply to the process of carrying out the task while the result is assessed and used by the delegating authority under its law.

o Both authorities agree on who is going to be in charge of communicating with the institution of the group concerned. The institution shall be informed of the delegation arrangement and that documentation and findings will be shared with other supervisory authorities.

o The delegating authority is adequately involved in the delegated process and information exchanged as necessary during its course. This involvement may consist of participating in the task to some degree, or in parts of it (e.g. for on-site examinations, the initial meeting with the credit institution, and/or any possible intermediate high-level meetings, and/or in the closing meeting where the draft outcome may be presented to obtain initial feedback from the institution).

o The delegate authority communicates the outcome to the delegating authority. The form of communication may vary depending on the task and/or the procedures agreed.

o The delegating authority considers the work done by the delegate authority. In case it considers that more work is needed, the delegating authority could ask the other authority whether it is willing to undertake the supplementary work or decide to perform the task itself.

o The delegating authority considers whether the findings communicated by the delegate authority have any bearing on the banking group as a whole, or on the credit institution/branch under its supervision.

o The delegating authority considers whether it is necessary to document the whole process. In the case of litigation, the documentation will help the delegating authority to demonstrate that it has acted within its authority and that delegation of responsibility has not taken place.

o Supervisors should consider if other supervisors and authorities outside the delegation arrangement need to be informed of the existence of the arrangements and the results.

DELEGATION OF ON- SITE EXAMINATIONS

1. Delegation of on-site examinations, may be defined as the action by which a supervisor (the delegating supervisor) entrusts all or some of the areas of an on-site examination to another supervisor (the delegate). It is important to mention that in the cases reviewed delegation has almost always taken the form of work sharing, whether vertical or horizontal.

1. CASES REVIEWED

2. Most of the cases presented relate to delegation in the context of on-site examinations for model validation (IRB), but some are of a more general nature and would apply also to delegation to other EEA supervisors, acting as home/host supervisor or one of the supervisors of the colleges in the delegation of an on-site examination. About the details we refer to point 2 of this report.

Model validation

3. The majority of the practical cases analysed relate to the model validation process under the CRD and have adopted a similar scheme. The cooperation framework was based on the business model used by the banking group: for local models, host authorities were entrusted with reviewing the design and application of the models, while the home supervisor was responsible for the centralised corporate governance and internal controls, together with ensuring consistency of the calibration of the models with regard to the other units of the group. For centralised models, the home authority was entrusted with reviewing the design of the model and host authorities with ensuring the proper application of the model at the local level.
4. A case was reported where the banking group is using advanced models while the subsidiaries are using standard approaches. The home supervisor has undertaken an on-site visit to the subsidiaries with regard to the “group models” but has requested that the host supervisor provides support in the revision. However, this is not a delegation of the on-site examination.

Other cases reported were:

5. A supervisor of a subsidiary of a European group has delegated –for reason of specific expertise- to the supervisor of another subsidiary of that same group the review of a specific area (shipping) located in a branch outside the European Union. Similarly the same supervisor appointed an expert from another “sister” supervisory authority to work with it on the on-site examination of an area (markets cross-border activities) of interest

to both authorities given that the banking group primarily uses the two locations to conduct this business.

2. RATIONALE FOR DELEGATING /ACCEPTING TASKS

6. The main objectives of delegating on-site examinations are to optimise resources and expertise, avoid redundant work for supervisors and avoid unnecessary burdens on banking groups. The arrangements for delegation of tasks relating to on-site examinations are, to a large extent, the reflection of how banking groups manage their activities (centralized versus decentralized model).
7. For all members pragmatism and practicality seem to have dictated that the most sensible arrangement was to defer to the "supervisor on the ground" with the relevant expertise and knowledge of local conditions and local markets. As such, supervisory tasks were aligned to the nature and location of models built. Efficiency of supervision while avoiding duplication of supervisory work was also mentioned. For cases not related to model validation, the existence of a recognised expertise at another supervisor was also a reason.
8. From a delegate's perspective, the main drivers for agreeing to undertake supervisory tasks delegated by another supervisor seem to be closely linked to the significance of the local market share of the unit under review, along with the quality of the cooperation with the authority offering to delegate tasks. In this respect, a long standing collaboration and/or expected reciprocity were often mentioned. The perspective to acquire a better knowledge of other supervisory processes, to prepare for on-going supervision (in the case of model validation) or the possibility of acquiring first hand and "tailored" information were deemed relevant. Last, but not least, the effectiveness of the burden sharing was also noted.
9. As far as model validation is concerned, the review/validation of models locally developed/managed, was delegated to host authorities on a voluntary basis. In the "other types of delegation" reported, one of the supervisors forming part of the college (but neither home nor host to the controlled unit) was solicited based on its expertise because it supervised another unit of the group that was heavily involved in the same business as the unit under review. Some supervisors are open to the delegation of on-site examinations regardless of prudential responsibility provided there is still a defined benefit to be derived and the experience or expertise of the delegate was a relevant factor.

