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LEGAL RISKS: THE CONCEPT AND KINDS¹

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The essence of legal risks in the context of banking activity and property losses of the subjects of entrepreneurial activity is analyzed in the article.

The author considers objective and subjective factors that contribute to emergence of legal risks.

Keywords: risk, legal risk, kinds of legal risks, consequences of non-compliance with legislation.

Risk in a broad sense is a possibility of occurrence of circumstances leading to:

- uncertainty or impossibility of obtaining the expected results from the fulfilment of a set goal;
- infliction of material damage;
- risk of currency losses and etc.

Risk from a legal point of view – an inherent to human activity, objectively existing and within certain limits capable of evaluating and volitional regulation probability of suffering negative consequences by legal entities due to adverse events logically associated with diverse backgrounds (risk factors). Risk is of double subject-object nature, respectively, elements of risk are divided into objective (factors and situation of risk) and subjective (subject and volitional regulation).

Legal risk is a current or future risk of loss of income, capital or damages due to violations or non-compliance with internal and external legal norms such as laws,

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by-laws of regulators, rules, regulations, prescriptions, constituent documents. In Russia, legal risks are getting particularly important, because due to the relatively short history of existing market economy the legislation still lacks of a clear regulatory framework and often basic definitions.

All companies are required to carry out activity in accordance with the legislation, the compliance with which is particularly important from a practical point of view and serves to the interests of both a company and consumers.

Although the risks are applicable to any business organizations, particular importance they gain in banking sphere, where regulatory authorities are obliged to provide protective measures against systematic failures in the banking structure and in economy. Historically, operational risks were recognized as inevitable costs of doing business.

The hallmark of legal risk in contrast to other banking risks is a possibility to avoid dangerous levels of risk if parties to a banking process fully comply with applicable laws and regulations, internal documents and bank procedures.

The Basle Committee has identified seven basic categories of events that lead to losses

Intra-company fraud – losses associated with deception, illegal property or non-compliance with laws or regulations in a company, where at least one of the parties is involved.

External fraud – losses associated with deception or illegal property or failure to comply with law by a third party. These include theft, robbery, hacker attacks and other similar factors.

Work-related practice and work safety – losses associated with actions that are contrary to laws or agreements concerning labor, health and safety that entail compensation for claims concerning compensation for personal injury or discrimination.

Customers, products and business practice – losses associated with unintentional or negligent mistake when performing professional duties in respect of particular customers or in connection with nature or design of products.

Damage to physical assets – losses associated with the loss or damage of resources due to natural disasters or other events.

Disruptions in business and systems failures – losses associated with failures in business or failure of systems. This category includes losses due to failure of computer equipment, software, networks or disruptions in the work of municipal services.

Performance, delivery and processes' management – losses associated with failures in transaction processing or processes' management, as well as losses caused by unsuccessful relations with suppliers and manufacturers.

So, legal risk refers to a group of operational risks, but its management within the framework of financial organization lets us to refer it to financial risks.

If we talk about categories of risks, there is an optimal *risks classification concerning the sphere* in the descending order of importance:

- 1) risks in the field of hostile takeover;
- 2) risks in the field of tax relations;
- 3) risks in the field of ownership and management of real estate, as well as other assets of company;
- 4) risks in the field of corporate relations;
- 5) risks associated with the implementation of judicial-claim activity;
- 6) risks associated with contracting with counterparties.

By *the source of origin* legal risks are:

- a) external (amending of legislation, its violation by bank's clients);
- b) internal (legal mistakes of a bank itself).

By *the place of origin*:

- a) bank - client (breach of agreement by bank, entailing its invalidity or penalties);
- b) bank - regulator (failure to provide information to a regulator);
- c) bank - economic entity, a person (under the control of regulator) (failure to perform control functions delegated by a regulator).

By *the stages of legal regulation mechanism*:

- a) legislative – norm-making;
- b) enforcement ones (law-enforcement, interpretational, other risks to the realization of law).

Where legal risk is a risk of losses due to the inability to meet the requirements of the legislation, including:

- violation of existing capital requirements;
- failure to anticipate future legislative requirements.

So, the emergence of risks associated with amending, termination or adoption of new normative legal acts in no way depends on the actions of corporate executives and cannot be prevented.

Normative legal risk is internal in part of orders, decisions, standards and orders issued inside of an organization and external in part of amendments in legislation.

The signs of *interpretational* risk are: organic connection with interpretation, with uncertainty in law and in regulated by it public relations; the variability of interpretation; divergence; its subjective-objective nature.

This is the risk of different approaches to the interpretation of these or those law norms by various state bodies. This is a sin, for example, of the Russian Ministry of Finance and the Federal Tax Service of Russia. This legal risk may result in payment of penalties, monetary compensation for damages, and deterioration of a company's reputation.

Emergence of risk in interpretational activity is caused by a complex of factors of objective-subjective nature.

The *objective* factors shall include: positive uncertainty of legal norms and the regulated by them diversity of particular life circumstances; the objective backlog of law from development of public relations; existence of areas of public relations falling under legislative reticence; the specificity of the language of law; existence of logical-structural defects of law (gaps, conflict of norms and conflict of interpretations, overregulation, imperfection of legal and terminological structures, etc.).

The *subjective* factors shall include: individual characteristics of the subjects of interpretation expressed by the level of their legal conscience (legal knowledge, deformations of legal conscience, legal pillars and readiness of a person), by the legal (professional) experience and other personal qualities, as well as by the actual dependence when formal independence from economic, political, departmental, personal and other interests.

Interpretation of norms and legal prescriptions contained in individually-legal acts (law-enforcement acts, individually-legal contracts), which are the carriers of information about proper and possible conduct of the subjects of law, is the process of extracting of meanings embedded in them by their creators, development of contained in them legal information that is clothed in a certain sign-symbolic form.

Interpretation of legal prescriptions that is expressed in the distortion of their meaning and inadequate reproduction of content volume (volitional, social, actually legal) generates their incorrect use in specific circumstances.

To the consequences of non-compliance with legislation, which are potentially very serious, include:

- carrying out of investigation by regulating (control-supervision) authorities;
- recognition by a court decision of contracts concluded with a violation as null and void and not having legal force;
- adverse media coverage (reputational risk);

- risk of legal action by third parties for damages caused by the unlawful actions of company;
- administrative responsibility (fines, etc.);
- criminal responsibility of officials.

Significance of legal risk is characterized by the amount of losses incurred by the company as a result of implementation of a risk event and which include payment of claims, judicial costs, attorney fees, costs of harmonization with law of company's internal documents, lost profits and the costs of elimination legal errors.