CENTRAL BANK INDEPENDENCE AND RESPONSIBILITY FOR FINANCIAL SUPERVISION WITHIN THE ESCB: THE CASE OF IRELAND

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ABSTRACT

La vigilanza delle istituzioni creditizie e finanziarie non rientra tra i compiti attribuiti dal Trattato al SEBC. Il contributo descrive come, in pratica, tale tipo di vigilanza sia organizzato secondo un'ampia varietà di strutture giuridiche nei venticinque Stati membri, con diversi gradi di coinvolgimento da parte della banca centrale. Lo studio descrive il nuovo assetto giuridico creato in Irlanda dal 2003, secondo cui la vigilanza della pressoché totalità del settore finanziario, istituti di credito compresi, è competenza di un organismo indipendente, ricompreso nella personalità giuridica della Banca Centrale Nazionale (BCN). Secondo tale schema, alla BCN compete, in termini giuridici, l'esclusiva responsabilità degli atti di vigilanza e regolamentari dell'autorità di vigilanza finanziaria. Ciò solleva la questione, ai sensi della legge irlandese, dei limiti della responsabilità della banca centrale per atti di vigilanza finanziaria. Il contributo analizza la giurisprudenza in Irlanda, nel Regno Unito e della Corte Europea di Giustizia in materia di responsabilità dell'autorità di vigilanza finanziaria secondo la legge irlandese e comunitaria, nonché le immunità statutarie di cui gode la banca centrale secondo la legislazione irlandese applicabile. I limiti della responsabilità della banca centrale per l'autorità di vigilanza finanziaria hanno rappresentato un punto critico nel parere rilasciato dalla BCE alle autorità irlandesi, allorché nel 2002 la BCE veniva consultata sulla ristrutturazione della Banca Centrale d'Irlanda. Il parere della BCE ha messo in luce che, istituendo un organo statutario dotato di funzioni indipendenti, ma ricompreso nella personalità giuridica di una BNC, la BCN sarebbe responsabile degli atti svolti da una parte costitutiva della banca centrale (l'autorità di vigilanza finanziaria), atti che rimarrebbero al di fuori del controllo dell'organo decisionale della banca centrale responsabile dello svolgimento dei compiti collegati al SEBC (il Governatore della banca centrale). La BCE ha considerato che tale struttura potesse causare dei rischi per l'integrità di una BCN, minacciando la sua indipendenza, contrariamente ai principi dell'Articolo 108 del Trattato. Il contributo descrive come la legislazione, nella sua attuazione, affrontasse le preoccupazioni della BCE, attribuendo al Governatore un ruolo preminente, relativamente alle problematiche connesse con la stabilità finanziaria. Lo studio conclude osservando che, nel suo parere sulla ristrutturazione della Banca Centrale d'Irlanda, la BCE ha chiaramente stabilito i limiti della riorganizzazione proposta, ammonendo contro il rischio che le funzioni di autorità di vigilanza finanziaria violino l'indipendenza della banca centrale.

1 INTRODUCTION

The supervision of credit and financial institutions is not among the tasks attributed to the European System of Central Banks (ESCB) under the Treaty establishing the European Community (the "Treaty"). This paper will describe the wide variety of legal structures under which the supervision of credit and financial institutions is, with varying degrees of central bank involvement, organised in the 25 Member States (see Section 2). It will analyse the novel legal structure deployed in Ireland since 2003, whereby the supervision of practically the entire financial sector, including credit institutions, is carried out by an autonomous body forming part of the legal personality of the national central bank (NCB) (see Section 3). Under this construction the NCB bears, in legal terms, sole liability and responsibility for the acts of the financial supervisor. This raises the important question as to the extent of the NCB's liability for the financial supervisor under Irish law. The paper will discuss in some depth the relevant case law in Ireland, the United Kingdom and the European Court of Justice shedding light on the scope of the NCB's liability for the financial supervisor under Irish and EC law, as well as the statutory immunities enjoyed by the NCB under applicable Irish legislation (see Section 4).

The paper will describe how the NCB's liability for the financial supervisor was a critical issue in the opinion provided by the ECB on the draft Irish legislation which restructured the Central Bank of Ireland by establishing the autonomous Irish Financial Services Regulatory Authority (IFSRA) as a constituent part of the renamed Central Bank and Financial Services Authority of Ireland. The paper will conclude by explaining how, in its opinion on the draft legislation restructuring the Central Bank of Ireland, the ECB clearly set the limits of the proposed reorganisation by warning against the risk of the IFSRA's supervisory functions encroaching upon the NCB's independence. As a result, the legislation, as enacted, ensured that the Governor of the CBFSAI has a significant role with respect to financial stability matters in order to protect the independence required of an ESCB national central bank under the Treaty (see Sections 5 and 6).

2 ROLE OF ESCB IN SUPERVISION OF CREDIT AND FINANCIAL INSTITUTIONS

2.1 PRUDENTIAL SUPERVISORY ROLE OF EUROSYSTEM UNDER TREATY

Although many NCBs in the ESCB are closely involved in the prudential supervision of credit and other financial institutions, such supervision is not one of the tasks attributed to the ESCB under the Treaty.[2] These functions are therefore

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2 Article 105(6) of the Treaty contemplates the possibility that the EU Council may confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings. For background information regarding the discussions on the appropriate role for the ESCB in banking supervision during the Maastricht Treaty negotiations, see Smits, *The European Central Bank*: *Institutional Aspects* (Kluwer Law International 1997), pp. 334-38.

performed on the responsibility and liability of NCBs and are not regarded as being part of the functions of the ESCB.[3] However, reflecting the close historical link between central banking and the prudential supervision of credit institutions, the Treaty prescribes a contributory role for the Eurosystem in the performance of supervisory tasks. In particular, Article 105(5) of the Treaty requires the Eurosystem to contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.[4] The European Central Bank (ECB) has taken the policy position that an institutional framework in which the Eurosystem's responsibilities for monetary policy in the euro area are coupled with extensive supervisory responsibilities of NCBs in domestic markets, and with reinforced co-operation at an area-wide level, would seem appropriate to tackle the changes triggered by the introduction of the euro, and that when viewed from a Eurosystem perspective, the attribution of extensive supervisory responsibilities (i.e., both macro and micro-prudential) to NCBs are likely to prove beneficial.[5]

2.2 SUPERVISORY ROLE OF NCBS UNDER NATIONAL LAWS

In practice, the supervision of credit and financial institutions is organised under a wide variety of legal structures in the 25 EU Member States, with varying degrees of central bank involvement. At one end of the spectrum, in nine Member States NCBs are directly and fully responsible for the supervision of credit institutions.[6] In some of these Member States (Greece,[7] Italy[8]) the NCB is, or

3 Article 14.4 of the Statute of the European Central Bank and of the European System of Central Banks (the "ESCB Statute").

4 In accordance with Article 122(3) of the Treaty, Article 105 of the Treaty does not apply to Member States which have not adopted the euro.

5 See European Central Bank, *The Role of Central Banks in Prudential Supervision*, 2001, p. 3, published on the ECB website at http://www.ecb.int/press/pr/date/2001/html/pr010322.en.html. As noted by Dr. Duisenberg, former ECB President, "[t]he Eurosystem strongly supports a continued involvement of national central banks in prudential supervision, although the institutional set-up of financial supervision needs to be tailored to the structure of the respective national financial system. Any solution other than direct responsibility should be coupled with close co-operation and operational involvement of central banks in order to allow the potential synergies between central banking and prudential supervision to be exploited." Dr. Willem F. Duisenberg, President of the European Central Bank, Amsterdam, 24 April 2002.

