

PROFESSIONALLY MOTIVATED OPINION IN THE BANKING LAW

ПРОФЕССИОНАЛЬНОЕ МОТИВИРОВАННОЕ СУЖДЕНИЕ В БАНКОВСКОМ ПРАВЕ

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The article is devoted to a comprehensive analysis of the concept of professionally motivated opinion applied by regulator (Bank of Russia) in respect of a credit institution. This concept (category) is seen in a variety of ways: as the approach used in international banking practice, as an institution of banking supervision, as assessment assigned by to the Bank of Russian to a credit organization, on the basis of analysis of numerous financial parameters of the latter, the ownership structure, the risks taken and the objective economic factors. The article discusses also the main directions of banking supervision, which includes elements of professionally motivated opinions as well as the goals of the latter.

Статья посвящена всестороннему анализу понятия профессионального мотивированного суждения, применяемого регулятором (Банком России) в отношении кредитной организации. Данное понятие (категория) рассматривается в различных аспектах: как подход, используемый в международной банковской практике, как институт банковского надзора, как оценка, присваиваемая Банком России кредитной организации на основании анализа многочисленных финансовых параметров деятельности последней, структуры собственности, принимаемых рисков, а также объективных экономических факторов. В статье рассматриваются также основные направления банковского надзора, в которых присутствуют элементы профессионального мотивированного суждения, а также цели его вынесения.

Key words: professional opinion, banking supervision, financial stability of the credit institution, the Central Bank of the Russian Federation, objective economic factors, financial parameters, financial statements, banking activities, banking risks, banking inspection.

Ключевые слова: профессиональное мотивированное суждение, банковский надзор, финансовая устойчивость кредитной организации, Банк России, объективные экономические факторы, финансовые параметры, финансовая отчетность, банковские операции, банковские риски, инспектирование.

The recent financial crisis has significantly increased a number of problems in the banking sphere, which in turn lead to the increase of losses, not only for banks but also for other financial institutions. The measures taken by financial regulators in different countries worldwide, for the prevention of negative consequences for the banking community were not able to fully mitigate the main risks and achieve financial ability.

Professionally motivated judgments play an increasingly important role in the mitigation of negative consequences of financial and economic crises in the Russian banking sector. The term "professionally motivated judgment" is utilized in the Russian practice to designate not only the measures taken by the Russian Central Bank to regulate the activities of Russian banks, but also the measures that are implemented by the banks themselves.

So what is a "professionally motivated judgment" in Russia? In the Russian practice the term "professional judgment" which is actively used in foreign countries possesses many different translations such as: motivated, professional, valued, qualified judgment. The

translation that is generally used is motivated or professional judgment. While analyzing the terms "motivated" and "professional" as standalone categories it is important to consider their meaning characteristics, to do so we must understand by what other categories the term can be alternated. (table 1).

Table 1.1

A comparative table of synonyms for the word
"motivated" and "professional"¹

№ п/п	Synonyms for "motivated"	Synonyms for "professional"
1	explanatory	qualitative
2	argumentative	immaculate
3	proving	qualified
4	rightful	-
5	legitimate	-

As we can see from the table above the terms are not interchangeable and they should rather be used in a complementing way, because individually each term

¹ the above list of synonyms is not exhaustive, the ones shown are those that we believe are most appropriate in conjunction with the judgment

has a unique meaning. It should be noted that the use of the terms has a unique meaning. It should be noted that the used of the term motivated judgment, professional judgment, motivated decision by a significant number of economists was the result of the implementation of these terms in many normative documents. But there is yet to be a clear definition of what exactly is a motivated judgment. A small number of economists, scholars and experts have attempted over the years to define the term, but their results have not caught on.

One of the earliest attempts to define the term was done in the year 2000 by the first deputy head of the Russian Central Bank A. Kozlov: "A motivated judgment is a professional evaluation of objective economic factors, which must be implemented not only by the Russian Central Bank but also by the numerous commercial banks. It's absolutely different from voluntarism or subjectivism" this definition notes both sides of the relationship, the commercial banks and the regulatory body.

