



# THE ROLE OF THE CENTRAL BANK LEGAL FUNCTION IN LEGAL RISK MANAGEMENT

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**I. LEGAL RISK**

**II. PREFERENCE OF MANAGING THE LEGAL RISK**

**III. LEGAL DEPARTMENTS' POSITION IN THE LEGAL RISK MANAGEMENT**

**IV. THE CBTR LEGAL DEPARTMENT AND LEGAL RISK MANAGEMENT**

**V. CONCLUSION**

## A- Definition

The concept of «*legal risk*» came to prominence when the Basel Committee on Banking Supervision used the words «...*including legal risk*» in their description of operational risk.

## A- Definition (Cont'd)

*“Legal risk for a business may be defined as falling to: operate within the law, be aware of its legal obligations, honour contractual commitments, agree remedies for compensation with a supplier in the event of default, show evidence that it has operated within the law, or recognize and effectively manage legal threats.”*

Chapman, Robert J., Simple Tools and Techniques for Enterprise Risk Management

## A- Definition (Cont'd)

There is not a standart, an undisputed definition of legal risk which contains its all components and valid for all companies.

## B- Logic of the Legal Risk Management

- *"The essence of risk management lies in maximizing the areas where we have some control over the outcome while minimizing the areas where we have absolutely no control over the outcome and the linkage between effect and cause is hidden from us."*

Bernstein, Peter L., 1996, *Against the Gods: The Remarkable Story of Risk*

- In the legal risk management, predictions of jurists which are based on analyzes and legally grounded regarding the weak points are based upon, and the company's field of work is tried to be kept in the safe area with the works done in this sense.
- The logic of legal risk management is not different from the underlying logic of managing any risk.

## B- Logic of the Legal Risk Management (Cont'd)

### ➤ The vital necessity

- You can not walk in the minefield without a detector even you should not.
- The legal function is the detector of central banks in legal risk management.

### **A- Importance of the Legal Risk Management Preference**

- Is there any way of compensating contradiction to law of central banks transactions?
- How does the detection of an illegality in a transaction influence the reputation of central banks?



### B- Expected Benefits

#### ➤ Just as examples

- Detection of future legal difficulties.
- Preventing legal disputes.
- Minimizing losses.
- Taking quick and effective decisions.
- Business continuity.
- More effective use of resources of central banks.
- Reducing the cost of risk.
- Protecting the reputation.

## **A- Position**

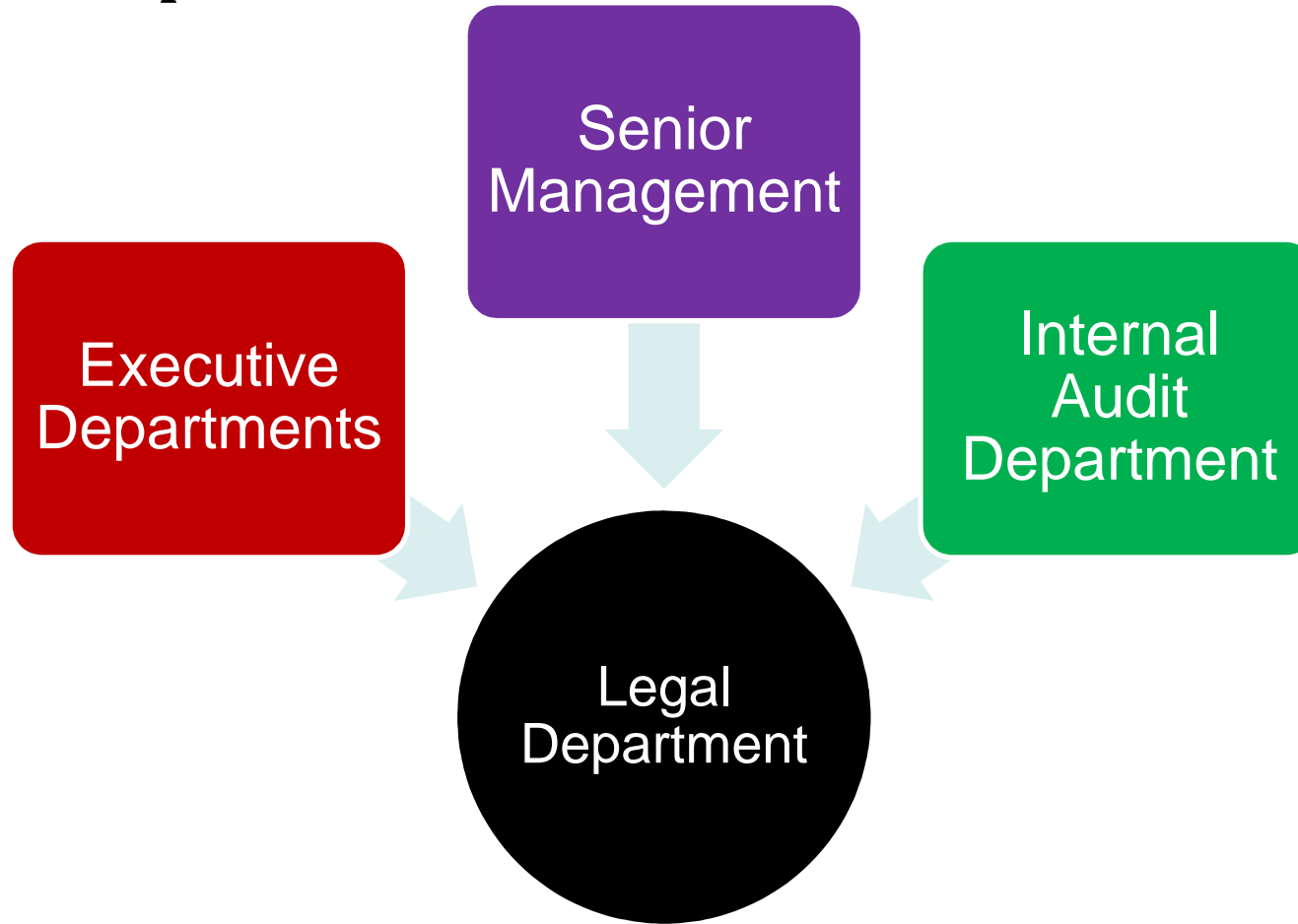
Legal Departments can not manage legal risk on their own even they should not.

