

## **Best Practice Elements in Reputational Risk Management in Banking**

**Findings of the First Forum on Reputational Risk Management in Banking  
Berlin, February 29, 2008**

The Basel Committee on Banking Supervision recognizes that reputational risk is not easily measurable. However, it expects the banking industry to further develop techniques for managing all aspects of reputational risk. To this end, the Forum on Reputational Risk Management in Banking, which took place for the first time on February 29, 2008, intends to define best practices based on a dialog among risk management practitioners.<sup>1</sup>

The following ten points summarize the key findings and conclusions of the first Forum. They convey a common understanding of reputational risk and of best practice elements in reputational risk management.

1. Reputational risk is defined as the current or prospective risk to earnings and capital arising from the adverse perception of financial institutions on the part of transactional stakeholders, i.e. clients, trading counterparties, employees, suppliers, regulators/ governmental bodies, and investors.<sup>2</sup>
2. Tangential stakeholders such as media, NGOs, trade unions, competitors, and the general public may influence how the bank's activities are perceived by transactional stakeholders.
3. It is the responsibility of all employees to safeguard the reputation of the bank.
4. Banks must assess the expectations of transactional and tangential stakeholders and ensure that the entire institution complies with its own well-defined and regularly revised set of rules, as laid down, for example, in the corporate responsibility policy or the code of conduct.
5. Senior management must make reputational aspects of strategic risk a major concern.
6. If not professionally managed, losses owing to primary risks, i.e. credit, market and liquidity risk, as well as operational risk,<sup>3</sup> pose a major threat to the reputation of a bank, in addition to their purely financial impact. The management of reputational risk linked to primary and operational risk is an integral part of each risk management function.
7. The management of reputational risk presented by ethical, environmental and social aspects of client relationships and transactions requires governance mechanisms with clear roles and responsibilities. These should, if possible, be integrated into existing structures and processes:
  - a. The reputational risk assessment process must be initiated by the relevant business function. It must be based on well-defined filter criteria<sup>4</sup> and supported, for example, by policies, guidelines, checklists or computer-aided tools.

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<sup>1</sup> Banks participating in the first Forum: ABN AMRO, Credit Suisse, Danske Bank, Dresdner Bank, HSBC, UniCredit Group, West LB; written input from UBS.

<sup>2</sup> Adapted from Committee of European Banking Supervisors, CP03 revised, June 2005.

<sup>3</sup> The management of operational risk covers legal aspects, i.e. legal compliance.

<sup>4</sup> Criteria should be independent of the potential deal size or business volume.

- b. The reputational risk assessment process must be supported by a reputational risk competence center, which is part of risk controlling (or compliance) and thus independent of business. This competence center provides a reputational risk assessment, leading to recommendations, which can be positive, conditionally positive, or negative. An authorized risk officer, who may or may not be part of the competence center, or a risk committee, should make the decision.
  - c. If business does not agree with this decision, it may refer the case to a more senior risk officer or risk committee. If necessary, a final decision will be taken by a reputational risk committee, which consists of top managers representing both business and risk controlling, and possibly corporate functions such as communications. This committee is chaired by either the CRO or CEO, or an executive member of the board.
  - d. If the decision has conditions attached, their fulfillment must be monitored on a regular basis. Further risk mitigation measures must be identified if necessary.
  - e. Client relationships must be reviewed on a regular basis.
8. The reputational risk assessment of proprietary trading and investment positions, as well as new products and services, should follow a similar process.
9. The reputational risk assessment process must be audited on a regular basis. Policies, guidelines, checklists and other tools must be reviewed regularly and adapted as required.
10. All business staff must be trained on a regular basis in order to enforce the reputational risk assessment process and to enable quick and reliable decisions.