3. DELEGATION PROCEDURES

Contacts between supervisors

10. In all the cases reviewed, there have been frequent bilateral contacts between both supervisory authorities, before, during and after the on-site examination.
11. With regard to model validations, the starting point was usually a letter from the home supervisor informing the host supervisor/delegate of the

request by the banking group to use advanced models; then, the staff to be involved were identified and started exchanging information on a frequent/regular basis; the teams in charge of the on-site examinations met and discussed their expectations, working procedures, scheduled visits, methods of exchanging of information and possible differences in regulatory treatments. In one case a steering committee with experts from the two authorities was created.

12. Focus seemed to be put on outcomes versus methodology as in the cases presented only very broad principles (and no operational guidance) on how to lead the examination were provided to the delegates.
13. Additionally, host supervisors have invited home supervisors to participate in the whole examination or in relevant meetings with the credit institutions. Conversely, home supervisors have organized presentations to be made by the parent banks and, in a closed session, have presented their own assessments.
14. In the other types of delegation reported, the inspection plan of the whole banking group has been discussed and decided in the college of supervisors, where decisions have also been taken with regards to which supervisors are best placed to conduct the examination. Then the chosen supervisors have jointly prepared the inspection plan and drafted the request for pre-visit information materials to be provided by the unit concerned.

a. Procedures and processes

15. The joint/delegated on-site examinations did not generally have to follow specific requirements in terms of processes and/or procedures requested by the delegating authority. In all the cases examined, the process was mainly outcome oriented. Certainly a balance has to be struck between precise mutual understanding of the objectives, methods and deliverables of the examination on the one hand and the efficiency of delegating to another supervisor not familiar with the delegating authority's procedures on the other. The experience is diverse: while in some cases the teams in charge of the on-site examinations met and discussed their working procedures, communicated with each other their scheduled visits, exchanged information, and discussed possible differences in regulatory treatments; in others there were little exchange of information.
16. The delegating authority got involved to some extent in the work of the delegate by taking part in some on-site meetings as well as by inviting the delegate to presentations and internal discussions.

b. Communication with the bank

17. The controlled institution is usually informed in advance of the forthcoming examination, although this does not appear to be related to the fact that some tasks are delegated. Some members indicated that before the

beginning of an on-site examination, the institution is notified by letter of the scope of the on-site examination and the process, including the delegation to the other authority with the details of the contact persons. One member indicated that in both cases reported, the bank had been informed of the right of delegating authority to use other expertise and of the confidentiality responsibilities of the delegate. In other cases oral information is provided on the distribution of tasks between the delegating and delegate authorities. The level of detail provided may vary from instance to instance but at a minimum the institutions are made aware of the cooperation arrangements and that documentation and findings will be shared.

c. Outcome of the delegated task

18. Model validation has a well defined framework that requires that findings are discussed and agreed in the context of Article 129 (2) of the CRD. Communication between authorities appeared to have taken place in different ways, examination reports⁸, e-mails and formal letters, depending of the status/complexity of the issues under discussion.
19. Some members indicated that for the model validation of a given group a report was made by each delegated authority which was the only signatory of its own report, whereas others indicated that documents were not officially signed by the delegates and that exact wording of the outcome was thoroughly discussed between the delegating and delegate authorities in order to reach a consensus. In the other types of delegation reported the delegate was not a signatory to the final report.
20. All members agreed that although the delegating authority is not legally bound by the analysis led by the delegate, it is expected to pay due regard to the findings of the delegate and their impact on its own assessment, which however does not necessarily give rise to any supervisory action on its part. In general, the conclusions of the reports on model validation are taken into consideration in the approval process. This holds true for the other types of delegation as well, especially since the delegate has been chosen for its recognised expertise in the regulatory area concerned.
21. Although cooperation is an on-going process, most countries reported that no follow-up delegation of tasks is contemplated at this stage. One member indicated that it would view an on-going relationship positively but noted that this might be on an informal/ad hoc basis.