One of the corner stone problems in defining the term "professional motivated judgment" is that there is no legal definition of the term, which leads to certain controversies in its use by banks and financial regulatory bodies. Another problem is that in the process of deliberating a professional motivated judgment certain subjective and objective factors may alter the result. The amount of subjectivity is in a professional motivated judgment is determined by a number of factors such as: the competence and professionalism of the personnel, their point of view and their professional experience. Thus the subjective factors are determined by the people directly involved in deliberating the professional motivated judgments.

Objective factors also affect the activities of banks; among them are economic, political and legal issues. While creating a professional motivated judgment of objective factors play a key role because their analysis allows the expert that carious of the judgment to create the judgment. For instance, among the factors are the materials, information, documents created accordingly to the legislation that are amended at a certain point in time.

Thus in the wide sense, the professional motivated judgment should be regarded a professional subjective evaluation of objective economic, political, legal and other factors performed in order to accomplish the necessary functions and goals of the subject necessary for taking the appropriate decisions.

One of the important aspects that plays a key role in achieving financial stability of the banking sphere are the preventive measures implemented in order to expose the possible risks as soon as possible

and minimize the possible negative consequences. One of these measures is the use of the professional motivated judgments by the financial regulators in risk oriented control of banks.

Recently there have been many discussions about the possible use of this method in risk oriented control of banks. The term, acquires a new meaning where as rule, commercial banks do not usually require this term. For example, a motivated judgment is a professional evaluation of objective economic factors that must be implemented y the regulatory body that evaluate the activities of commercial banks [1].

Examining the use of the professional motive judgment from the point of view of the regulatory body (Russian central bank) we can see that the terms semantic load will include the need to assess the credit institution on the basis of compliance with both the formal rules and requirements, and in terms of the economic content of operations and accompanying interpretation risks.

There are several factors that require the Russian Central Bank to use the professional motivated judgment among them are the risks associated with the activities of banks which sometimes lead to the bankruptcy of banks, which affects the stability of the banking system as a whole. The absence of a possibility to perform the necessary control of banks, that do not work within the set regulations on the limits of allowed concentration of risk to capital.

One the other hand, a significant effect is achieved by implementing the documentation of the Basel committee, in which special attention is given to the use of the professional motivated judgment. The global banking community has been moving away from the formal evaluation of risks by using documents towards the analysis on the basis of the professional motivated judgments, which itself is base on the thorough analysis of the strategies development structure of ownership and corporate governance, internal documentation and risk management procedures, apart from that, the use of the motivated professional judgment can positively affect the development of a new model of the Russian baking system of control that would not only set the formal criterion, but also a quality analysis of the risks of the baking activities which will in turn resolve the issues of the development of quality approaches in the banking sphere.

Currently there are some elements of the professional motive judgment in the Russian legislation, for example it is stated the representatives of the Russian central bank can issue a professional motivated judgment [2], or other acts that determine which tactics must be subjected to the professional motivated judgment and other deter the way the professional motivated judgments must be carried out.

For example, according to the current Russian legislation a professionally motivated judgment can be carried out by the following:

- The Board of Directors of the Bank of Russia – a professional motivated judgment determines the possibility of a re-check of credit institution (or its affiliate) on the same issues for the same reporting period of the credit institution (or its affiliate) for an already checked period in order to control the activities territorial branches of the Bank of Russia, checks, or at the request of the respective structural units of the Bank of Russia in order to assess the financial condition and quality of the assets and liabilities of a credit institution;
- regional branches of the Bank of Russia, overseeing the activities of credit institutions [3];
- Department of licensing and financial Restructuring of Credit Institutions and the Bank of Russia's Banking Supervision Department of the Bank of Russia, which present to the main inspectorate a motivated opinion on the appropriateness of audits of banks on the proposals of the deposit insurance agency [4];
- authorized representatives (employees) of the Bank of Russia;
- representatives (employees) of the Bank of Russia and representatives of the Deposit Insurance