6 *Cyprus*: Section 26(1) of the Banking Law (No 66(I) of 1997); Section 6(2)(d) of The Central Bank of Cyprus Law of 2002 (No 138(I) of 2002); *Czech Republic*: Act on the Czech National Bank (Česká národní banka), Articles 2(2)(d) and 44; *Greece*: Law No. 2548, Provisions relating to the Bank of Greece, Articles 2(1)(d), 8; *Italy*: Consolidated Banking Law, Article 4; *Lithuania*: Lietuvos Bankas Act, Article 8 (6) and Chapter 7; *Portugal*: Banco de Portugal Organic Law, Article 17; Decree-Law No. 298/92 of 31 December of 1992, Article 93(1); *Slovakia*: The National Bank of Slovakia (Národná banka Slovenska) Act, Article 36; *Slovenia*: Bank of Slovenia (Banka Slovenije) Act, Article 23; Banking Act, Article 123; *Spain*: Law of Autonomy of Banco de España, Article 7 (6).

7 The Bank of Greece is responsible for the supervision of a small number of financial institutions in addition to credit institutions, including financial leasing companies, factoring companies, mutual guarantee companies, counterguarantee funds, bureaux de change and money market broker companies. Law No. 2548, Provisions relating to the Bank of Greece, Articles 2(1)(d), 8.

8 The Banca d'Italia has supervisory powers over credit institutions and financial intermediaries, and also has responsibility for the prudential supervision of investment firms and asset management companies. Consolidated Banking Law, Articles 4 and 5. A draft Law on Measures for the Protection of Savings was recently proposed, one of whose aims was to reform the institutional framework in Italy for the regulation and supervision of financial markets and intermediaries. The draft Law envisaged that the Banca d'Italia would be responsible for safeguarding financial stability and the prudential regulation and supervision of credit institutions, insurance companies, investment firms and other financial intermediaries. A newly established authority, the Authority for the Financial Markets (Autorità per I mercati finanziari – AmeF), would be responsible for conduct of business regulation and supervision. See Opinion of the European Central Bank of 11 May 2004 on a draft Law on Measures for the Protection of Savings (CON/2004/16), published on the ECB's website at http://www.ecb.int/ecb/legal/pdf/en_con_2004_16_f_sign.pdf.

will shortly become (Slovakia[9]), responsible for the supervision of not only credit institutions, but also other financial institutions and activities. In these Member States NCBs would appear, logically, to be liable for their supervisory decisions to the extent provided under applicable national laws. At the other end of the spectrum, in eight Member States an independent public authority that is legally and operationally separated from the NCB is responsible for the supervision of practically the entire financial sector.[10] In some of these Member States (Austria,[11] Latvia[12]) the NCB has an institutional role in the appointment and dismissal of the members of the supervisory authority's decision-making body. Also, given the important financial stability role of NCBs, for example in connection with a central bank's traditional lender-of-last-resort function, arrangements for co-operation between the supervisory authority and the NCB in these Member States are prescribed by law (e.g., Hungary[13]) or by less formal instruments (e.g., United Kingdom[14]). However, it would seem clear that in these Member States the NCBs are not in any way liable for supervisory decisions.

The remaining eight Member States have adopted nuanced variations on these two contrasting structures, laying down mechanisms allowing for varying degrees of central bank involvement in the conduct of supervision. In legal terms there are certain similarities with the structures deployed in four of these

9 A legislative reform is underway in Slovakia as a result of which responsibility for the supervision of the non-banking financial sector (capital markets, insurance business and pension schemes) will be transferred to the Národná banka Slovenska on 1 January 2006. See Opinion of the European Central Bank of 22 September 2004 at the request of Národná banka Slovenska on a draft law on supervision of the financial market (CON/2004/31), published on the ECB's website at http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html.

10 *Austria*: Federal Act on the Institution and Organisation of the Financial Market Authority (Finanzmarktaufsichtsgesetz); *Denmark*: Financial Business Act; *Hungary*: Act CXXIV of 1999 on the Hungarian Financial Supervisory Authority (Pénzügyi Szervezetek Állami Felügyelete); *Latvia*: Law on the Financial and Capital Market Commission of 20 July 2000; *Luxembourg*: Law of 23 December 1998 establishing the Financial Sector Supervisory Commission; *Malta*: Malta Financial Services Authority Act; *Sweden*: Ministry of Finance Regulation (1996:596) of 6 June 1996 Förordning med instruktion för Finansinspektionen; *United Kingdom*: Financial Services and Markets Act.

11 The Oesterreichische Nationalbank (OeNB) names persons for the function of deputy chairperson of the Supervisory Board, as well as two additional members of the eight-member Supervisory Board and one member of the two-member Executive Board of the Austrian Finanzmarktaufsicht (Financial Market Authority or FMA), who are appointed by the Federal Minister of Finance (in the case of the Supervisory Board members) and the Federal Government (in the case of the Executive Board members). The Federal Minister of Finance is required to hear the OeNB prior to the dismissal of a member of the FMA Supervisory or Executive Boards that the OeNB named, except in case of imminent danger. Federal Act on the Institution and Organisation of the Financial Market Authority (Finanzmarktaufsichtsgesetz), Sections 5, 7 and 8.

12 The Chairperson and the Deputy Chairperson of the Council of the Latvian Financial and Capital Market Commission (FCMC) are appointed by the Parliament for a period of six years upon a joint proposal of the Governor of Latvijas Banka and the Minister of Finance. One of the grounds for dismissal of the Chairperson and his/her Deputy by the Parliament is where an application for dismissal is submitted jointly by the Governor of Latvijas Banka and the Minister of Finance. The Chairperson of the FCMC appoints and removes the other members of the FCMC's Council, and is required to co-ordinate his/her decision with the Governor of Latvijas Banka and the Minister of Finance. Law on the Financial and Capital Market Commission, Articles 13(3), 13(4) and 14(4).

13 The Act on the Hungarian Financial Supervisory Authority (FSA) explicitly addresses the FSA's relationship with the National Bank of Hungary (NBH), requiring the FSA to co-operate with the NBH in the course of performing its tasks, and requiring the FSA, in the cases specified by law, to issue or withdraw licenses after requesting the preliminary opinion or agreement from the NBH. Act. No. CXXOIV of 1999 on the Hungarian Financial Supervisory Authority, Article 6/C.

14 A Memorandum of Understanding (MoU) between the UK Treasury, the Bank of England and the UK Financial Services Authority (FSA) establishes a framework for co-operation between the Treasury, the Bank and the FSA in the field of financial stability. The MoU clarifies that the Bank of England is responsible for the overall stability of the financial system as a whole, which will involve, *inter alia*, being able in exceptional circumstances to undertake official financial operations in order to limit the risk of problems in or affecting particular institutions spreading to other parts of the financial system. See Memorandum of Understanding Between HM Treasury, the Bank of England and the FSA, para. 2, published on the Bank of England's website at http://www.bankofengland.co.uk/legislation/mou.pdf.

Member States (Belgium,[15] France,[16] Germany[17] and Poland[18]) insofar as the NCB makes a substantial contribution to the performance of supervisory tasks, but is not as such responsible for supervision. Notwithstanding the substantial role of the NCBs it would appear to be clear that in these four Member States the NCBs are not, logically, liable for supervisory decisions.

In the Netherlands a legislative reform is currently being implemented as a result of which De Nederlandsche Bank will be assigned responsibility to carry out prudential supervision (i.e., the financial soundness of financial enterprises and contributing to the stability of the entire financial sector), while an independent body, the Autoriteit Financiële Markten (AFM) or Authority for Financial Markets, will be assigned responsibility to carry out the supervision over the conduct of business in the financial markets.[19] Under this functional, so-called 'twin peaks' structure, both De Nederlandsche Bank and the AFM will supervise the entire financial sector in close cooperation with one another in matters concerning their respective fields of competence. It would be interesting to ascertain whether it is possible for the boundaries between the liability of these two public authorities for supervisory decisions affecting individual institutions to be clearly drawn.