4. BARRIERS TO DELEGATION / DOCUMENTATION OF THE DELEGATION

22. With regard to on-site examinations no practical barriers to delegation were identified. The working language is usually English, which has never been presented as an obstacle although one member pointed out that this might require some extra time to get to understand each other's working procedures. Similarly, as delegation in the context of validation of models

⁸ The reports to the home authority may include findings as well as formal opinions.

is still in its early stages, all possible practical barriers may not have been encountered yet.

23. Regarding legal barriers, in principle, delegating on-site examinations between supervisory authorities in the European Union seems feasible and legally sound as long as domestic laws allow the possibility of entrusting to other supervisors, or receiving from them, the duty to carry out supervisory tasks.
24. Although there is little international experience, some countries have a long record of delegating on-site examinations to domestic experts, mainly, external auditors. Situations can vary from one country to another. One member indicated that their national Banking Act allows for delegating tasks to a third party. The supervisory authority defines the content of the examination and receives an examination report afterwards. Another member indicated that the delegation of tasks to external experts was expressly provided for in national law but that use of expert evidence was not limited to this article. Regarding the possibility for access by the delegating authority to the working documents of the delegate different situations may arise: in that country, it is likely that the terms of appointment of the auditor (to which the authorised firm agrees) would expressly provide that the supervisor is given access to the working papers.
25. One member indicated that evidence provided from a foreign supervisor would generally be admissible in enforcement proceedings taken by the supervisor although it would be open to the court/tribunal to exclude the evidence, or afford it little weight, if it thought it appropriate to do so.
26. Given the lack of a sufficiently long track record, some supervisors are concerned about litigation, in particular if the parent bank or the unit challenges the decision to impose a sanction after an on-site examination carried out by another supervisor on the grounds that the delegating authority has no right to impose a sanction based on evidence produced by a third party.
27. Some elements found in the practical cases may help to demonstrate to a court the existence of an adequate balance between delegation, accountability and transparency:
 - Written memorandum or exchange of letters between both supervisors outlining expectations, distribution of tasks and confidentiality issues. In one of the cases reported on model validation, the memorandum was a multilateral agreement.
 - Communication to the credit institution informing it that a supervisor from another authority is joining the on-site examination. The other supervisor may act in its capacity of an expert (the delegate) or as delegating authority.
 - Report sent by the other authority with the findings.

28. Access to working documents may prove useful when justifying a sanction. Between EU supervisors, transmission of the working documents relating to a delegated on-site examination should be covered by the CRD provisions on the exchange of information. A legal issue may arise if those working documents have to be transmitted to a third party that has a legitimate interest in the matter (e.g, a court) and in such cases, prior notification/request for authorisation should be made to the delegate.

LIQUIDITY CONCESSIONS PRACTICES

1. INTRODUCTION

1. Article 41 of the CRD provides for the supervision of the liquidity of the branches of credit institutions by the host supervisory authority in “cooperation” with the home supervisory authority. In certain circumstances this “cooperation” may involve the home supervisory authority carrying out liquidity supervision, on a centralised basis, for the whole credit institution including branches in other EEA Member States. This arrangement, sometimes referred to as a “Liquidity Concession” (LC), requires the explicit agreement of both the home and host supervisors.
2. An LC can be viewed as an intensive form of cooperation through delegating a bundle of tasks from the host authority to the home authority, and by granting conditionally an exemption from the liquidity requirements applying to the branch by following the business structure of a large credit institution with cross-border activities. Host supervisors need to consider which tasks are going to be delegated and to what extent.
3. An LC is generally considered to be the delegation of tasks rather than responsibility with virtually all LCs in operation being agreed on this basis⁹. Two Member States which only participate in LCs as home supervisors consider that the distinction between tasks and responsibilities is not always clear and one Member State which also participates in LCs only as the home supervisor holds that there is no delegation at all, rather that an exemption has been granted. Those Member States which consider it to be a delegation of responsibility do not participate in LCs.