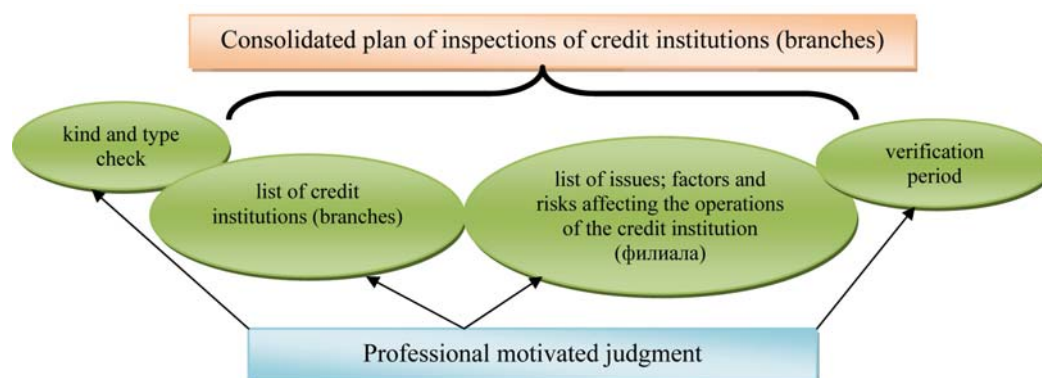
Agency – a professional motivated judgment of the financial position of the bank that is a member of the obligatory deposit insurance in banks of the Russian Federation to address the usefulness of the participation of the Deposit Insurance Agency in the implementation of measures for the prevention of its bankruptcy [6].

Now let's take a closer look at how the profession motivated judgments is applied in risk oriented control of commercial banks.

The most clear and evident example of its use by the Russian central bank is the performing of analysis of the activities of commercial banks. Application of the professional motivated judgment in this case can be considered at several stages:

1. Scheduling the inspections.
2. Conduct pre-audit preparation for the audit.
3. Checking the credit institution and its registration.

While checking the commercial bank the professional motivated judgment is used starting from the planning of the check, when the list of the bank that need to be check is created it is important to note that on obligatory criteria of the check is the definition on the boundaries. The type of the check, the period and the time of the check, the question to be analyzed (scheme 1).



Scheme 1. Influence of the professional motivated judgment on the formation of the consolidated plan of inspections of credit institutions (branches)

The banks that to be inspected are determined based on the analysis of its activities. It's important to pay special attention to the special problems in the activities of the bank which are hard to check without an onsite inspection. Besides that during the creation of the professional motivated judgment it should be considered whether the following information should be analyzing facts or event that affected the bank in a negative way, the concentration of risks the commercial banks takes other events that might lead to the negative

consequence of the bank.. While preparing for the check the matters that are to be studied are analyzed in a detailed way, individual assignments are given to the members of the workgroup.

At the stage of pre-audit preparation for the audit the details of the issues to be examined on the basis of the list of issues and an inspection of the structure and content of the audit report of the credit institution (or its branch) , and, if necessary , individual assignments

are made members of the working group. During the pre-audit preparation for the audit on the basis of professional motivated professional it is necessary to determine:

- The preliminary amount and composition of the list of documents to be analyzed , as well as other information necessary for the audit , for the audited period;
- Validation method.