A somewhat novel legal structure is deployed in Estonia, Finland and Ireland whereby the supervision of practically the entire financial sector, including credit

15 In *Belgium* the Banking, Finance and Insurance Commission, an independent body with legal personality, is the single supervisor of the financial sector. The Commission and the Banque Nationale de Belgique (BNB)/ Nationale Bank van België (NBB) are obliged to collaborate closely on all issues of common interest and in particular with regard to international co-operation in respect of prudential matters, inter-sectoral aspects of prudential policy relating to various providers of financial services, macro-prudential analyses and legal studies. Staff members of the BNB/NBB may be seconded to the Commission and vice-versa. Also, three of the seven members of the Commission's Management Committee are required to be appointed from among the members of the Board of Directors of the BNB/NBB. Law of 2 August 2002 relating to the supervision of the financial sector and on financial services, Article 44 et seq., particularly Articles 49, § 6, third sentence, 55, 117 and 118.

16 In *France* the prudential supervision of credit institutions is carried out by the Commission Bancaire, a service of the French State *(service de l'État)*. The Governor of Banque de France chairs the Commission Bancaire, and the Banque de France provides the General Secretariat of the Commission Bancaire with staff and resources necessary for carrying out on-site inspections of credit institutions. See in this respect the relevant provisions of the Financial and Monetary Code, and in particular the provisions concerning the Commission Bancaire (Articles L.613-1 to L.613-34).

17 In *Germany* the BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht – Federal regulatory agency for financial services and financial markets) is the consolidated supervisor of the financial sector under the legal and professional supervision of the Federal Ministry of Finance. The BaFin and the Deutsche Bundesbank are required to work together, and this cooperation includes ongoing monitoring of credit institutions by the Bundesbank, including analysing and assessing documents, audit reports and annual accounts submitted by credit institutions, conducting and analysing banking audits to determine the reasonable equity capital and risk management procedures of credit institutions and evaluating audit findings. The cooperation between the Bundesbank and the BaFin is further defined in an inter-institutional agreement in which the details of their respective roles in day-to-day supervision are defined. The Bundesbank is required to follow the BaFin's guidelines when performing its extensive operational functions in the supervision of credit institutions. Law on the Federal agency for financial services regulation, Articles 1, 2; Gesetz über das Kreditwesen (KWG or Banking Law), Article 7; Vereinbarung über die Zusammenarbeit der Bundesanstalt für Finanzdienstleistungs-aufsicht und der Deutschen Bundesbank bei der Beaufsichtigung der Kredit- und Finanzdienstleistungsinstitute, available on the web page of BaFin at www.bafin.de.

18 In *Poland* banks are supervised by the Commission for Banking Supervision, which is chaired by the President of the Narodowy Bank Polski. The decisions of the Commission are carried out and co-ordinated by the General Inspectorate of Banking Supervision, a separate organisational unit within the structure of the Narodowy Bank Polski that is designated by law as the executive body of the Commission for Banking Supervision. The General Inspector of Banking Supervision is appointed and recalled by the President of the Narodowy Bank Polski, acting in agreement with the Minister of Finance. The Act of the National Bank of Poland (Narodowy Bank Polski), Articles 25(1), 26(1), 29.

19 See Opinion of the European Central Bank of 7 June 2004 at the request of the Ministry of Finance of the Netherlands on a draft Financial Sector Supervision Act (CON/2004/21), published on the ECB website at http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html.

institutions, is carried out by an autonomous body forming part of the legal personality of the NCB.[20] The focus of this article is the liability implications of this structure for Ireland's NCB.

3 ESTABLISHMENT OF CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND AND IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

The Central Bank and Financial Services Authority of Ireland Act, 2003 (the "Act") reorganised and re-named the "Central Bank of Ireland" as the "Central Bank and Financial Services Authority of Ireland" (CBFSAI).[21] As was previously the case within the Central Bank of Ireland, the Governor of the CBFSAI continues to have sole responsibility for the performance of the central bank's ESCB-related functions,[22] consistent with his position as a member of the ECB Governing Council.[23]

The main reform introduced by the Act was the establishment of a new "body" called the Irish Financial Services Regulatory Authority (IFSRA) as a constituent part of the CBFSAI, whose statutory functions and powers broadly relate to the supervision of virtually all credit and financial institutions and insurance undertakings in Ireland, as well as the protection of consumers of financial services.[24] The IFSRA comprises no fewer than eight and no more than ten members appointed by the Minister for Finance, three of whom are a Chairperson, a Chief Executive responsible for the day-to-day management of the IFSRA and a Consumer Director responsible for monitoring the provision of financial services to consumers.[25]

The IFSRA is stated to be a "body" that is separate from its members and continues in existence despite any vacancy or change in its membership.[26] Notwithstanding this semi-personification of the IFSRA, the IFSRA is also stated to be "a constituent part of" the CBFSAI.[27] Only the CBFSAI has been endowed with legal personality, with the body corporate formerly called "Central Bank of Ireland" being continued, but with the corporate name of "Central Bank and Financial Services Authority of Ireland".[28]

"Except as expressly provided by the Act", the CBFSAI's affairs are managed and controlled by its board of directors.[29] The CBFSAI's board of directors comprises twelve persons: the Governor, who is also the Chairperson of the

20 *Estonia*: Financial Supervision Authority Act; *Finland*: Act on the Financial Supervisory Authority; *Ireland*: Central Bank Act, 1942, as amended.
21 See, e.g., section 5 of the Central Bank Act 1942, as amended. References in these footnotes to the Central Bank Act 1942, as amended, shall be understood as referring to the Central Bank Act 1942, as amended by the Central Bank and Financial Services Authority of Ireland Acts 2003 and 2004.
22 Section 19A(2) of the Central Bank Act 1942, as amended.
23 ESCB Statute, Article 10.1.
24 Sections 33A through 33AF of the Central Bank Act 1942, as amended.
25 Sections 33E(1), 33E(2), 33F(1), 33F(4), 33H(1), 33I(1), 33Q(1), 33Q(4) and 33S(1) of the Central Bank Act 1942, as amended.
26 Sections 33(B)(1), 33B(3) of the Central Bank Act 1942, as amended.
27 Section 33(B)(2) of the Central Bank Act 1942, as amended.
28 Section 5(1) of the Central Bank Act 1942, as amended.
29 Section 5(4) of the Central Bank Act 1942, as amended.

board, the CBFSAI's Director General, the Secretary General of the Department of Finance, the IFSRA Chairperson, the IFSRA Chief Executive and seven other directors appointed by the Minister for Finance, four of whom are members of the IFSRA.[30] It is important to emphasise that the CBFSAI board does not have primary responsibility for the performance of the CBFSAI's main central banking or supervisory activities since the ESCB-related functions are exclusively vested in the Governor and the functions relating to the supervision of credit and financial institutions are primarily vested in the IFSRA. The residual functions of the CBFSAI which remain under the responsibility of the CBFSAI's board of directors include carrying out the efficient and effective co-ordination of the activities of the constituent parts of the CBFSAI and the exchange of information among those parts.[31]

4 LIABILITY OF CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND FOR SUPERVISORY ACTIVITIES OF IRISH FINANCIAL SERVICES REGULATORY AUTHORITY

Ireland has thus established a legal structure for the supervision of credit and financial institutions and insurance undertakings by a statutory body enjoying independent functions, but located within the legal personality of its NCB. The NCB is endowed with legal personality as a corporate body, while the IFSRA is a statutory body within and forming a constituent part of the NCB that does not enjoy any separate legal personality as a corporate body. While this construction is quite unique in that Irish statutory bodies are normally endowed with legal personality, as a matter of Irish administrative law the legal form and personality of a state-sponsored body is entirely dependent on the statute under which it is established.[32]

Consistent with its legal personality, the CBFSAI may take legal proceedings and be proceeded against in its corporate name.[33] The IFSRA may, in relation to the functions of the CBFSAI that the IFSRA is to perform, bring and defend legal proceedings, and do any other thing, in the name of the CBFSAI,[34] and any act done in the name of, or on behalf of, the CBFSAI by the IFSRA in the performance of the IFSRA's functions is taken to have been done by the CBFSAI.[35] Under this construction the CBFSAI bears, in legal terms, sole liability and responsibility for the supervisory acts of the IFSRA. It is therefore of critical importance to understand the precise scope of the CBFSAI's liability for the supervisory activities of the IFSRA under Irish law. This paper will therefore outline in some depth the relevant case law in Ireland, the United Kingdom and the European Court of Justice shedding light on the scope of the

30 Sections 18B(1), 18B(2) and 18B(5) of the Central Bank Act 1942, as amended.
31 Section 5A(1) of the Central Bank Act 1942, as amended.
32 See Hogan and Morgan, *Administrative Law in Ireland* (3rd ed. Round Hall Sweet & Maxwell), pp. 114, 134-37.
33 Section 5(2) of the Central Bank Act 1942, as amended.
34 Section 33C(6) of the Central Bank Act 1942, as amended. (The powers given to the IFSRA Chief Executive in the second sentence of this sub-section derive from his or her position as a statutory office-holder exercising functions of the CBFSAI vested in the IFSRA.)
35 Section 33C(12) of the Central Bank Act 1942, as amended.

