

Agata Jakubowska\*

## Financial institutions as an example of institutions of public trust

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### 1. Introduction

Nowadays, in a complicated world of multilateral and various relationships and also affluence of information, the reliability of which is hard to verify, there occurs a risk of fallacious assessment of processes and phenomena that occur. This results in an increase in uncertainty and risk in an making economic and extra-economic decisions. This gives great significance to the issue of confidence in relationships between the entities. Special importance is attributed to reliance on relationships that, from their nature, are burdened with asymmetry, and their effects determine the future of the weaker side of the relationships. Such relationships include the contacts between a patient and a doctor, an aggrieved person and law enforcement and judicial bodies, customers and financial institutions, customers and insurers, etc. The functions of institution of public trust are attributed to the entities offering the aforementioned services. This situation is usually controlled in a better or worse way by appropriate legal regulations.

#### 1.1. Institution – the essence of the notion

In order to speak about institutions of public trust, the essence of the notion of institution should be understood<sup>1</sup>. In the literature of the subject we can find two different definitions of this notion. Institution can be understood among others, as:

- a group of people organised according to certain rules for the purpose of satisfaction of a need [1, p. 73],

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\* University of Economics in Katowice, Department of Management, Department of Economy and Policy of Transformation

<sup>1</sup> Latin. Institutio – habit, instruction

- an element of social life that serves the satisfaction of the needs of individuals and that also constitutes an element of social control maintaining coherence and functionality of a social system [7, p. 66],
- an organisation composed of people and things they need to act [22, pp. 355–356; 8, p. 126],
- formal principles, rules (such as legal regulations) and / or informal structures (such as conventions, standards of behaviour, imposed codes of conduct) [14, p.6],
- common activity controlled by an action of an individual is both unstructured form of relationship between individuals that it is created by (e.g. family) and an organised form of activity, i.e. an enterprise [12, p. 1178],
- durable social group, understood as every association of people, which in the awareness of those people constitutes some kind of separate entirety. The function of the institution is to execute the tasks set by a broader group. To perform these tasks they are equipped with tangible and intangible goods and with some system of regulations that control the group activity [11, p. 700, 18, p. 16],
- „institutions are the rules of the game in a society, the structure of which influences interpersonal interactions (interpersonal exchange) and influences the condition of the economy in a particular period of time” [13, p. 3].

Analysing the definitions presented above we can distinguish some elements that make an institutions:

- groups of people that form an institution, performing particular roles in it, and with attributed scopes of duties and responsibilities,
- standards and rules determining the cooperation of individuals within a particular institution, that are formally accepted principles of acting and / or informal standards of behaviour, yet generally operating in particular institutions,
- tasks and goals that a particular institution performs or should perform,
- resources that an institution has at its disposal, that serve the achievement of goals and the satisfaction of the needs of individuals (both tangible and intangible ones such as reliance or image).

Institutions can be classified through the identification of their structure, activities performed in them and repetitions in these actions. Because of the criterion of formality and the rules or principles of the economic game, they can be divided into formal and informal institutions. The group of the first ones includes the system of property rights, government regulations and laws. On the other hand, informal institutions include culture, values, level of trust and thinking models, tradition and religion [16, pp. 5–6; 20, p. 596]. Institutions can also be analysed in a narrow and broad approach. Speaking about groups of

people forming an institution and resources as the elements of institutions, we can speak about the institution as a narrowly perceived (organisation). It is worth observing that a part of representatives of institutionalism consider organisations (and thus narrowly perceived institutions) to be something distinct from institutions themselves, while writing that „organisations are some kind of emanation of institution”. And then, we talk about institutions in a broad approach when we perform their division into formal and informal institutions (just as Douglass Cecil North perceived them).

## 1.2. Trust towards financial institutions

Trust is a complex notion and it has no simple definition in literature. Therefore, profound literature studies that might allow for the arrangement of this knowledge and adoption of some methodological assumptions are necessary. Francis Fukuyama's definition is one of major definitions of trust: “trust is expectation that arises in a community on the subject of regular, honest and co-operating behaviour of other community members on the grounds of commonly accepted standards” [4, pp. 26–27]. According to Nan Lin „trust is a conviction or expectation that a partner will consider the interests of the other partner in the course of exchange” [9, p. 147], Barbara Misztal, in turn, says that „trusting is to believe that results of somebody else's intentional actions will be appropriate from our point of view” [10, pp. 9–10]. Trust can be analysed in terms of many scientific disciplines. From the economic point of view, trust can be discussed in the perception of transactional costs. The bigger the trust between economic entities that enter various relationships, the smaller the transactional costs, which may not occur at all.