For example, when choosing an audit method the following parameters can be used:

- Continuous test method in which the data are subjected to verification of each balance sheet date the audit period;
- The method of random checks, which are determined by the most significant balance sheet dates in the audited period or specific dates that contain data on individual transactions and operations;
- Combined method, which uses a method and a spot check and continuous verification method depending on the nature of operations and transactions. In addition, the sample is determined

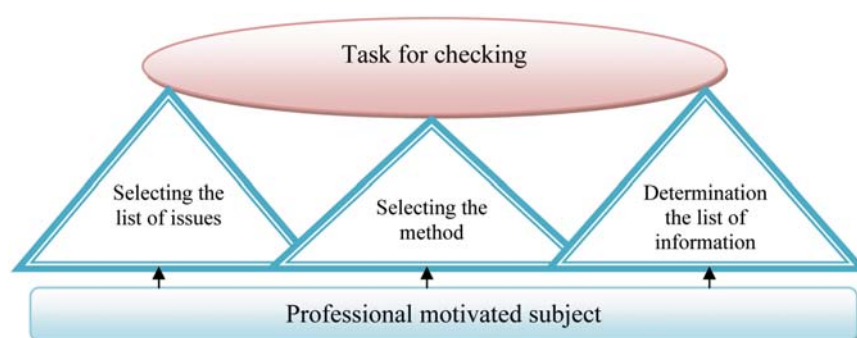
by the documents (information) necessary for the examination (for example a selective list of balance sheet accounts, customer documents).

For example, when determining the list of balance sheet accounts to be audited, it is advisable to use the notes to the statements, information on the causes of changes in the scope of the reporting period (indicating the balance sheet accounts, which occurred the most significant changes.)

The check of all the documentation (information) is appropriate in the following cases:

- Checking the available documents does not allow to achieve the needed results;
- The amount of documents is so small that analyzing them does not seem reasonable;
- A reasonable result can only be achieved by analyzing all of the documents.

At the stage of pre-audit preparation, the professional motivated judgment allows us to conclude whether it is necessary to check these or other matters in order to identify forward methods and means of verification and to establish the required minimum list of information and documents to be checked (see scheme 2).



Scheme 2. Impact of the professional motivated judgment on the preparation of the tasks of checking of the commercial banks (branches)

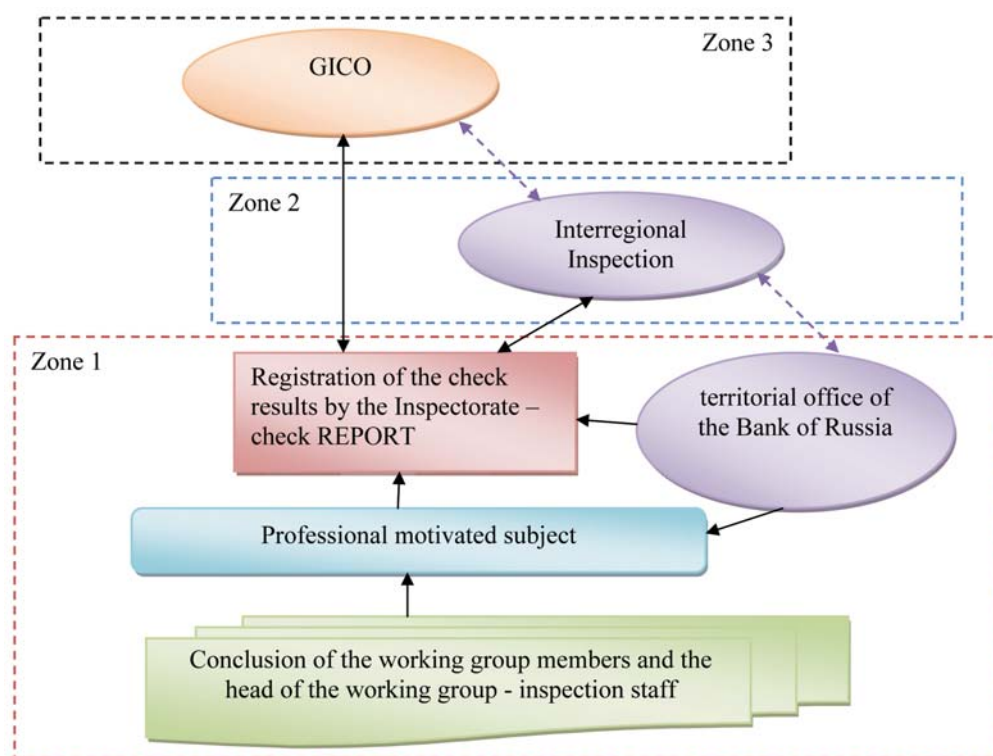
At this stage of formation of the professional motivated judgment the current state and trend of financial and economic activity of the audited entity is considered (credit institution, subsidiary or non-bank credit organizations, and other structural units) which allows the Russian Central Bank to implement a risk-based supervision approach.

