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REPUTATIONAL RISK IN BANKS – POLISH NORMATIVE (LEGAL) ASPECTS

Abstract

A generally accepted standard, both in regulatory and market terms, is risk management, in particular with regard to material risks, in the operation of a bank. The Polish legislation on banking activities also includes norms on the system of managing risk, including reputational risk. The purpose of this article is to establish the legal relevance of reputational risk for banks, including to specify its place within the risk management system, as well as an attempt to identify particular stages in the process of managing reputational risk. The direct purpose of this article is to verify the following theses: 1) reputational risk is a material risk involved in banking activities and, for the above reason, it should be taken into account in the risk management system so that its management is the bank's legal obligation; 2) the currently applicable Polish legislative framework offers sufficient solutions with regard to reputational risk. As a result of the analyses carried out, the former thesis has been verified positively and the latter negatively. Considering the normative approach to the discussed problems, primarily, the dogmatic legal method will be used in the article, and the analysis will cover provisions of generally applicable law. The main conclusion from the analysis carried out is that reputational risk management is a legal requirement imposed on a bank that has not been made specific.

Key words: risk management, banking activities, reputation, reputational risk.

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1. Introduction

In Poland, banking activities are regulated activities, which means that provisions of generally applicable law impose limits on them, both in the subjective and objective sense, and that there is a legally defined procedure for verifying fulfilment of the requirements imposed (licencing procedures held by appropriate public authorities[1]). As far as the former is concerned, appropriate legal provisions point to entities entitled to undertake such activities, including the necessary conditions to become such an entity and the method of their verification. When it comes to the latter (objective aspects), legal provisions specify a permissible scope of the activities, a manner of undertaking specific activities and additional requirements that should be complied with during the process.

Every economic activity involves risk [Iwanicz-Drozdowska 2005: 34]. Bearing in mind the nature of banking activities, the role of banks in economic transactions and variability of economic conditions [Wierzbicka 2016: 67], in case of banking activities, risk is a particularly important issue, and risk management is a key task of a bank. One of the manifestations of the complexity of this issue is the specification of many risk types, which also includes reputational risk.

The purpose of this article is to establish the legal relevance of reputational risk for banks, including to specify its place within the risk management system, as well as an attempt to identify particular stages in the process of managing that risk. Considering the normative approach to the discussed problems, primarily, the dogmatic legal method will be used in the article, and the analysis will cover provisions of generally applicable law. Such narrowed scope is justified, in the first place, by the lack of a broader discussion of the normative aspects in the previously published literature of the subject. The available studies concentrate on issues relevant from the point of view of management science or refer to supervisory regulations adopted by the Financial Supervision Authority or other bodies whose competences have been taken over by the Authority.

[1] As regards the banking market, the appropriate state authority is the Financial Supervision Authority (hereinafter: "KNF").

The direct purpose of this article is to verify the following theses:

1) reputational risk is a material risk involved in banking activities and, for the above reason, it should be taken into account in the risk management system so that its management is the bank's legal obligation;
2) the currently applicable Polish legislative framework offers sufficient solutions with regard to reputational risk.

2. Risk management system in banks

The currently applicable legislation, especially provisions of the Act of 29 September, 1997 – Banking Law [Banking Law], provide for the operation in banks of a management system (Art. 9 (1) Banking Law), which makes up a set of rules and mechanisms with regard to decision-making processes implemented in a bank and to the assessment of the pursued banking activities (Art. 9 (2) Banking Law). In accordance with the will of the Polish legislator, that system is composed of at least two elements (Art. 9 (3) Banking Law):

1) risk management system [Kawulski 2013: 108],
2) internal control system.

At the same time, Art. 9 (2a) of the Banking Law requires that the management system should also include the procedures of anonymous reporting of violations of law as well as the procedures and ethical standards applicable in the bank.

The subsequent provisions of the Banking Law relate directly to particular elements of the management system, which also includes the risk management system. Pursuant to Art. 9b (1) of the Banking Law, the tasks within the risk management system are as follows: identification, measuring[2] or estimating, control, monitoring of the risk inherent in the activities of a bank for the purpose of ensuring regularity of the processes of defining and implementing specific objectives of the bank's operation.