⁹ Of the 25 answers,

- 4 countries (AT, HU, LV, MT) have not responded to the question. Austria does not feel it is in a position to assess this issue without having been involved in such agreements.
- 12 countries consider it to be a delegation of tasks (DE, IE, NL, LUX, UK, BE, FI, EE, NO, SK, EE, GR). 4 of which are involved in liquidity concession arrangements as host and home supervisors, 3 as home supervisors and 4 neither as host nor as home supervisors.
- 6 countries (BG, CZ, CY, LT, PL, RO) consider it to be a delegation of responsibilities. 2 countries mentioned that the responsibility and the underlying task are two non-detachable issues. None of these 5 countries are involved in liquidity concession arrangements.
- 2 (IT and PO) consider that the borderline is not very clear and that it may not always be possible to strike a clear distinction between delegation of tasks and responsibilities. Both are involved in liquidity concession arrangements as home supervisors
- 1 country (FR) considers it to be exclusively an exemption framework where no delegation of tasks is involved. France is involved in a liquidity concession arrangement as home supervisor.

4. A general principle of LCs is the obligation on the home authority to report on a regular basis to the host authority so there is a strong indication that there is no change in the location of responsibility i.e. it remains with the host. Furthermore, delegation of responsibilities could be viewed as a breach of Article 41 of the Capital Requirements Directive (CRD).
5. For these reasons and because delegation of responsibilities is outside the scope of this work, LCs are, within this paper, considered to be a delegation of tasks.

2. CASES REVIEWED

6. CEBS members were requested to complete a questionnaire with respect to their experience of LCs¹⁰.
7. There are 5 delegating authorities/host supervisors that have used the LC by exempting a branch from the local requirements of liquidity supervision and by relying on the global supervision of liquidity performed by home supervisors (UK, The Netherlands, Ireland, Germany, Greece). Conversely, there are 10 countries that have accepted liquidity concessions as home supervisors (UK, The Netherlands, Ireland, Germany, France, Finland, Belgium, Portugal, Greece, Italy). In general, LCs are granted mostly to EU branches. Three supervisory authorities (UK, Ireland, and The Netherlands) may also grant LCs to third country branches.

As host supervisors (delegating authority)

8. The 5 countries that have LCs in place (Germany, Ireland, The Netherlands, UK, Greece), all have regulations that impose regulatory limits and/or reporting requirements on branches.
9. It seems then that the main reason for not putting more LCs in place is that EEA branches in many countries are not subject to quantitative requirements.¹¹ Moreover, some host supervisors may have reservations about entering into LCs for branches that have a wide deposit base or are systemic in their countries.

As home supervisor (delegate authority)

10. 10 countries as home supervisor have entered into liquidity concessions (Italy, Germany, Belgium, Ireland, Finland, The Netherlands, Portugal, UK, Greece, France).
11. From the home supervisor's perspective it seems that there are no major problems in accepting the arrangement. Given the fact that home supervisory regimes always encompass all the branches of a credit

¹⁰ 25 answers have been received.

¹¹ Some host supervisors mentioned that they have not been approached by the credit institution nor by the home supervisor. Another reason mentioned was that they have not felt the necessity to be involved in this kind of agreement.

institution, the assignment of the supervision of the liquidity of a foreign branch does not represent additional work except for the periodic reporting to the host supervisor. Only one home supervisor has rejected such a request and it was basically due to specific circumstances at the time of the application (to wait for the elaboration of the guidance on liquidity).

3. RATIONALE FOR DELEGATING TASKS / ACCEPTING DELEGATION

12. Avoiding unnecessary burdens on banking groups seems the main reason for both home and host supervisors to enter into this kind of arrangement. In this respect, host supervisors are expected to abstain from collecting and monitoring information on the branches' liquidity positions in normal times. Optimising resources or avoiding redundant supervisory work does not seem to be a key issue in this context.
13. From the host supervisor respondents it appears that there are no particular criteria for determining which branches will be granted a LC. Each LC is determined on a case by case basis and is unique in some way. LC arrangements may also change over time and are kept under review.
14. The host authorities have mentioned that a pre-existing relationship and experience with the other supervisory authority can be a factor in deciding to enter into a LC. However, the conditions remain the same.