It should be noted that at the stage of verification, the methods of validation and the sample size of documents (information) might be corrected during the check based on the analysis of the causes (character) of violations (deficiencies) of the audited credit institution (for example, intentional act or a technical error, misuse of the official position, multitude of

violations and their materiality, deficiencies in the regulatory processes and internal controls).

The validation phase of the credit institution and its registration in the implementation of risk-based supervision is the most important because the acquired results allow the use of measures of supervisory response to the subject audit.

At this stage, the professional motivated judgment is the basis of the audit results, which is formed on the basis of the conclusions (opinions) of inspection units or territorial institutions of the Bank of Russia (if subordinated inspection units are available), interregional inspectorate and the General



Scheme 3. Influence of subjective factors on the check results

Inspectorate of Credit Institutions (GICO), which in turn have a certain degree of influence on the formation of the final results.

We will demonstrate the level of influence of subjective factors on the test result (see scheme 3).

As we can see from the scheme, the effect of structural units on the test results can be divided into three zones:

- The impact of the first zone is characterized by a strong direct influence of subjective factors, since the subject of the inspection and the inspection body are located in the same territory (Inspection and territorial office of the Bank of Russia), access to primary documents and direct contact with the audited personnel, obtaining clarification and explanations from the latter on key issues make up 60%;
- The second zone is characterized by a less strong influence of subjective factors – both direct and indirect – during the check done by the interregional inspectorate of the Bank of Russia or in approving and reviewing the results of an inspection carried out inspection units, respectively – 30% (with an indirect effect);
- The third zone is characterized by a weak influence of subjective factors in the case of indirect participation: when considering the approved test results in order to make the response – 10%.

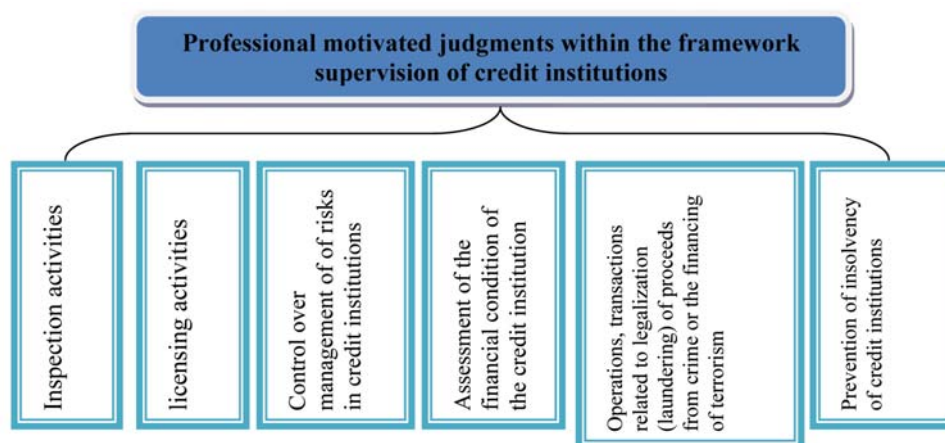
Thus the more remote the consideration of materials verification, examination of information and other necessary documents, the less the influence of subjective factors on decision-making. In addition, the analysis of the issue (test results) by individual structural units ensures high objective assessments. As a result, the resulting material allows the supervisory unit of Bank of Russia to make more informed decisions on the use of supervisory measures to the audited entity.