Trust is also an indispensable element of social capital. Robert Putnam, writes that „Social capital refers to features of social organization, such as networks, norms, and trust, which facilitate coordination and cooperation for mutual benefit (...) [17, p. 258]”. Then, he also states that „... the higher the level of trust within community, the larger the probability of cooperation” [17, pp. 264–265]. It is important to distinguish the two notions, the notion of trust and of public trust. Definitions that have been quoted refer to generally comprehended notions of trust and public trust refers to various types of institutions or organisations understood as a collection of structural rules within which some actions and interactions occur [19, pp. 103–149]. What is more, public trust is in general an enforced consequence of natural or / and created information asymmetry, frequently also of market asymmetry, associated with the provision of services, that social and economic order often depends on.

Trust is essential in the activity of all institutions, however, there are also such institutions that, because of their role in community, must be equipped with this quality. Financial institutions are generally considered to be such institutions. They have to fulfil both a social and economic role in the economy. The social role of financial institutions is manifested in ensuring the security and stability of all entities that deposit or lend financial resources. On the other hand, the economic role of financial institutions consists in the provision of financial supplies that enable full use of economic resources that are available, and also in the investment of financial resources that households possess and in the transforming these resources into active money capital.

Financial institutions manage the capital that is deposited by clients (that is other people's capital), they are institutions in which trust comes into particular prominence. While depositing their financial resources, the customers have to place confidence in it, believing in getting their money back or multiplying the capital that was deposited, thus apart from economic reasons the customers are guided by trust towards institutions while making decisions [3, p. 19]. An attempt is also made to determine some characteristic features that distinguish institutions of public trust from others:

- subordination of their activity to broadly understood social interest,
- existence of legal solutions ensuring protection of the right or name of such an entity,
- observance, by the institution, of principles of professional ethics adopted in practice,
- specific character of relationships between the entity of public trust and the consumer of its benefits or service, that finds its expression in some amount of trust and secrecy, and obligation to observe professional secrets,
- subjection of institutions of public trust to stricter principles of responsibility for mistakes and omissions while executing operations [21, p. 54],

Employees of institutions of public trust also have to meet some requirements, for example:

- high requirements as for professional qualifications of people employed in them, both with respect to theoretical as well as practical background,
- the right of exclusiveness to do a particular job (a particular activity) [21, p. 54].

A lot of aforementioned qualities that characterise institutions of public trust find their reflection in articles, acts and legal regulations of financial institutions. Of course, there occurs a question whether it is enough to call institutions distinguished, against others by the qualities mentioned above, the institutions of public trust. What are the relationships between financial institutions and shareholders and how does information and market asymmetry influence these relationships and public trust?

Various types of relationships occur between financial institutions and other entities (especially between external entities). Here we can speak about some kind of symmetry or asymmetry between them. With respect to this we can distinguish the model of asymmetric relationship and the model of asymmetric relationships. The first model is a situation in which a financial institution and its shareholders remain in partnership relationships, cooperate with each other and communicate with each other. A privileged position of any entity is out of the question here. Then, in the other model a financial institution occupies a privileged position and its shareholders conform to it. Models of information asymmetry and symmetry are also associated with these models. In the case of such institutions as financial institutions, we can certainly speak about information asymmetry that consists in the fact that the scope of information that parties that execute transactions have at their disposal or remain in some relationships with each other is different [compare 15].

Everyone will probably agree with the statement that financial institutions as institutions of public trust should not take advantage of their privileged situation in relationships with other entities. However, in reality we often face both information asymmetry and asymmetry in relationships for the benefit of just financial institutions. They are just the ones that impose conditions to other entities that remain in various relationships with them. So, in such a situation can we speak about aware trust of entities towards financial institutions or rather about some generally accepted principle of trust towards these institutions? What does actually prove the fact that financial institutions are institutions of public trust?

It is generally believed that banks are the pillar for financial institutions because they are the ones that mostly constitute the major source of capital for other market entities. Banks (and also other financial institutions) have been undergoing changes for years. Passing the law on NBP [*National Bank of Poland*] and banking Law in 1989 was of fundamental significance for the banking sector. The following years brought further changes in the banking system that contributed to formation of diversified organisational structures. Changes of economic, political, legal, social or technological character had enormous impact on these transformations. There occurred institutions and regulations ensuring security for the new banking system. Within the framework of Narodowy Bank Polski [*National Bank of Poland*] banking supervision system has been established that, while being equipped with appropriate tools of control, has been supervising banking institutions. Also, various types of tools that serve the accomplishment of various goals have been implemented. And so, for example refinance loans and loans on securities occurred for the purpose of stimulating the loan activity of commercial banks, the system of special deposits was established to ensure the stability of the banking system, and an instrument of open market operations occurred for the