CBFSAI's liability for the IFSRA under Irish and EC law, as well as the statutory immunities enjoyed by the CBFSAI under applicable Irish legislation.

4.1 LIABILITY OF FINANCIAL SUPERVISOR FOR NEGLIGENCE AT COMMON LAW

The leading Irish precedent on the liability of a financial supervisor is *McMahon v. Ireland, the Attorney General and the Registrar of Friendly Societies*.[36] This case concerned an action brought by a depositor who lost money as a result of the liquidation of the Private Motorists' Protection Society (PMPS). The aggrieved depositor brought an action against the Registrar of Friendly Societies, the body responsible for the supervision of industrial and provident societies. The depositor argued that the Registrar had failed in his duty of care to prospective depositors with the PMPS by not taking action sooner, for example by exercising his statutory power to direct the PMPS to suspend the acceptance of deposits.[37]

The High Court per Blayney J. held that the Registrar was not liable in negligence as there was insufficient proximity between the Registrar and the depositors to give rise to a duty of care on the part of the Registrar in these circumstances.[38] Blayney J. held that the Registrar was entitled to the protection of the principle referred to by Finlay C.J. in the Supreme Court decision in *Pine Valley Developments Ltd. v. The Minister for the Environment*[39] that "[i]f a man is required in the discharge of a public duty to make a decision which affects, by its legal consequences, the … property of others, and he performs that duty and makes that decision honestly and in good faith, it is … a fundamental principle of our law that he is to be protected. It is not consonant with the principles of our law to require a man to make such a decision in the discharge of his duty to the public, and then leave him in peril by reason of the consequences to others of that decision, provided that he acted honestly in making that decision."[40] Blayney J. concluded from this that the Registrar was "entitled to immunity from the type of claim being made by the [depositor]."[41]

In *McMahon*, Blayney J.[42] cited at length and explicitly followed the advice of the UK Privy Council in *Yuen-Kun-Yeu v. Attorney General of Hong Kong*.[43] That case concerned a negligence action brought by Hong Kong residents who had deposited money with a company authorised to accept deposits by the Hong Kong Commissioner of Deposit-Taking Companies. After the company went into liquidation the depositors argued that the Commissioner knew or ought to have known that the company's affairs were being conducted fraudulently, speculatively and to the detriment of its depositors, and that the Commissioner

36 [1988] I.L.R.M. 610.
37 *Ibid.* at 611-13.
38 *Ibid.* at 615.
39 [1987] I.L.R.M. 747 at 758 (quoting Moulten L.J. in *Everitt v. Griffiths* [1921] 1 A.C. 631 at 695).
40 [1988] I.L.R.M. 610 at 616-17.
41 *Ibid.* at 613-16.
42 *Ibid.* at 617.
43 [1988] A.C. 175, P.C. Another case following *Yuen* is *Davis v. Radcliffe* [1990] 1 W.L.R. 821, P.C., where the Privy Council dismissed an action brought by depositors of a failed bank on the Isle of Man seeking damages against the Manx authorities responsible for the supervision of the banking system.

should never have registered the company as a deposit-taking company, or should have revoked its registration so as to save the depositors from losing their money.

The Privy Council per Lord Keith advised that the Commissioner did not owe members of the public who might be minded to deposit their money with a deposit-taking company in Hong Kong a duty, in the discharge of his supervisory powers, to exercise reasonable care to see that such members of the public did not suffer a loss through the fraudulent or improvident management of the company.[44] The fact that the Commissioner had "cogent reason to suspect that the company's business was being carried on fraudulently and improvidently", based on information not available to the public raising serious doubts about the company's stability, did not create a special relationship so as to give rise to a duty on the part of the Commissioner to take reasonable care to prevent the company from causing financial loss to subsequent depositors.[45]

In considering the Commissioner's discretion to remove the company from the register, Lord Keith noted that "[i]t might be a very delicate choice whether the best course was to deregister a company forthwith or to allow it to continue in business with some hope that, after appropriate measures by the management, its financial position would improve." Lord Keith also noted that "[t]he Commissioner did not have any power to control the day-to-day management of any company, and such a task would require immense resources. His power was limited to putting it out of business or allowing it to continue."[46] Lord Keith further noted that the class to whom the Commissioner's duty is alleged to have been owed must include the many inhabitants of Hong Kong who might choose to deposit their money with any deposit-taking company.[47]

In *Yuen* the depositors made a related argument that they had relied on the registration of the company when they deposited their money with it, and that by registering the company and allowing the registration to stand the Commissioner had negligently made a continuing representation that the company was creditworthy. The Privy Council rejected this argument, holding that "reliance on the fact of registration as a guarantee of the soundness of a particular company would be neither reasonable or justifiable". In this regard, Lord Keith stated the registration system "was designed to give added protection to the public against unscrupulous or improvident managers of deposit-taking companies, but it cannot reasonably be regarded, nor should it have been by any investor, as having instituted such a far-reaching and stringent system of supervision as to warrant an assumption that all deposit-taking companies are sound and fully creditworthy."[48]

Finally, from a public policy perspective, Lord Keith noted *obiter* that, even if the Commissioner were to be held to owe actual or potential depositors a duty of care in negligence, "the prospect of claims would have a seriously inhibiting

44 *Ibid.* at 190-98.
45 *Ibid.* at 196.
46 *Ibid.* at 195.
47 *Ibid.*
48 *Ibid.* at 197.

effect on the work of his department" and "[a] sound judgment would be less likely to be exercised if the Commissioner were to be constantly looking over his shoulder at the prospect of claims".[49]

To sum up, the *McMahon* case, taken together with the *Yuen* case, establish that the CBFSAI is insulated under common law from liability for negligent decisions of the IFSRA.

