Do banks manage Reputational Risk? - a case study of European Investment Bank

(Working Paper)

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Abstract

Purpose: The purpose of this paper is to explore the definitions surrounding reputational risk and study the ways leading banks of European Union treat reputational risk management.

Design and Methodology: The paper uses a sample of leading banks of European Union to study the disclosure of reputational risk using qualitative and quantitative content analysis. The paper then uses the case study approach to explore reputational risk management at the organisation level.

Findings: The key finding of this paper is that disclosures of reputational risk is not standard in the industry. Banks use various ways to publish their reputational risk strategies. The disclosure about procedures of measurement and management have not been disclosed extensively.

Originality/value: The paper offers insight of the author based on the data available for public and also the information provided by European Investment Bank, which has not been studied in the past for reputational risk management.

Keywords:Banking, Reputational Risk, Reputation Risk Management, European Investment Bank

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1 INTRODUCTION

Reputation is the belief and trust that a variety of people have for your organisation and they expect the same attribute in future (Honey [2009]). The reason why people use Google is because of its reputation to provide extensive internet related products and services. We get emotionally and rationally attached to an organisation when we decide who to work for, what to buy, sell, invest and supply (Larkin [2003]). Building a good reputable business brings a sense of responsibility towards the community. In the words of Warren Buffett :

> *" It takes 20 years to build a reputation and five minutes to ruin it.*
> *If you think about that, you'll do things differently."*

Management of reputation risk is critical and should not feature when there is reputation crisis (Aula [2010]). Managing reputation requires soft skills like prudence, anticipating future needs and trends, understanding stakeholder's requirements, listening to their needs, planning and taking action in a positive way (Rayner [2004]). Taking an example of the giant cellular company of the 2000s Nokia, presently battling to revive its reputation in the market with net cash of Q3 2012 €3.6 billion (drop from €4.2 billion in Q2 2012). Nokia failed to meet the demands of its stakeholders by not providing a better software. It failed to anticipate and plan for the present market technology and lost its reputation.

Reputation is difficult to be quantified and thus, it becomes equally problematic to assign monetary terms to it. It is that *valuable hidden asset* that only emerges as a gap between book value and market capitalization (Honey [2009]). Judy Larkin in her book "Strategic Reputational Risk" compares reputation to a "Cinderella asset" - one that is ignored but has a potential to shake the organisation's foundation. In the present world of social networking it has become difficult to manage reputation and thereby increases the wavelength of reputation risks (Aula [2010]). Businesses are at constant scrutiny by the social media and there is no hiding place. An organisation might lose its reputation by any of its links internal as well as external. A well established reputation management reduces the risk and increases opportunity (Larkin [2003]). Reputational risk has been defined in numerous ways, but the one that relates to the context of banking and finance has been stated by the Basel Committee on Banking Supervision (Committee et al. [2009]):

> "Reputational risk can be defined as the risk arising from negative perception on the part of customers, counter-parties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding (e.g. through the interbank or securitisation markets)."

The definition clearly summarizes the impact of a bad reputation on bank's performance. The reputation of financial services becomes a critical and sensitive subject because of the very nature of the industry being managing money (Walter [2006]). Thus management of its reputational risk should be the foremost preventive measure in monitoring risks.

Considering that reputation has a value, there are ways to measure it and anything that reduces this value is a risk (Honey [2009]). There are two ways of measuring reputation. One gives a monetary valuation using market capitalization or Return on Assets. The other uses a relative approach of valuation as intellectual capital using internal performance scorecard and other indices (Honey [2009]). Both the measures have their advantages and disadvantages. The first has been used in many earlier papers and is based on stock market reactions due to an operational loss (event study). The second, however, has not been used extensively due to its very nature being subjective. In this paper, we attempt to study the treatment of reputational risk by banks.

This paper is organized as follows. In Section 2, we discuss the concepts surrounding reputational risk and review the recent literature. Section 3 we give details about the current research. Section 4 would cover the methodology and sample used for the study. We try to study the disclosure of reputational risk by leading banks of European Union and then analyze the understanding of reputational risk at European Investment Bank. We state the findings in Section 5. Finally, in Section 6 we present some conclusions and further possibilities of research.