## **A- Position (Cont'd)**

### **➤ Volleyball referee metaphor**

- Legal departments are like volleyball referees. They should be placed not far from the court, so as to see the court entirely from above.

#### **B- Co-operation**



## **B- Co-operation (Cont'd)**

### **1. With executive departments**

- Executive departments should be volunteer to be in cooperation with legal department.
- Legal department should avoid to undertake the obligations of executive departments regarding the legal risk management.

## **B- Co-operation (Cont'd)**

### **2. With senior management**

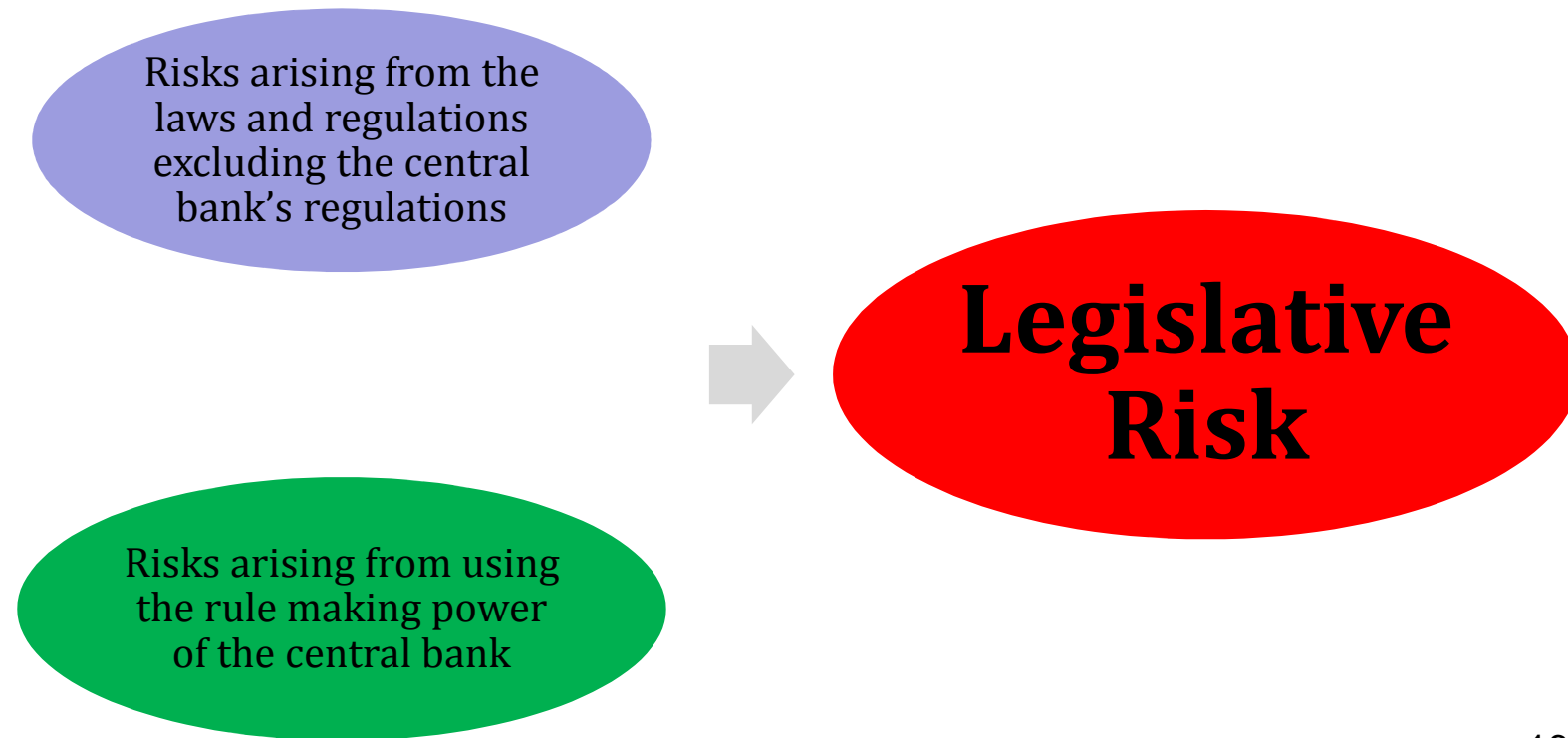
- Legal risk management process must be conducted so as to include administration activities.
- Existence of the senior management's desire to involve the legal department to administration activities contributes to process to become operative.