In the context of the cited assumptions of Art. 9b (1) of the Banking Law, two conclusions must be made. First, the discussed provision defines the basic elements of the risk management process that should be referred also to reputational risk. Second, in the light of the provisions of Art. 9a (1) and (2) of the Banking Law, in the wording of Art. 9b (1) of the Banking Law, two

[2] In literature of the subject, a distinction is made into less and more measurable risks, and risk measurability itself affects the calculation as a part of actual measurement [Dybiński 2025].

elements are missing that are necessary for proper operation of the management process in respect of any type of risk. Those elements are reporting and assessment of an identified risk. The above-mentioned provisions of Art. 9a of the Banking Law confer specific tasks on the bank's governing bodies, for the effective implementation of which it is necessary to have information on a number of things and, in turn, to provide such information to the governing bodies. The management board of a bank was made responsible for the designing, introducing and ensuring the operation of the management system, which also includes the risk management system. The supervisory board was entrusted with supervision over the introduction of the management system (including the risk management system) and with assessment of the system's adequacy and efficiency. From the point of view of the supervisory board of a bank considered significant, another important thing is the provision of Art. 9cb (1) item 2 of the Banking Law, requiring that a bank should have an operative Risk Committee, to be composed of the bank's supervisory board members. The tasks of such Committee are laid down in Art. 9cb (3) of the Banking Law. The above-mentioned risk assessment is necessary for effective monitoring and reporting of a risk, and to make appropriate decisions as a part of the risk management process.

The postulates under the Banking Law with regard to the risk management system were developed in an implementing act (regulation) adopted on the basis of statutory delegation under Art. 9f (1) item 1 of the Banking Law. The currently applicable legislative act in this area is the Regulation of the Minister of Finance, Funds and Regional Policy of z 8.6.2021 concerning the risk management system, the internal control system and the remuneration policy in banks [Regulation].

Under § 7 (1) of the Regulation, as a part of the risk management system, a bank manages risk through: identification, measuring or assessing, monitoring, control, including risk mitigation, reporting risk, including evaluation of the effectiveness of the measures taken to mitigate the risk.

In the context of the provision of § 7 (1) of the Regulation, several conclusions can be drawn, a part of which is unfortunately critical. First, the wording of that provision is inconsistent with the wording of Art. 9b (1) of the Banking Law. In fact, certain elements appear in the former that are missing in the appropriate provision of the Banking Law (reporting). The provision of § 7 (1) supplements in this regard the incomplete, as noted above, wording

of Art. 9b (1) of the Banking Law. From the point of view of the practice of applying the legislative regime, this is a positive modification. However, bearing in mind the general principles and the status of both legislative acts, it should still be assessed negatively. A provision of an implementing act, that is a piece of legislation of a lower rank, should not approach the same issues differently from a statutory act. The second issue refers to inconsistency in the formulation of particular elements of the risk management process. Art. 9b (1) of the Banking Law points to 'measuring or estimating'. On the other hand, in the wording of § 7 (1), the same element was defined as 'measuring or assessing'. In this respect, the conclusions made in relation to the provision of Art. 9b (1) of the Banking Law (assessment is a desired element of the process) remain valid, however, the method of approaching the element of assessment is unfortunate. Assessment should be an independent element of the risk management process, and not an element combined with measurement (literal wording of the provision suggests a combination of the two). At the same time, also in this context, the evaluation made above of the consequences of such legal situation remains valid.

Since the Constitutional purpose of issuing regulations is to implement the provisions of a statute (implementing legislation), it is postulated, with a view to remedying the inconsistencies identified above in the applicable statutory framework, to amend the provisions of Banking Law. Then, following such amendment, to introduce appropriate modifications to the provisions of the Regulation. Art. 9b (1) of the Banking Law could have the following wording: "*1. The tasks of the risk management system are identification, measuring or estimating, assessment, control, monitoring of risk and reporting about risk involved in the bank's operation so as to guarantee a regular process of designating and implementing specific objectives for the activities pursued by the bank.*" Upon introduction of such modification, § 7 (1) of the Regulation could read as follows: "*1. Within the framework of the risk management system, the bank shall manage risk by adopting appropriate measures as a part of identifying, measuring or estimating, assessing, controlling monitoring risk and reporting about risk, including the assessment of effectiveness of the measures adopted to mitigate risk.*".