Within the framework of the supervision of credit institutions, the inspection activities of the Bank of Russia is connected with the need to make recommendations on specific issues of credit institutions motivated professional judgment containing a reasoned point of view on the state of the credit institution based on qualitative characteristics of the processes in the activities of the organization being audited.

The example above of the application of professional motivated judgment by the Bank of Russia at various stages indicates the following:

First, professional motivated judgments play a decisive role for all of the stages, thus, determine the priority actions of the regulatory body;

Secondly, the professional motivated judgment is limited by regulatory standards and internal



Scheme 4. The main directions of banking supervision in which there are elements of professional motivated judgments

administrative guidance documents and is reasoned;

Thirdly, the professional motivated judgment is used only in those areas of activity of the regulatory body, which allows performing the tasks assigned to it and the attached tasks.

The foregoing suggests that the importance of the use of professional judgment motivated the Bank of Russia in the framework of risk-based supervision is:

- Increasing the efficiency of banking regulation and supervision,
- Feasibility of "comparability" powers of the Central Bank of Russia to international standards and requirements,
- Introduction of rules and regulations of Basel II and Basel III,
- Strengthening the role of the substantive approach to risk assessment of credit institutions,
- Supervision on a consolidated basis,
- The development of risk-based approaches to supervision.

These and other factors indicate the need for further improvement of the system of banking regulation and supervision, including the use of professional motivated judgment on the basis that in turn it will give greater flexibility to banking supervision.

Currently, professional motivated judgments are used in individual stages of the supervision of credit institutions. However, it should be noted that the level of its interpretation, its study and application is insufficient, as evidenced by, inter alia, taking place ambiguity content and applications in separate regulations of the Bank of Russia. There are still many unresolved questions regarding the application of principles and criteria for exercising a professional motivated judgment.

Nevertheless, the basic directions of the Bank of Russia, in which there are elements of a professional motivated judgment in the ongoing supervision of credit institutions is presented below. (see scheme 4).

Given the fact that the elements of a professional motivated judgment are present in almost all of the most important issues of banking supervision (see Diagram 4), the need to implement the professional motivated judgment in the supervisory practices of the Bank of Russia emerges more and more clearly since professional motivated judgments with systemic study of this issue and the disclosure of this concept in the regulations for the implementation of effective regulation.

In deciding on whether to apply the category "professional motivated judgment" in the legislation, as well as the definition of its scope of "influence" when making supervisory response measures it is necessary to resolve some problems during the formation of the new tool of banking supervisory practice.

So in this regard, experts focus on the following issues in the application of professional motivated judgment "by increasing the circulation of documents between supervisor and supervised banks , increasing intervention of supervisory authorities in the economic activities of the banks there is a risk of corruption; there are questions about the level of qualification and experience of officials of the Bank of Russia, which will make a reasoned judgment and prepare supervisory proposals based on it (for this reason, the Bank of Russia has launched an educational program for banking supervisors and inspectors) "[8] . Resolving these and other issues will allow the use professional motivated judgments in order to improve the stability of the banking system.

Summing up the above, it should be noted that for the purposes of banking supervision professional motivated judgments are professional, regulated and reasoned assessments of financial, economic, legal and economic factors of the activities of the audited entity. A professional application of professional motivated judgment, based on results of a comprehensive analysis of the activities of credit institutions and their divisions, the study of the development strategy, structure, ownership and management of documents regulating the organization of the internal control procedures for the implementation of risk management, allows to target the supervision [7] primarily on :

- Identification of areas of activity of credit institutions and their branches , bearing the greatest risks for the activities of these organizations, most of the risk in force defects management, monitoring , and (or) other intra- systems;
- Identifying weak (unstable) of credit institutions and the implementation of them in a more intensive supervision mode than credit institutions, whose condition is not serious .

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The continuation in the upcoming issue

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