purpose of balancing the demand and supply of financial resources kept by commercial banks in the Central Bank. In fact banks have always been considered institutions of public trust (although not always justifiably) and aforementioned changes and new tools only contributed to the strengthening of such an image of banks in community awareness. However, it should be stated that even in banking law, a bank is not directly called an institution of public trust. However, it is also important that the Polish Constitutional Tribunal applied this doctrine while giving reasons for its judgement <sup>2</sup>. It „stated that bank privileges are justified because of specific social and economic significance of banks as entities of public trust. Judges of the Polish Tribunal also indicated the fact that banks while defending their interests as individual legal entities, act at the same time for the benefit of their customers that deposited their money in them” [more in 6]. Therefore why is the notion of bank as an institution of public trust so frequently used? Magdalena Dąbrowska claims that „it is not about literally understood trust, but about perceiving banks as institutions under special supervision of the state in which legal system determines the framework of cooperation for them in a much more detailed way than for other economic entities” [more in 2]. It is also rightly noticed by Andrzej Janiak, that the public trust, banks among others are endowed with, should be associated with higher demands towards entities of public trust such as: higher requirements towards professionalism of actions or more severe responsibility of those entities [5, p. 26]. He also postulates the abolition of the so-called bank privileges such as the right to security of a debt, bank deduction, reduction and exemption from court fees, official power of banking documents, bank mortgage, bank enforceable titles and general terms and conditions of agreements and regulations [5, p. 26]. It seems legitimate to claim that less privileged situation of banks and also equal access and understanding of information, might reduce asymmetry of relationships and information between banks and other entities in these relationships.

### **1.3. Trust in financial institutions in the light of public opinion**

For many years the studies concerning the trust of society towards various institutions, including financial institutions among others, have been performed. The latest research performed by TNS Polska as requested by Związek Banków Polskich [*Polish Banks Association*]<sup>3</sup> concerning the image of the

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<sup>2</sup> Decision of Polish Constitutional Tribunal of 16th May 1995 (k 12/93) OTK 1995, part I section 14.

<sup>3</sup> More on the subject of research on the webpage of Związek Banków Polskich [*Polish Banks Association*] at [www.zbp.pl](http://www.zbp.pl) (as of 20.05.2013), further information will be presented on the grounds of this research.

banking sector proves that banks, despite the economic situation in the country and all over the world, enjoy the trust of Polish people and in these rankings, they come before other entities of the financial sector. In 2013 as compared to the previous year, the reputation of Polish banks increased by 7 points and at present it amounts to 28 points<sup>4</sup>. Among the respondents 73% assess banks well and very well. Nearly 40% express a similar view while answering the question about the general assessment of the banking sector. Banks provide the feeling of security for 48% of respondents, 37% Polish people believe that banking sector is resistant to economic crises and 54% believe that they have good prospects for development. The fall of Amber Gold was presented by 15% respondents as the reason for the decrease in trust towards banks and security of deposits. In general, 48% respondents trust banks, and 57% respondents trust the bank the services of which they use. A bank was indicated as an institution of public trust by 59% respondents and 27% think that banks are not institutions of public trust. There is also a question of customer satisfaction with banking services, where in 2012 the level of satisfaction reached 77%.

We should wonder how the aforementioned results of research really show whether banks (or financial institutions) are institutions of public trust. We speak about a positive image of banks, satisfaction with services or security of deposits. It is stated that a bank is an institution of public trust but we do not ask the respondents why they think so. Maybe it is just a proof of the fact that bank as an institution is a notion that is deeply-rooted in awareness of the people. It has already been mentioned that more is demanded from institutions of public trust. The requirements as for professionalism and responsibility are for example larger. Thus, every institution of public trust should observe some rules such as the principle of professionalism, reliability, business-like character, exactitude or the principle of best knowledge<sup>5</sup>. These principles ought to be observed in relationships between financial institutions (institutions of public trust) and other entities. Financial institutions ought to treat their shareholders with reasonable care and skill, reliability and in a partnership way. Financial institutions should not apply their knowledge and possibilities in the way that might violate the interests of entities with which they remain in various relationships and information transferred by financial institutions should be reliable and transparent.

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<sup>4</sup> Reputation of banking sector in our country as measured by aggregated TRI\*M index (Indeks TRI\*M – a synthetic single-number *index*, that is the measure of the level of satisfaction of the customer with services, based on a set of standardised questions).

<sup>5</sup> See chapter 1 section 2 “The Principles of Good Banking Practice” at [www.zbp.pl](http://www.zbp.pl) see also section 2 of general provisions of SKOK code of ethics.

## 2. Conclusions

Without any doubts there is a conviction in people's awareness that financial institutions (and first of all banks) are institutions of public trust. However, even in banking law, a bank (or a financial institution) is not directly called an institution of public trust. Trust is also undoubtedly associated with security, therefore the security of banks and the whole banking sector is the people's own interest. The awareness of this is certainly translated into trust towards these institutions. Information and relationship symmetry and also less privileged position of financial institutions favour the trust of entities towards just those institutions that are generally called institutions of public trust. Financial institutions receive an enormous capital in the form of social trust which favours winning a strong market position by them. However, it is important that these institutions should not use this advantage but should fulfill worthily the role of institutions of public trust that is attributed to them.

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