3. Reputational risk

Reputational risk is subject to the provision of § 18 item 10 of the Regulation. This provision contains a non-exhaustive list of risk types that should be taken into account in the implementation of a risk management strategy. Such implementation should be achieved through introducing and updating the bank's internal regulations (policies, procedures).

Reputational risk appears also in other provisions of the Regulation, however, on those occasions, those provisions do not concentrate directly on the discussed type of risk but on other risks [Wojtacka-Pawlak 2020: 46[3]]. For example, in § 47 item 4 of the Regulation, it is indicated that, as a part of the principles governing liquidity risk management, the bank should introduce the rules of liquidity risk management taking into account the factors listed in the discussed provision and the ensuing possible consequences of reputational risk. A similar solution is provided for under § 18 item 3 letter (a) of the Regulation in respect of risk arising from securitization. Although those provisions do not relate directly to reputational risk, a conclusion can be inferred on their basis that the risk is relevant to banks and should be taken into account in many processes.

In the light of the circumstances cited above, it must be concluded that the legislative framework of reputational risk is fragmentary. Although the risk is taken into account in the provisions on the risk management system and, as a result, management of that risk is the bank's legal duty, the method of performing this duty has not been made specific, which means that banks have much discretion in that area. Because of the importance of that issue and its impact on other types of risk, it is postulated to extend the provisions by introducing minimum requirements dedicated only to reputational risk.

4. Definition of reputational risk

Although in the context of reputational risk, the Regulation imposes a requirement to define the terms of managing the risk (the discussed § 18 item 10 of the Regulation), and other provisions of the Regulation take that risk into account in the processes of managing other risk types (above-mentioned § 18

[3] As a consequence of the above, reputational risk is also referred to in certain recommendations of the Financial Supervision Authority, however, no such document is dedicated to reputational risk.

item 3 letter (a) and § 47 item 4 of the Regulation), it is difficult to infer a definition of reputational risk from the wording of the rules of the Regulation.

Deliberations on the definition of reputational risk should start with defining reputation, which is of key importance in this respect. In the literature of management science, it is pointed out that reputation is an intangible asset capable of contributing to the development (or increase) of competitive edge and market value [Szwajca 2017: 232], however, at the same time it is vulnerable to a number of threats of different type [Szwajca 2018: 640]. So understood reputation is, in the opinion of authors, a result of evaluation (aggregated opinion) [Szwajca 2017: 230] of a specific party and its activities by stakeholders (an effect of the party's perception) [Szwajca 2014: 618–619].

The above shows that reputation is also related to axiological aspects. From this perspective, in the context of banks, the value of customers' trust becomes especially important [Grzybowski 2015: 19], which means that reputation and its significance should also be considered along these terms (building or loss of trust) [Wojtacka-Pawlak 2016: 656; Koleśnik 2020: 45]. Although reputation is considered an intangible asset, it can also have an important tangible significance, especially as we take into account business aspects. Due to the above, protection and strengthening of reputation is considered an important task of an entity, including its governance [Głuszek 2010: 71].

As regards risks present in banking activities, reputational risk was defined by the Basel Committee in the studies of this body on risk management in banks. The Basel Committee pointed out that this is a risk of potential or actual loss (reduction of profit or capitals) arising out of negative perception of financial institutions (including banks) by their stakeholders, which category should be understood in broad terms (not only customers but also shareholders, partners, employees, public authorities, etc.) [Miklaszewska 2015: 99]. In later papers, the Basil Committee extended the approach to reputational risk by pointing to the consequences of the risk's materialization also in the form of negative influence on business relations [Adebah 2023: 322]. and access to financial resources [Koleśnik 2020: 47]. Invariably, however, the cause is negative perception of a bank by widely understood stakeholders [Fiordelisi 2013: 1359].