4. DELEGATION PROCEDURES

15. An LC is usually initially agreed for a period of three to five years, meaning that once an arrangement is put in place, it provides the framework for the long term (but revocable) supervision of liquidity.
16. From the cases reviewed it appears that the host authority is approached by a credit institution requesting the concession, as it is mainly for the benefit of the credit institution that the concession is granted.
17. Before entering into a LC, there are certain conditions that need to be met. Although the exact wording and details of the LC arrangements may be different, the mechanism and basic aspects are similar.

Contacts between supervisors / Outcome of the delegated tasks

18. The initial contacts prior to the setting up of the LC are fundamental in understanding the scope of the delegation.
19. The delegation of the supervision of branch liquidity to the home supervisor and the branch exemption from local liquidity requirements requires host supervisors to understand the change in the supervisory focus and, in particular, how home authorities supervise liquidity risk. In this respect, one member requires an agreement with the home supervisor on the mutual recognition of liquidity rules and two other members have to be provided with a description of the arrangements for the supervision of liquidity implemented by the home supervisor. They need to be satisfied, in particular, that the scope of liquidity supervision

performed encompasses the whole credit institution (i.e. including EEA branches) and focuses on the credit institution's short-term liquidity position.

20. Additionally, there are a number of general conditions and safeguards which must be met before a LC is granted. They encompass:

1. Conditions to be met by the credit institution:

- the branch should be fully integrated with its head office for liquidity management purposes;
- the head office should assure the host supervisory authority in writing that liquidity is available at all times to the branch if needed; and
- information on whole bank liquidity will be made available to the host supervisory authority in the event of a crisis.

2. Conditions to be met by the home supervisory authority include acceptance of the conditions imposed on the credit institution and the commitment to keep the host supervisor informed (see below):

- the home supervisor should be aware of, and have no objection to, both the dependence of the branch on the head office for liquidity and the assurance given that liquidity will be available;
- the home supervisor should inform the host supervisory authority of any material or persistent breaches by the bank of its liquidity rules, or risks that such breaches are imminent;
- the home authority undertakes to inform the host authority in the event that it becomes aware of any grounds for believing that any credit institutions which have been given a concession are no longer sufficiently integrated for liquidity management purposes; and
- the home authority periodically confirms to the host supervisor that it remains satisfied with the arrangements for liquidity supervision and their operation.

This set of conditions is mainly aimed at ensuring that the host supervisor is adequately involved during the time the liquidity concession is in place.

3. On its part, the host authority should inform the home authority if it detects through routine liaison, non-routine contact or other statistical analysis that a branch may be experiencing liquidity difficulties.

21. The information is provided through a variety of means, mostly through a written report (for example, annual confirmation from the home supervisor) complemented by contacts of line side supervisors and telephone calls. This exchange of information may also take place during the periodic meetings held under the aegis of any bilateral Memorandum of Understanding.

22. That said, the experience of the functioning of LCs in respect to the intensity of the contacts appears to differ from authority to authority.
23. In general, the perception is that LCs work well and are a good supervisory tool. The line-side supervisors are cooperating and communicating on an on-going basis. However it was also recognised that there can be some drawbacks in certain instances, for example, when the host authority sees little liquidity related information on the entity as a whole meaning that it may, therefore, derive an incomplete picture and, in some cases, a false sense of security.

Communication with the credit institution

24. The credit institution is fully informed of the LC. Correspondence between supervisors setting up the arrangement is usually copied to the institution for information.

5. BARRIERS TO DELEGATION / DOCUMENTATION OF THE DELEGATION

25. In general, no practical barriers have been identified by either home or host supervisors. However, in one case reported, delegation is limited to institutions which do not use advanced models which would be accepted by the home supervisor but not by the host supervisor.
26. Regarding legal barriers, all host supervisors with LCs in place have stipulated the conditions in their national legislation. No home supervisor mentioned the need to include a specific provision in its national legislation (especially where liquidity supervision already encompasses the whole credit institution, including all its EEA branches). However, it may be advisable to have a general provision in the law which states that a task delegated from another supervisor can be accepted.
27. The documentation of the LC differs, it may take the form of correspondence between the line supervisors of the institution in question, but it can also be a formal agreement signed by the executive directors of the supervisory authorities. Both home and host supervisors usually keep records of the information exchanged in the course of the concession.