2 BACKGROUND AND EXISTING LITERATURE

In this section we provide the definitions concerning reputation risk. Firstly, give a brief concept of reputation, and then risk concerning it. We then review the previous literature focusing on measuring and managing reputational risk. We also study the regulatory requirements for banks on the management of reputational risk.

2.1 What is Reputation?

According to Oxford English dictionary reputation is " the beliefs or opinions that are generally held about someone or something" (Rayner [2004]). As stated by Jenny Rayner in her book "Managing Reputational Risk" the definition itself gives the complexity which arises based on the beliefs and opinions which may or may not be same as reality. These beliefs are result of years of relationship with the organisations. Honey [2009] in his book " A short guide to reputational risk" quotes the definition from Invisible Advantage by Johnathan Low and Pam Cohen Kalafaut as Reputation is:

> *" In a sense a company's reputation is the ultimate intangible. It's literally nothing more than how the organisation is perceived by a variety of people. It is slippery, volatile, easily compromised, impossible to control, amorphous."*

The above definition clearly states the nature of reputation, its intangibility and hence a difficulty in calculation using monetary terms (Honey [2009]). It also gives the power of reputation, as a good reputation is built in years but can be destroyed by small incident or crisis (Rayner [2004]). Gary Honey uses acronym for REPUTE to define the nature of reputation as "slippery, volatile, amorphous" as: (Honey [2009])

- "**R**elational Construct": All stakeholders have a different relationship with your organisation and do business based on the reputation they have for your organisation.
- "**E**xception Attributed": Reputation of your organisation might be because of an exception feature which is different from all other in the industry.
- "**P**erception comparison": Reputation is the belief about your organisation, a perception in the eyes of others.
- "**U**nintended Consequences": Competition in market brings about third party influences and also consequences and situations which are not foreseen. A good reputation can turn to a bad one due to these consequences
- "**T**rack Record": Reputation is built over a period of time based on the work done by the organisation.
- "**E**motional Appeal": Trust on an organisation follows from reputation. When trust is tampered reputation is tarnished.

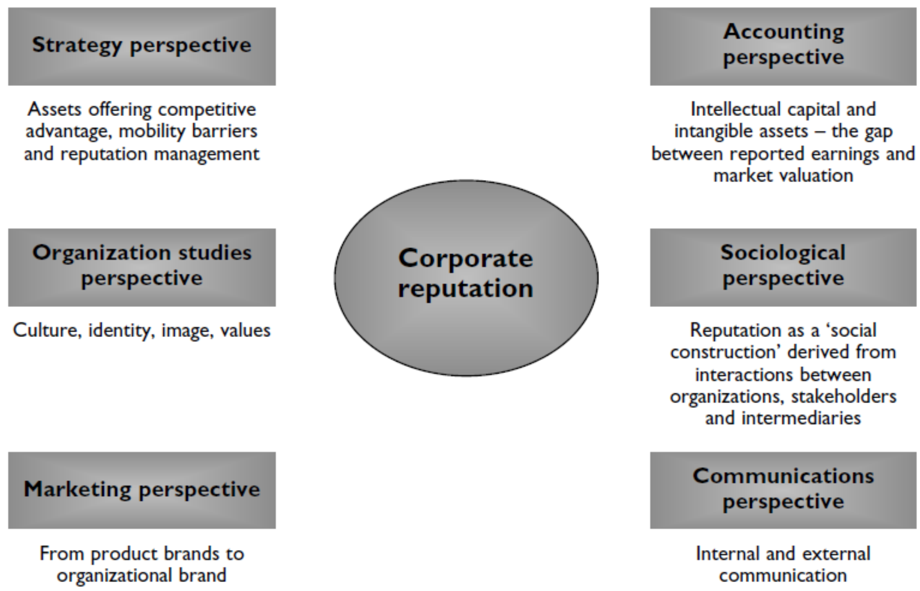
The social structure how a firm is formed, the activities it is involved in and, media influences on the reputation of the firm (Fombrun and Shanley [1990]). If these are incorporated while understanding reputation of the organisation it could be beneficial (Fombrun and Shanley [1990]). A good reputation attracts investors, enhances the firm's market position and lowers the cost of capital (Fombrun and Shanley [1990]).

To summarize, reputation is a magnifying glass for your organisation in the eyes of others, it is fragile and delicate. Organisations need to identify the sources and drivers of their reputation and monitor those regularly. The methods used for measuring reputation of the organisation can be varied and self adapted to suit the needs of the organisation.