4.2 STATUTORY IMMUNITIES OF CENTRAL BANK AND FINANCIAL SERVICES AUTHORITY OF IRELAND

This insulation at common law of the CBFSAI from liability for negligent supervisory decisions has been confirmed by Irish legislation conferring a series of elaborate statutory immunities on the CBFSAI.[50] Thus, the CBFSAI, the members of its board, the members of the IFSRA and employees and agents of the CBFSAI or any of its constituent parts are not liable for damages for anything done or omitted in the performance or purported performance of their functions, unless it is proved that the act or omission was in bad faith.[51] Without limiting the effect of this general immunity,[52] it is also provided that the fact that the CBFSAI has authorised or revoked an authorisation, or regulated the activities, of a person, under any of its functions is not a warranty by the CBFSAI as to the person's solvency or performance.[53] It is also provided that neither the CBFSAI nor the Irish State is liable for losses incurred because of the insolvency, default or performance of any such person or body.[54] Finally, it is provided that neither the CBFSAI, the members of its board, the members of the IFSRA and employees and agents of the CBFSAI or any of its constituent parts are liable to pay damages arising out of a failure to comply with the IFSRA's responsibility to increase awareness among the public of available financial services, the costs to consumers and associated risks and benefits.[55]

These detailed provisions put beyond any doubt that the CBFSAI enjoys immunity from liability to depositors and other creditors of a failed bank or financial institution where the IFSRA is negligent in the way it carries out its

49 *Ibid.* at 198.
50 These immunities are of some interest on account of their elaborate drafting, and have attracted some international academic attention in the context of comparative law studies regarding the liability of bank supervisors. See Hüpkes, *The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada* (Kluwer Law International, 2000), p. 137, n.73; Smits and Luberti, *Supervisory Liability: An Introduction to Several Legal Systems and a Case Study*, in *International Bank Insolvencies: A Central Bank Perspective* (Giovanoli and Heinrich eds., Kluwer Law International, 1999), p. 363, at p. 366.
51 Sections 33AJ(1) and 33AJ(2) of the Central Bank Act 1942, as amended.
52 Sections 33AJ(6) of the Central Bank Act 1942, as amended.
53 Sections 33AJ(3) of the Central Bank Act 1942, as amended. Section 9(5) of the Central Bank Act 1971 provides in similar terms that the grant of a licence to a bank shall not constitute a warranty as to the solvency of the bank to whom it is granted. Sections 33AJ(4) of the Central Bank Act 1942, as amended, also provides in similar terms that the fact that the CBFSAI in performing any of its functions has approved or revoked the approval, or regulated the affairs or activities, of a stock exchange or a financial futures or options exchange, or has approved, amended, revoked or imposed rules, or has consented or refused to consent to amendments of rules, is not a warranty by the CBFSAI as to the solvency or performance of the exchange or any member of the exchange.
54 Sections 33AJ(5) of the Central Bank Act 1942, as amended. Section 9(5) of the Central Bank Act 1971 provides in similar terms that the CBFSAI shall not be liable in respect of any losses incurred through the insolvency or default of a bank to whom a licence is granted.
55 Section 33C(4) of the Central Bank Act 1942, as amended.

supervisory functions.[56] These immunities also confirm the CBFSAI's common law immunity from any liability for negligent misrepresentation.[57]

4.3 LIABILITY OF BANK SUPERVISORS UNDER EC LAW

The question of whether bank supervisors can be held liable for losses resulting from defective supervision under Community law has recently been resolved by the European Court of Justice (ECJ). In the *Peter Paul* case[58] depositors in a bankrupt German bank sought compensation in respect of the loss of their deposits beyond the amount recoverable under the Deposit-Guarantee Schemes Directive[59] on the grounds of allegedly defective supervision by the former Bundesaufsichtsamt für das Kreditwesen (Federal Office for the Supervision of Credit Institutions). As a matter of German law, the liability of the Bundesaufsichtsamt to compensate third parties for any damage arising from a wilful or negligent breach of official duty under the German Civil Code is statutorily precluded.[60] However, the depositors challenged this statutory immunity on the ground that it was contrary to Community law, and in particular the three banking directives subsequently codified in the Consolidated Banking Directive.[61]

The ECJ, on a preliminary reference from the Bundesgerichtshof (Federal Court of Justice), held that the directives in question do not preclude a national rule preventing individuals from claiming compensation for damage resulting from defective supervision on the part of the national authority responsible for supervising credit institutions.[62] The ECJ took note of the supervisory obligations

56 See Breslin, *Banking Law in the Republic of Ireland* (Gill & McMillan 1998), p. 47; Donnelly, *The Law of Banks and Credit Institutions* (Round Hall Sweet & Maxwell, 2000), pp. 17-18.

57 While there is much discussion regarding whether it is competent for the Irish Oireachtas (National Parliament) to establish special statutory rules of immunity for State-sponsored bodies under the provisions of the Irish Constitution, this issue would appear to be moot where, as here, the relevant immunities are simply declaratory of the underlying position at common law. See generally Hogan and Morgan, *Administrative Law in Ireland* (3d. ed., Round Hall Sweet & Maxwell, 1998), pp. 809-10 (citing *Byrne v. Ireland* [1972] I.R. 241; *Ryan v. Ireland* [1989] I.R. 177; *W. v. Ireland (No. 2)* [1997] 2 I.R. 142).

58 Case-222/02, *Peter Paul, Cornelia Sonnen-Lütte and Christel Mörkens v Bundesrepublik Deutschland,* Judgment of the Court of Justice (Full Court) of 12 October 2004, Reference for a preliminary ruling: Bundesgerichtshof – Germany, published on the website of the Court of Justice at http://www.curia.eu.int/en/content/juris/index_rep.htm. See Roeges, *L'Affaire Peter Paul, une affaire à suivre,* Euredia 2003/1, p. 5.

59 Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, OJ 1994 L 135, p. 5.

60 The legal basis of this immunity was Article 6(4) of the KWG or Banking Law, which provided that the Bundesaufsichtsamt exercised the supervisory functions assigned to it only in the public interest. This provision was adopted in response to two decisions by the German Supreme Court during the 1970s where it was held that the objective of banking supervision as set out in the Banking Law was not only to protect the stability and soundness of the German banking system in general, but also to protect individual creditors against risks arising from hazardous banking activities, with the result that the banking supervisory authority could be liable for breach of official duty under the Bürgerliches Gesetzbuch (BGB or German Civil Code). See *Wetterstein*, 15 February 1979, BGHZ 74, 144 (148) (= NJW 1979, 1354, 1355); see also the decision of the Supreme Court in *Herstatt*, 12 July 1979, BGHZ 75, 120 (= NJW 1979, 1354). Paragraph 6(4) of KWG or Banking Law was designed to confirm that banking supervision is exercised solely in the public interest and not in the interest of third parties, such as depositors or other creditors of the financial institution, thereby barring suits on the ground that the banking supervisory authority violated an "official duty owed to a third person". See Hüpkes, *The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada* (Kluwer Law International, 2000), pp. 132-34.

61 Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, OJ 2000 L 126, p. 1.

62 It is noted that the conclusions of the ECJ are similar to those reached earlier by the British House of Lords in the BCCI case, *Three Rivers District Council v. Bank of England*, [2000] 2 W.L.R. 1220, 1236-58, 1270-73 (per Lords Hope and Millett).

imposed on national authorities vis-à-vis credit institutions under those directives, and of the fact that the objectives pursued by those directives also include the protection of depositors.[63] However, the ECJ considered that it does not follow from this that those directives confer on individual depositors rights capable of giving rise to liability on the part of the State on the basis of Community law in the event that the deposits are unavailable as a result of defective supervision on the part of the competent national authorities.[64] Rather, the ECJ took the view that those directives are restricted to the harmonisation of that which is essential, necessary and sufficient to secure the mutual recognition of authorisations and of prudential supervision systems, making possible the granting of a single licence recognised throughout the Community and the application of the principle of home Member State prudential supervision.[65] The ECJ concluded that the coordination of the national rules on the liability of national authorities in respect of depositors in the event of defective supervision does not appear to be necessary to secure these results.[66]

The ECJ also noted that, as under German law, it is not possible in a number of Member States for the national authorities responsible for supervising credit institutions to be liable in respect of individuals in the event of defective supervision. In this regard the ECJ noted that those rules are based on considerations related to the complexity of banking supervision, in the context of which the authorities are under an obligation to protect a plurality of interests, including more specifically the stability of the financial system.[67]

Thus, the statutory and common law immunities enjoyed by the CBFSAI under Irish law would appear to be beyond challenge as a matter of current Community law.[68]

4.4 TORTIOUS LIABILITY FOR MISFEASANCE IN PUBLIC OFFICE

Thus far, it would appear that the CBFSAI enjoys a robust immunity from liability for the decisions of the IFSRA under Irish law. However, the CBFSAI's immunities are not absolute, and liability still lies for acts or omissions that are proved to have been in "bad faith".[69] In the context of a financial supervisor's activities, this is understood to include liability in cases of intentional wrongdoing by that authority's officials, where damages may be recovered for the tort of misfeasance in public office and a range of other intentional torts.[70]