## B- Co-operation (Cont'd)

### 3. With internal audit department

- Auditing is such a weighty responsibility that it cannot be just loaded internal audit department by excluding legal department.
- Legal departments' having a regular and an active role in internal auditing process is important for successful risk audit.
- This gives opportunity of having data to legal department for future legal risk management.

### A- Managing the Legislative Risk





### A- Managing the Legislative Risk (Cont'd)

#### 1. Legal risk arising from the laws and regulations excluding the central bank's regulations

- Tracking all legislation and regulation activities out of the CBRT as of the beginning provides;
  - preventing contradiction to laws,
  - immediately taking step to reserve the CBRT from incompatible with legal characteristics, purposes and duties of it before related institutions and organizations.

### A- Managing the Legislative Risk (Cont'd)

#### 2. Legal risk arising from using the rule making power of the central bank

- The rule making power of central banks is more than an ordinary authority.
- Central banks must use their power compatible with constitution, general principles of law, international law, laws and jurisprudence of Supreme Court, regulating principles, rules and techniques. And hierarchy between regulations made by central bank with different names must be determined.
- The delicate balance between being independent and being clear, transparent and accountable by theory of democracy should be reflected to use of the rule making power.

### **B- Managing the Contractual Risk**

Contracts that constitute primarily high risk for central banks are the ones resulting from their principal activities.

### C- Managing the Non-Contractual Risk

- What would happen if the collection of the banknotes were decided by the court, based on preventing the violation of intellectual rights?
- If compensation were decided by the court, how could this amount be calculated?
- In order to manage the risks even the possibility of which cannot be afforded, a continuous risk management is required in this field.

### D- Managing the Legal Risk Arising From Daily Executions of Activities.

- Unique transactions or establishments of central banks such as *“reserve requirement ratios”, “transactions done as the lender of last resort”, “open market operations”, “management of country’s gold and foreign exchange reserve”* must be defined and applied compatible with general principles of law, basic rules of disciplines such as commercial-obligations law.
- The issues regarding work division and power sharing between organs should be included to the legal risk management content.

### E- Managing the Dispute/Litigation Risk

- In resolution of conflict using the extrajudicial legal remedy -if favorable for the institution- is an important tool in legal risk management.
- Many factors such as being profitable financially or the results that might be encountered in case of bringing the dispute before the court, are considered in determining the way to be used in resolution of the conflict.
- *“Success in litigation risk management, means preventing the preventable and achieving optimal results when prevention fails.”*

Palmer, Michael, 1999, Litigation Risk Management: Strategic Thinking  
For Mission Success

### **As a conclusion:**

- Unique, sui-generis legal structure, authority, obligation and operational areas of the central banks makes legal risk management necessary, important and specific for them.
- Whatever they were named, the works done by legal departments in central banks are legal risk management.
- Since legal departments in central banks are structured as consultation units, they are not able to achieve risk management on their own.
- It is critical for the success of the process that;
  - the central banks have a legal risk management culture,
  - senior management, executive and internal audit departments of the central banks are volunteer to include the legal department into the process.

### **As a conclusion (Cont'd):**

- Central banks have legal risks arising from various obligation and authorities and their activities, separated into different areas. Actually the heaviest risks for central banks are the ones that can result in loss of reputation.
- Any risk that can hinder conducting central banks' activities continuously and smoothly cannot be taken.
- Legal departments' achieving effective legal risk management by including all activities of the central banks is vitally important for central banks.



***THANK YOU FOR YOUR INTEREST AND PATIENCE.***

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