2.2 Why manage Reputation?

Balmer [1998] states the stages how Corporate Identity got evolved . He states the stage 1 in the time period 1950 to 1970, where the Corporate Image evolved with reference to graphic designs of Hegemony, Writings and Martineau. The late 1980s and 1990s constituted of organisational Identity or Corporate Identity. Corporate reputation gained attention in the 1990-2000 when many authors discussed the concept and compared it with the concept of corporate image.

Figure 1: Corporate reputation: converging ideas *(Source: Adapted from Schultz et al., 2000)Larkin [2003]*



They also agreed to the fact that reputation could be managed. Presently, all fields like accounting, strategy, sociology, organisation studies, communication and marketing have some perspective relating to Corporate Reputation, but none have been successful in having a same concept (refer figure 1 for the various perspective) (Larkin [2003]). Taking into consideration the history of evolution of the corporate reputation, and the present status of it being inconsistent in various fields. We analyze the changes in the business environment during the years, which would help us answer our problem of "Why manage reputation?"

The key changes in Business environment as pointed by Rayner [2004] has been a consequence of four factors:

- **Change in stakeholder perspective and governance**: Two decades back we trusted whatever we heard from doctors, accountants, lawyers or politicians. We believed in them, but now we have a fear and uncertainty in our minds (Larkin [2003]). We question for the authenticity of the medicines prescribed, we doubt the suggestion of an accountant and lawyer and we doubt politicians to be a true leader who would look into public interest. There has also been changes in the governance of businesses. There is strong urge from the stakeholders for organisations to be more transparent (Larkin [2003]). There have been introductions of various laws and frameworks like the Basel II framework published in July 2009. It introduced the concept of reputational risk management for banks and how they could incorporate it in their policies. It states in Page 26

Point 53 as:" *Bank management should have appropriate policies in place to identify sources of reputational risk when entering new markets, products or lines of activities. In addition, a bank's stress testing procedures should take account of reputational risk so management has a firm understanding of the consequences and second round effects of reputational risk.*" (Committee et al. [2009]). Stakeholders now have an immense power and if this is power is used by organisations to enhance their reputation, it would serve as a boost for the organisation (Rayner [2004]). It is therefore the most important criterion for the present managers to manage the reputation.

- **"Globalisation"**: has brought about change of views, words and actions internationally. With the rise in of multinational companies, there is a rise in public and political expectation (Rayner [2004]). The economical growth has brought about growth in global competitions (Rayner [2004]). This competition brings about the risk of reputation not only within organisation but also externally, thus impacting reputation. These economies intensify the role and value of company's reputational risk (Scott and Walsham [2005]).

- **Advancement in the field of technology, internet and radical change in media**: With the rise of communications and internet, there has been a rise in the risk of reputational damage. The trend of using social media services like twitter, facebook, LinkedIn, etc. has increased the wavelength as to how information flows and passes from one part of world to the other (Aula [2010]). Media has been a pivotal in structuring the issues that concerns us (Larkin [2003]). Thus, we demand for more information and also expect the organisations to be like a mirror in their policies and standards (Rayner [2004]). This leads to the solution of providing right information at right time (Rayner [2004]).

- **Importance of intangible assets**: Post the financial market crisis of 2001, it was proved that some banks went beyond their contractual obligations to support their investors (Committee et al. [2009]). Thus, only financial indicators relating to the earnings of the business doesn't fulfill the needs of the investors (Rayner [2004]). There has been changes in how business is operated and the relationship it has with its stakeholders. Present annual reports of the company not only compromises of financial indicators but also gives details of the vision statement, their corporate social responsibility, corporate reputation, quality skills, number of employees, their investment in research and development so on and so forth. These all are nothing but intangible assets owned by the company. There have also been changes in government laws which encourages the companies to declare the non-financial assets (Rayner [2004]). These demands have forced organisations to manage and monitor reputation as a key indicator (Rayner [2004]).