While the tort of misfeasance in public office has a long history, its precise contours remain a matter of much debate.[71] Liability for misfeasance in public

63 Paragraphs 35-39 of the judgement.
64 Paragraph 40 of the judgement.
65 Paragraph 42 of the judgement.
66 Paragraph 43 of the judgement.
67 Paragraph 44 of the judgement.
68 For a critical review of the Advocate General's opinion in the Peter Paul case, see Tison, *Who's Afraid of Peter Paul?* The Financial Regulator, Vol. 9, No. 1, p.1, at pp. 7-8.
69 Sections 33AJ(1) and 33AJ(2) of the Central Bank Act 1942, as amended.
70 Hadjiemmanuil, *Banking Regulation and the Bank of England* (LLP 1996), pp. 339-40, 366.
71 McMahon and Binchy, Law of Torts (Butterworths, 3d. ed., 2000), p. 548; Hogan and Morgan, *Administrative Law in Ireland* (3d. ed., Round Hall Sweet & Maxwell, 1998), p. 813.

office has been successfully established against public bodies in some modern Irish cases.[72] The most scientific judicial definition of the tort would appear to be that of Keane J. in *McDonnell v. Ireland*, who approved a formulation that "misfeasance in public office is committed where an act is performed by a public official, either maliciously or with actual knowledge that it is committed without jurisdiction, and is so done with the known consequence that it would injure the plaintiff."[73] In *Corliss v. Ireland* Hamilton J. suggested that the necessary degree of malice "may be inferred from recklessness".[74] The judgement of Finlay C.J. in *Pine Valley* suggests that misfeasance arises where a public official's actions "constitute such a gross abuse of power or wholly unreasonable exercise of power as to lead to an inference that he was aware that he was exercising a power which he did not possess".[75] A broader view was taken by the Supreme Court in *Deane v. Voluntary Health Insurance*, where the Court indicated that a public body might be liable for misfeasance in public office if its statutory powers were merely exercised "unreasonably and unfairly" in a manner which caused loss and damage.[76] Commentators have noted that the decisions in other common law jurisdictions do not set the boundaries of liability for misfeasance of public office so widely insofar as they require that the public authority was knowingly reckless outside the scope of its legal powers or, if professedly acting within them, was doing so "maliciously" in the sense of being activated by an ulterior predominant purpose, such as to hurt the plaintiff for conduct unconnected with the exercise of the power.[77]

4.5 LIABILITY OF FINANCIAL SUPERVISOR FOR MISFEASANCE IN PUBLIC OFFICE: BCCI CASE

In 1991 the Bank for Credit and Commerce International, S.A. (BCCI), a Luxembourg-incorporated entity, went into insolvent liquidation as a result of "fraud on a vast scale perpetrated at a senior level in BCCI."[78] UK depositors sought to circumvent the difficulties presented by common law precedents on the question of supervisory negligence by bank supervisors, and the associated statutory immunities, by bringing proceedings against the Bank of England for the tort of misfeasance in public office.[79] In very general terms, the BCCI depositors alleged that from the time that the Bank of England granted BCCI a full licence as a deposit-taker in 1980 until shortly before its collapse in 1991 the Bank was not legally entitled under applicable UK banking laws to rely on the supervision of the Luxembourg bank regulators because BCCI's principal place of business was in London rather than Luxembourg. The depositors further

72 See *Callinan v. Voluntary Health Insurance Board,* unreported, Supreme Court, July 28, 1994; Re *"The La Lavia"*, unreported, High Court, July 26, 1994 (cited in Hogan and Morgan, *Administrative Law in Ireland* (3d. ed., Round Hall Sweet & Maxwell, 1998), p. 815).

73 Unreported, Supreme Court, July 23, 1997 (cited in Hogan and Morgan, *Administrative Law in Ireland* (3d. ed., Round Hall Sweet & Maxwell, 1998), p. 812).

74 Unreported, High Court, July 23, 1984 (cited in Hogan and Morgan, *Administrative Law in Ireland* (3d. ed., Round Hall Sweet & Maxwell, 1998), pp. 813-14).

75 [1987] I.R. 23 at 36.

76 Unreported, Supreme Court, July 28, 1994, p. 29 (per Blayney J.), discussed in McMahon and Binchy, *Law of Torts* (Butterworths, 3d. ed., 2000), pp. 552-53.

77 McMahon and Binchy, *Law of Torts* (Butterworths, 3d. ed., 2000), p. 553; see also Hogan and Morgan, *Administrative Law in Ireland* (3d. ed., Round Hall Sweet & Maxwell, 1998), p. 813, n. 73.

78 *Three Rivers District Council v. Bank of England,* [2000] 2 W.L.R. 1220, 1227h (per Lord Steyn).

79 See Proctor, BCCI: *Suing the Supervisor,* The Financial Regulator, Vol. 6, No. 1, p. 35 at p. 37.

alleged that the Bank knew or was reckless that losses to depositors would result both from its granting BCCI a licence and then failing to revoke BCCI's licence in the years preceding its collapse.

In its first decision in this case, *Three Rivers District Council v. The Governor and Company of the Bank of England*,[80] the House of Lords outlined the main elements (or, in the words of Lord Steyn, "matrix") of the tort of misfeasance in public office that would have to be established for the Bank of England to be held liable to the BCCI depositors. *First*, the defendant must be a holder of public office, a broad concept covering the Bank of England, which may be vicariously liable for the acts of its public officials.[81] *Second*, there must be an exercise of power in the exercise of public functions, a requirement satisfied by the exercise of public functions by named senior officials of the Bank of England's Banking Supervision Department.[82] *Third*, the public officer must have a required state of mind comprising (i) targeted malice (i.e., conduct specifically intended to injure a person) and/or (ii) knowledge, foresight, or a lack of an honest or good faith belief that the public officer has no power to do the act complained of and that the act will probably injure the plaintiff. An act performed in a state of mind of reckless indifference (i.e., subjective recklessness) as to the illegality or outcome of the act is sufficient to ground liability for the tort.[83] *Fourth*, any plaintiff must have a sufficient interest to found a legal standing to sue. There is no reason why such an action cannot be brought by a particular class of persons such as depositors at a bank, even if their precise identities were not known to the Bank of England.[84] *Fifth*, the public officer's act must, as a factual matter, have caused the plaintiffs damage.[85] *Sixth*, regarding damages recoverable, the public officer must know that his act would probably injure the plaintiff, or a person of a class of which the plaintiff was a member (e.g., depositors). Foresight or subjective recklessness about the consequences, in the sense of not caring whether the consequences happen or not, is sufficient.[86]

In *Three Rivers* it was noted that imposing liability for acts which although wrongful were not committed with foresight or injury to the plaintiff "may have a stultifying effect on governance without commensurate public benefit"[87] by "not allowing public officers, who must always act for the public good, to be assailed by unmeritorious actions".[88]

In its second decision, the House of Lords, by a slender 3-2 majority, held that the depositors pleaded a reasonable cause of action against the Bank.[89] This decision merely established that the depositors were entitled to a full trial on

80 [2000] 2 W.L.R. 1220.
81 *Ibid.* at 1230h (per Lord Steyn) and 1268h-1269a (per Lord Hobhouse).
82 *Ibid.* at 1231a (per Lord Steyn) and 1267a (per Lord Hutton).
83 *Ibid.* at 1231b-1232d (per Lord Steyn) and 1269d-e (per Lord Hobhouse).
84 *Ibid.* at 1233d-e (per Lord Steyn).
85 *Ibid.* at 1233g (per Lord Steyn).
86 *Ibid.* at 1234a-1235h (per Lord Steyn) and 1261h-1262c, 1265f-h (per Lord Hutton).
87 *Ibid.* at 1265d (per Lord Hutton).
88 *Ibid.* at 1235h (per Lord Steyn).
89 *Three Rivers District Council v. The Governor and Company of the Bank of England (No. 3)* [2001] 2 All E.R. 513 (per Lords Steyn, Hope and Hutton, Lords Hobhouse and Millett dissenting).

the merits of their case, and not that the Bank of England was in any way liable for its supervisory actions. Indeed, two of the five members of the House of Lords would have barred the depositors' claim outright on the basis that it had no realistic prospect of success.[90]

Three Rivers establishes the important legal precedent that a bank supervisor may potentially incur liability to a depositor for misfeasance in public office. In view of the high profile of the BCCI litigation, the case has been a source of concern to supervisors in other common law jurisdictions, such as Ireland, which apply the tort of misfeasance in public office.[91] In this respect, it is clear that *Three Rivers* would be treated as a highly persuasive precedent by any Irish court considering the potential liability of a financial supervisor for misfeasance in public office.