Based on the presented circumstances and conclusions made, for the purpose of risk management by banks, a following definition of reputational risk can

be reconstructed: "*reputational risk is a risk of consequences, in particular loss of trust, following from negative perception of a bank by its stakeholders*." The proposed definition seems very general, however, this is a deliberate solution. Its construction on the basis of consequences allows to include any types of results. At the same time, with a view to axiological aspects and the public trust institution status attributed to banks, trust has been additionally emphasized. On the other hand, 'perception' and 'consequences' are expressions that contribute to the definition's flexibility.

Bearing in mind the previous findings, in particular the need to supplement the legislative framework with regard to reputational risk and the identified lack of a definition of that risk, it must be pointed out that the proposed supplementation should, in the first place, consist in the introduction of such definition. Since many specific provisions of the Regulation contain a reference to § 18 of the same legislative act, an effective solution would be to supplement § 18 item 10 of the Regulation. For example, after supplementation of the provision, appropriate application of § 22 (2) of the Regulation, requiring adoption of risk management rules in subsidiaries [Dybiński 2025: Legalis] in compliance with the terms laid down in § 18, will require also considering the provisions on reputational risk. Using the proposed definition, it is postulated to consider introducing the following wording of § 18 item 10 of the Regulation: "*10) with regard to reputational risk – the rules of managing that risk, understood as the risk of consequences, in particular loss of trust, following from negative perception of a bank by its stakeholders*,".

5. Conclusion

It is a legal obligation of a bank to implement and ensure operation of a risk management system whose important element is reputational risk management. The applicable legislation refers to this type of risk in general terms, without introducing specific requirements in this area, also when it comes to managing the risk. In the light of the identified relevance of this subject matter for the system of risk management in banks, it is postulated to introduce minimum requirements in this regard.

Legal provisions on this subject matter do not contain any legal definition of reputational risk. However, on the basis of the existing jurisprudence and studies by international fora, the following definition of the risk can be formulated:

"*Reputational risk is a risk of consequences, in particular loss of trust, following from negative perception of a bank by its stakeholders*".

When it comes to identifying specific stages in the process of reputational risk management, the currently applicable legal solutions provide that these will be at least the following elements:

1) identification,
2) measurement or assessment,
3) monitoring,
4) control, including mitigation of risk,
5) reporting risk and evaluation of the effectiveness of the measures taken to mitigate the risk.

Since the contents of particular legislative acts are inconsistent, it is postulated to introduce an appropriate amendment to the applicable provisions. The purpose of such an amendment would also be to reinforce certain elements of the risk management process in general, which would apply also to reputational risk management. The proposed changes should concern the content of Art. 9b (1) of the Banking Law and § 7 (1) of the Regulation. The first one could have the following wording: "*1. The tasks of the risk management system are identification, measuring or estimating, assessment, control, monitoring of risk and reporting about risk involved in the bank's operation so as to guarantee a regular process of designating and implementing specific objectives for the activities pursued by the bank.*". Upon introduction of such modification, the second one could read as follows: "*1. Within the framework of the risk management system, the bank shall manage risk by adopting appropriate measures as a part of identifying, measuring or estimating, assessing, controlling monitoring risk and reporting about risk, including the assessment of effectiveness of the measures adopted to mitigate risk.*".

It is postulated to consider introducing the following wording of § 18 item 10 of the Regulation: "*10) with regard to reputational risk – the rules of managing that risk, understood as the risk of consequences, in particular loss of trust, following from negative perception of a bank by its stakeholders,*".

In the light of all presented circumstances, it must be concluded that the thesis formulated at the beginning that: reputational risk is a material risk involved in banking activities and, for the above reason, it should be taken into account in the risk management system so that its management is the bank's

legal obligation – has been verified positively. The second thesis has been verified negatively, namely that: the currently applicable Polish legislative framework offers sufficient solutions with regard to reputational risk – as the applicable provisions require supplementation at least by the elements indicated in the article.

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