2.3 What is Reputational Risk?

"Reputation risk is any action, event or circumstance that could adversely or beneficially impact an organisation's reputation" (Rayner [2004]). Rayner [2004] argues that there is nothing as reputational risk, it is simply the risks from various sources that can influence the reputation. She emphasizes reputational risk to be reputational *impact*. Walter [2006] defines reputational risk for banking and financial industries as "the possibility of loss in the going-concern value of the financial intermediary - the risk adjusted value of expected future earnings". He further gives a definition of reputational risk as:

"Reputational risk comprises the risk of loss in the value of a firm's business franchise that extends beyond event-related accounting losses and is reflected in a decline in its share performance metrics. Reputation-related losses reflect reduced expected revenues and/or higher financing and contracting costs. Reputational risk in turn is related to the strategic positioning and execution of the firm, conflicts of interest exploitation, individual professional conduct, compliance and incentive systems,leadership and the prevailing corporate culture. Reputational risk is usually the consequence of management processes rather than discrete events, and therefore requires risk control approaches that differ materially from operational risk."

Basel Committee gives guidelines for the banks to identify their sources for reputational risk by defining the reputational risk as a negative belief by the stakeholders which can affect a bank's performance. They state reputational risk as "multidimensional and reflects the perception of other market participants". Further, Basel committee suggests management of the risks and addressing in its ICAAP and to ensure a contingency plan (Committee et al. [2009]). Reputation risk is risk arising due to the difference in organisations performance and stakeholder expectation. Different stakeholder groups have different expectation and thus management of reputation risk becomes crucial, difficult and delicate (Honey [2009]). The effect on reputation is intangible and might occur slowly and eventually harm could be in the form of losses: customer loss, employee/managers loss, future business partner loss, increase in the credit, increase cost of maintenance due to stricter vigilance (Perry and De Fontnouvelle [2005]). Before reviewing previous literature on measuring and managing reputational risk, we would look into the regulatory requirements for the banks on reputational risk.

2.4 What are the regulatory requirements for financial institutions?

There are various regulatory requirements given to banks regionally based on the country and also by the Basel Committee on Banking Supervision (BCBS) which is a committee of banking supervisory authority (Committee [2013]). The BCBS provides standards and procedures on banking supervisory matters. It was established in 1974 by the Governors of Group of ten countries post the problems in international currency and banking markets, (Committee [2009]) presently constitutes of 27 member countries. It mandates its activities by exchanging information; enhancing international banking business; and by setting supervisory standards wherever necessary. The Basel committee formed the Basel Capital Accord in July 1988. This constituted of capital measurement system agreed by the G10[1] Governors (Committee [2009]). The 1988 Accord focused mainly on credit risk and post that the committee has been working on various risks like market risk, operational risk, Valuation and liquidity risks etc. In July 2009, the committee published a set of documents which focused on strengthening the Basel II capital framework (Committee [2009]). Under this framework, BCBS addresses various risks including reputational risk. It has separate sections that gives details about the need for an improved risk management outlining that the financial institutions were not prepared for the risk concerning the products serviced by them (Committee et al. [2009]). Under the section C of the "Specific risk management topics" section of the Enhancements to Basel II framework Reputational Risk has been covered. They define Reputational risk as mentioned in the Introduction. Breaking down the definition to enable and formulate a guideline and standard for banking industry, we suggest the division of reputational risk management layout in two blocks namely: a. Analyzing Block b. Management Block.

For the Analysis block, the rules that banks should follow:

- Analyze the perception of stakeholders with standardized engagement policy
- Set up standardized rules of management of reputational risk
- Identify the potential sources of reputational risk which could give rise to credit, liquidity, market and legal risk.
- Formulate policies for identification of the source of reputational risk.
- Include reputational risk scenarios in the stress tests
- Measure the amount of support required to avoid reputational damage or the losses it would incur thereof
- Measure the impact of reputational risk on liquidity position

For the Management block, the rules that bank should follow:

- Engage with the stakeholders based on the procedures defined and supported by the analytic block

[1] G10 refers to the group of countries that participate in the General Arrangements to Borrow (GAB). It constitutes of Belgium, Canada, France, Germany, Italy, Netherlands, Sweden, Switzerland, United Kingdom and United States. Luxembourg is an associate member of G10. (source: IMF)

- Train employees about the impact of reputational risk and align compensation in a way that the degree of risk is considered in their remuneration
- Formulate policies to be put for identification of reputational risk at employee level and escalation matrix for the assessment of all transactions on case to case basis
- Establish reputational risk management committee with a proper escalation matrix
- Involve senior management in the monitoring of reputational risk
- Conduct audits regularly for reputational risk management system
- Monitor reputational risk on regular basis

In the next section we would cover the relevant previous literature relating to measurement of reputational risk.