4.6 LIABILITY OF FINANCIAL SUPERVISOR FOR OTHER INTENTIONAL TORTS

Misfeasance in public office is not the only intentional tort for which a supervisor may be liable under Irish law. Potentially, a number of other torts may provide a basis of liability in certain cases, including the torts of interference with contractual relations,[92] intimidation[93] and malicious prosecution.[94] It has been suggested that the tort of intimidation may be relevant to bank supervision where the threat of taking *ultra vires* supervisory action is used to coerce a supervised institution to conform to the supervisor's wishes by behaving in a way involving loss to themselves (e.g., by abstaining from entering into transactions of a particular description or by participating in the costly rescue of another institution) or to a third party (e.g., by "blackballing" that third party and abstaining from any contractual relationship with it).[95] Inducement to breach of contract could also be relevant in situations involving the application by a financial supervisor of informal pressure on a regulated institution.[96] An action was, for example, commenced on this ground against the Bank of England by a merchant banker accused of fraud, but ultimately acquitted of criminal charges, in connection with the Guinness insider-dealing affair, who allegedly lost his job as a result of pressure exercised by the Bank on his employer in pursuance of the Bank's responsibility to ensure the prudent management of banks.[97] Liability for malicious prosecution could potentially arise where a financial supervisor or its officers are activated by improper motives in the prosecution of criminal offences.[98]

90 *Ibid.,* [2001] 2 All E.R. 513 (per Lords Hobhouse and Millett dissenting). See Proctor, *BCCI: Suing the Supervisor*, The Financial Regulator, Vol. 6, No. 1, p. 35.

91 See generally Proctor, BCCI: Suing the Supervisor, The Financial Regulator, Vol. 6, No. 1, pp. 36, 41; see also Dharmananda and Dzakpasu, *Central Bank Liability to Depositors: Three Rivers May Not Open Floodgates* [2002] J.I.B.L. p. 40, p. 43.

92 McMahon and Binchy, *Law of Torts* (Butterworths, 3d. ed., 2000), pp. 821-30.

93 *Ibid.,* at pp. 830-34.

94 *Ibid.,* at pp. 981-86.

95 Hadjiemmanuil, *Banking Regulation and the Bank of England* (LLP 1996), p. 369.

96 *Ibid.,* at p. 369.

97 *Ibid.,* at pp. 369-70.

98 *Ibid.,* at p. 368.

4.7 CONCLUSIONS RE CBFSAI'S LIABILITY FOR SUPERVISORY DECISIONS UNDER IRISH AND EC LAW

To sum up, in the *McMahon* case the Irish High Court held that a financial supervisor is not liable to depositors of a failed deposit-taking institution for negligence in the exercise of its supervisory functions. In reaching this conclusion the High Court followed the advice of the UK Privy Council in the *Yuen-Kung-Yeu* case, where similar conclusion was reached that a Hong Kong supervisory authority was not liable to depositors of a failed deposit-taking institution for negligence. This insulation at common law from liability for negligent supervisory decisions has been confirmed by Irish legislation conferring a series of statutory immunities on the CBFSAI. The recent decision of the European Court of Justice in the *Peter Paul* case has confirmed that bank supervisors may not be liable for losses resulting from defective supervision under Community law, meaning that the statutory and common law immunities enjoyed by the CBFSAI under Irish law would appear to be beyond challenge as a matter of current Community law.

However, the CBFSAI's immunities are not absolute, and liability still lies for acts or omissions that are proved to have been in "bad faith". This would include liability for cases of intentional wrongdoing by the financial supervisor's officials, where damages may be recovered for the tort of misfeasance in public office and a range of other intentional torts. The potential scope of a financial supervisor's liability for misfeasance in public office has become a more live topic in recent years as a result of modern developments in Irish and English case law. Liability for misfeasance in public office has been successfully established against public bodies in some modern Irish cases. The judgement of Finlay C. J. in the *Pine Valley* case suggests that misfeasance may arise where a public official's actions constitute such a gross abuse of power or wholly unreasonable exercise of power as to lead to an inference that he was aware that he was exercising a power which he did not possess. A broader view was taken by the Supreme Court in the *Deane* case, where the Court indicated that a public body might be liable for misfeasance if its statutory powers were merely exercised unreasonably and unfairly in a manner which caused loss and damage.

The decision of the British House of Lords in the *BCCI* case would be treated as a highly persuasive precedent by any Irish court considering the potential liability of a financial supervisor for misfeasance in public office. At the risk of generalisation, the *BCCI* case establishes the precedent that a bank supervisor may potentially incur liability to a depositor for misfeasance where a public officer has the required state of mind comprising targeted malice (i.e., conduct specifically intended to injure a person) and/or knowledge, foresight or a lack of an honest or good faith belief that the public officer has no power to do the act complained of and that the act will probably injure the plaintiff. An act performed in a state of mind of reckless indifference (i.e., subjective recklessness) as to the illegality or outcome of the act is sufficient to ground liability.

Misfeasance in public office is not the only intentional tort for which a financial supervisor may be liable under Irish law. Potentially, a number of other torts may provide a basis for liability in certain cases, including the torts of interference with contractual relations, intimidation and malicious prosecution.

5 COMPATIBILITY OF CBFSAI'S LIABILITY FOR FINANCIAL SUPERVISOR WITH CENTRAL BANK INDEPENDENCE REQUIREMENTS UNDER TREATY

The ECB was consulted by the Irish Department of Finance on the draft Central Bank and Financial Services Authority of Ireland Bill, 2002, and delivered its opinion on the draft legislation on 5 June 2002.[99] The central concern in the ECB opinion was whether the CBFSAI's liability for the new supervisory authority was compatible with central bank independence requirements under the Treaty.

The ECB opinion highlighted the fact that the legislation would establish a structure for the supervision of financial institutions which involved setting up a statutory body enjoying independent functions (the IFSRA), but located within the legal personality of a NCB. Having particular regard to the unique structure of the IFSRA as a constituent part of the CBFSAI, the ECB noted that Ireland's NCB would be accountable or liable for acts performed by a constituent part (the IFSRA) which would be outside the control of the CBFSAI's key decision-making body responsible for its ESCB-related tasks (the Governor). The ECB considered that such a structure could pose a risk to a NCB's integrity, threatening its overall institutional independence. In this regard, the ECB noted that under Article 108 of the Treaty, when exercising the powers and carrying out the tasks and duties conferred upon it by the Treaty and the ESCB Statute, neither a NCB nor any member of its decision-making bodies shall seek or take instructions from, *inter alia*, any government of a Member State 'or from any other body', which would include a statutory body such as the IFSRA.[100]

The final legislation restructuring the Central Bank of Ireland addressed the ECB's concern by ensuring that the Governor has a significant role with respect to financial stability matters. While the Governor does not serve as the Chairperson, Chief Executive or a member of the IFSRA, the Governor has been given a number of specific financial stability powers. *First*, the IFSRA is required to consult the Governor, and may act only with the agreement of the Governor, on any matter relating to the financial stability of the Irish State's financial system, including (but not limited to) the issue, revocation and

99 Opinion of the European Central Bank of 5 June 2002 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill, 2002 (CON/2002/16), published on the ECB website at http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html. The ECB is required to be consulted by national authorities on draft legislative provisions within its fields of competence, including *inter alia* any draft national legislation on NCBs and on rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. Article 105(4), second indent, of the Treaty; Article 2, third and sixth indents, of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions, OJ L 189, 3.7.1998, p. 42.