2.5 Measuring and Managing Reputational Risk

Reputational risk identification is related to the reputational risk management (Bebbington et al. [2008]). Managing reputational risk comprises mainly of the five major steps (Eccles et al. [2007]): 1. Knowing your organisation's reputation, 2. Evaluating your organisation's reality, 3. Reducing the gap between reality and perception, 4. Monitoring the change in perception, 5. Having a person in-charge of reputational risk.

Knowing the organisation's reputation comprises of elements that forms the organisation namely: financial status, quality of employees, management quality, environmental, social and governance (ESG) strategy, and the standard of the goods and services provided (Bebbington et al. [2008]). There are numerous papers dealing with measuring reputation of an organisation in non-financial and financial industries using event study method and analyzing the impact on reputation due to some operational losses (Fiordelisi et al. [2012], Perry and De Fontnouvelle [2005]). The techniques used for evaluating reputation of the organisation are varied and depends on what the organisation adapts. Chun [2005] states "Three school of thoughts" that are currently being used for evaluating the reputation of a firm. These are based on the treatment of stakeholders. According to her the three schools are: The Evaluation School, The Impressional School and The Relational School. The Evaluation School focuses on the investors, and links the reputation to financial performance data of the company. Annual Fortune Studies are based on this data. The major limitation of Fortune survey as highlighted by Fryxell and Wang [1994] is that it is based on financial construct and it is "too good to be true". The Impressional School considers the image of an organisation as its reputation with employers and customers as their focus. This links reputation to a buyer's view, employer's view and media's view. Post all this the third school "The Relational School" which considers multiple stakeholders as their focal point. According to this view an organisation may have several reputation based on the stakeholder group.

Going in the details of the ways for measuring reputation:

Fortune's AMAC (America's Most Admired Companies) was the first developed reputation ranking report in the year 1983 (Schwaiger [2004]). The parameters used for ranking are: 1. Financial Soundness, 2. Quality of Products and Services, 3. Innovativeness, 4. Long-term Investment value,5. Financial Soundness, 6. Ability to Attract, develop and retain talent,7. Quality of Management and 8. Acknowledgment of social responsibility. CEOs and financial analyst are surveyed in the process and the rating is done based on the survey report. According to Fryxell and Wang [1994] the AMAC survey is not a good tool for measuring reputation (Chun [2005]Schwaiger [2004]). This measure have been disapproved and criticized for focusing more on financial performance (Fombrun and Shanley [1990]).There have been numerous research in analyzing the dependability of the Fortune AMAC survey which also suggested the Fortune's AMAC report is highly dependent on past performance.

The Financial Times "World's Most Respected Companies" ranking was developed in the year 1998 with the focus on the perception of peer CEOs (Chun [2005]). The following attributes are considered: 1. Strong and well thought strategy, 2. Quality of products/services, 3. Maximizing Customer satisfaction, 4. Successful change management and globalization, 5. Business Leadership 6. Innovation, 7. Robust and human corporate culture and 8. Globalization of business. The respondents of the survey are from major global corporations. The survey consists of open ended questions and are usually done via phone and in some cases through mail and personal interviews (Larkin [2003]).

Britian's Most Admired companies by the *Management today* surveyed CEOs and opinion forums and the attributes used are: 1. Quality of management, 2. Ability to attract/retain talent, 3. Quality of marketing, 4. Financial soundness, 5. Value as a long-term investment, 6. Environmental responsibility, 7. Quality of products and services, 8. Capacity to innovate (Larkin [2003]).

Asia's Most Admired Companies by *Asian Business* surveyed Senior executives, CEOs and company board members to arrive at their rankings for largest listed companies in Asia: Hong Kong, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand, and also some companies of China. In their survey they measure: 1. Quality of management, 2. Quality of products and services, 3. Contribution to the local economy, 4. Being a good employer, 5. Potential for growth, 6. Being honest and ethical, 7. Potential for future profit, 8. Ability to cope with the changing economic environment (Larkin [2003]).

"Gesamtreputation" developed by *German Manager Magazine* surveys executives of German companies on a 11 point scale based on : 1. Quality of Management, 2. Innovativeness, 3. Ability to communicate, 4. Environmental responsibility, 5. Financial and economic stability, 6. Product Quality, 7. Value for money, 8. Employee Orientation, 9. Growth Rates, 10. Attractiveness to Executives, 11. Internationalization (Schwaiger [2004]).