100 *Ibid.,* paragraph 6.

suspension of a licence or other authority.[101] *Second*, the Governor has been given powers to authorise a CBFSAI employee to investigate the business and carry out on-site inspections of licensed credit institutions, building societies, trustee savings banks, approved stock exchanges, authorised investment business firms and authorised collective investment schemes.[102] *Third*, the Governor may, with respect to his functions, issue guidelines to the IFSRA as to the policies and principles that the IFSRA is required to implement in performing the CBFSAI's functions.[103] *Fourth*, whenever requested, the IFSRA is required to provide the Governor with advice, information and assistance with respect to the performance of the Governor's functions.[104]

The ECB opinion expressed the view that all these provisions are fundamental – and should be made the most of in practice – to allow for the continued close involvement of the central banking functions in supervision matters. Indeed, the ECB opinion noted that this involvement is a necessary condition to allow the Eurosystem to contribute adequately to monitoring the risks to financial stability in the euro area, and that, in addition, it also safeguards a smooth co-ordination between the central banking functions exercised at the Eurosystem's level and the supervisory functions carried out at national level.[105]

6 SUMMARY AND CONCLUSIONS

The prudential supervision of credit and financial institutions is not among the tasks attributed to the ESCB under the Treaty. In practice, the supervision of credit and financial institutions is organised under a wide variety of legal structures in the 25 EU Member States, with varying degrees of central bank responsibility. At one end of the spectrum, in nine Member States NCBs are directly and fully responsible for the supervision of credit institutions. At the other end of the spectrum, in eight Member States an independent public authority that is legally and operationally separated from the NCB is responsible for the supervision of practically the entire financial sector. The remaining Member States have adopted nuanced variations on these two contrasting

101 Sections 33C(9), 33C(9A) and 33C(9B) of the Central Bank Act 1942, as amended. In an opinion issued on a subsequent CBFSAI Bill, the ECB considered that a non-judicial administrative review of financial stability decisions taken by the IFSRA with the agreement of the Governor proposed as part of the remit of a new Financial Services Appeals Tribunal would be inconsistent with the independent discharge of the Governor's ESCB-related task of contributing to the stability of the Irish State's financial system. See Opinion of the European Central Bank of 19 November 2003 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill (No.2) 2003, paragraph 6, published on the ECB website at http://www.ecb.int/ecb/legal/pdf/en_con_2003_24_f_sign.pdf.

102 Section 17A of the Central Bank Act 1971, as amended; section 41 of the Central Bank Act 1989, as amended; section 41 of the Building Societies Act 1989, as amended; section 24A of the Trustee Savings Bank Act 1989, as amended; sections 30(5), 30(6), 30(6A), 30(6B), 36(1), 36(1A), 36(1B) and 55 of the Stock Exchange Act 1995, as amended; sections 22(5), 22(6), 22(6A), 22(6B) and 64 of the Investment Intermediaries Act 1995, as amended; section 75 of the Central Bank Act 1997, as amended; European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 1989 (S.I. No. 78 of 1989), as amended, Regulation 99.

103 Section 33D(1), (2) of the Central Bank Act 1942, as amended.

104 Sections 33C(1)(c) and 33C(8) of the Central Bank Act 1942, as amended.

105 Opinion of the European Central Bank of 5 June 2002 at the request of the Irish Department of Finance on a draft Central Bank and Financial Services Authority of Ireland Bill, 2002 (CON/2002/16), paragraph 5, published on the ECB website at http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html.

structures, laying down mechanisms allowing for varying degrees of central bank involvement in the conduct of supervision. For example, in Belgium, France, Germany and Poland NCBs make a substantial contribution to the performance of supervisory tasks, but are not as such responsible for supervision.

A somewhat novel legal structure is deployed in Ireland whereby the supervision of practically the entire financial sector is carried out by an autonomous body forming part of the legal personality of the NCB. Under this construction the NCB bears, in legal terms, sole liability and responsibility for the acts of the financial supervisor. This raises the important question as to the extent of the NCB's liability for the financial supervisor under Irish law.

Under Irish law the CBFSAI is immune from liability for negligence on the part of the financial supervisor. However, the CBFSAI's immunities are not absolute, and liability still lies for acts or omissions of the supervisor that are proved to have been in "bad faith". This would include liability for cases of intentional wrongdoing by the supervisor's officials, where damages may be recovered for the tort of misfeasance in public office and a range of other intentional torts, including the torts of interference with contractual relations, intimidation and malicious prosecution. The potential scope of liability for misfeasance in public office has become a live topic in recent years. Liability for misfeasance in public office has been successfully established against public bodies in some modern Irish cases, and a broad view regarding the scope of liability for misfeasance has been taken by the Irish Supreme Court in one case. The decision of the British House of Lords in the *BCCI* case, which establishes that a bank supervisor may potentially incur liability to a depositor for misfeasance in public office, would also be treated as a highly persuasive precedent by any Irish court considering the CBFSAI's potential liability for misfeasance on the part of the supervisor.

The extent of the NCB's liability for the financial supervisor was a critical issue in the opinion delivered by the ECB to the Irish authorities on the draft legislation restructuring the Central Bank of Ireland and establishing the autonomous financial supervisor as a constituent part of the newly restructured central bank. The ECB opinion highlighted that, by setting up a statutory body enjoying independent functions, but located within the legal personality of a NCB, the NCB would be accountable or liable for acts performed by a constituent part of the central bank (the financial supervisor), but which would be outside the control of the central bank's decision-making body responsible for its ESCB-related tasks (the CBFSAI Governor). The ECB considered that such a structure could pose a risk to a NCB's integrity, threatening its overall institutional independence, contrary to the independence required of an ESCB central bank under Article 108 of the Treaty.

The final legislation restructuring the Central Bank of Ireland addressed the ECB's concern by ensuring that the Governor has a significant role with respect to financial stability issues. In particular, the financial supervisor is required to consult the Governor and to act with the Governor's agreement with respect

to any matters relating to the stability of the Irish State's financial system, including the supervisor's decisions relating to the issue, revocation and suspension of licences. The Governor has independent powers to investigate the business and carry out on-site inspections of credit and financial institutions. The Governor may issue binding guidelines as to the policies and principles that the supervisor is required to implement. Finally, the supervisor is required to provide the Governor with all necessary advice, information and assistance with respect to the performance of the Governor's functions.

To sum up, the ECB has a strong policy in favour of the attribution of extensive supervisory responsibilities to NCBs. Such an attribution fulfils the Eurosystem task under Article 105(5) of the Treaty to contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. However, by locating an autonomous financial supervisory authority within the legal personality of a NCB, the restructuring of the Central Bank of Ireland posed a risk to a NCB's institutional independence by making the NCB accountable or liable for acts performed by a constituent part of the central bank, but outside the control of the central bank's decision-making body responsible for the discharge of its ESCB-related tasks. The fundamental philosophical premise underpinning the ECB opinion is that to saddle an ESCB NCB with liability and accountability for a financial supervisor, without endowing the central bank with a corresponding role with respect to the systemically significant decisions of the supervisor, would infringe the independence required of an ESCB NCB under the Treaty. In its opinion on the restructuring of the Central Bank of Ireland the ECB clearly set the limits of the proposed reorganisation by warning against the risk of the financial supervisor's functions encroaching upon the central bank's independence. As a result, important safeguards were introduced to protect the independence required of a national central bank member of the ESCB under the Treaty by ensuring that the Governor has a significant role with respect to financial stability issues.