Far Eastern Economic Review is based on the reader's choice of Far Eastern

Economic review who participate in the survey for Asian multinational and 20-40 local companies in Australia, Hong Kong, India, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand. The survey is based on the following criteria of measurement of reputation: 1. Quality of products/services, 2. Long-term management, 3. Vision, 4. Innovation, 5. Financial soundness 6. Whether others try to emulate the company (Larkin [2003]).

The above measures provide a ranking for a company based on various criteria which are comparable to each other and as highlighted earlier consider the financial aspect of the company. Many authors have tried to measure reputation using various other measures like brand equity, image and identity (Schwaiger [2004]). Most of them use only single stakeholder's view and thus doesn't give the correct image or identity (Schwaiger [2004]). " The Relational School" (Chun [2005]) that considers multiple approach satisfies the needs of many stakeholders. Charles Fombrun developed the Relational Quotient (RQ) which was based on 20 attributes based on 6 factors namely: Emotional Appeal, Product and Services, Vision and Leadership, Workplace environment, Social and environmental responsibility and Financial Performance. This could be used to provide information which could be tailored for various stakeholder groups (Fombrun and van Riel, Honey [2009]). Post the development of Relational Quotient Dr. Arlo Brady in his book The Sustainability Effect – Rethinking Corporate Reputation in the 21st Century (2005) gives details about his approach to calculating reputation. He uses the categories similar to Fombrun: 1. Knowledge and skills, 2. Emotional connections, 3. Leadership, vision and desire, 4. Quality, 5. Financial credibility, 6. Social credibility 7. Environmental credibility (Honey [2009]). Reputational risk driver measurement model as described by Prof. Gary Honey in his book "A short guide to Reputation Risk" was developed at the Kingston University and is so named as "The Kingston Risk driver model". Under this model the author uses the concept of risk definition as "Expectation - Performance". The categories used are:

1. Performance

a. Stewardship indicators: Board quality, succession planning, decision taking etc

b. Sustainability indicators: Environmental, social and economic combination

2. Expectation

a. Attention indicators: Media magnetism, generic or specific

b. Association indicators Family linkage: corporate or trading brand names

There are many services like strategic media intelligence and clipping services (Eccles et al. [2007]) which uses the media reports from television, radio, newspaper, NGO blogs etc. and gives the reputational risk index for the organisation. Similar, methodology is used by RepRisk AG which is a leading provider of dynamic business intelligence on environmental, social and governance risks. They monitor a set of 27 issues under environmental, social and governance headings. These services sometimes are not completely accurate and relevant to the organization but they give a good picture of the emerging risks from various sources.

Once the organisation has formulated the reputation of the organisation from various stakeholder view, it needs to evaluate the reality. Evaluating reality is a challenge because executives tend to believe that their reputation is good, they overestimate the organisation's capabilities (Eccles et al. [2007]). They tend to set low targets which are easy to achieve or higher targets to impress the superiors (Eccles et al. [2007]). The next task of closing the gap between reality and perception requires identifying response options, identifying and prioritizing the emerging risk, identifying risks that could be avoided and those that needs mitigation (Rayner [2004]). Developing the strategies and plan of action for reducing the gap and implementing them is part of the reputational risk management process (Larkin [2003]).The organisation needs to monitor in real time the perception of all its stakeholders using surveys, focus groups and interviews etc (Eccles et al. [2007], Larkin [2003]). These processes in all forms the framework of reputational risk for the organisation and these can be designed according to the needs of the organisation.

Considering, the above ways of measuring and managing reputational risk the question arises:"Does organisation specifically identify reputation risk?CIMA [2007]". Bebbington et al. [2008]summarizes that many organizations manage their reputational risk as part of corporate social reporting. This paper tries to explore the approach used by banks in managing reputational risks. According to Davies [2002]"Reputation Risk Management does not equal crisis management planning because once an organization has done something that reveals even the possibility that they had incompetent, corrupt or selfserving people in key positions, no amount of immaculate crisis response, expensive advertising or highly paid PR consultants can prevent the fall out." He also outlines the holistic approach which doesn't necessarily work in crisis situation but is inbuilt in the organisation's action plans.

3 THE CURRENT RESEARCH

This research seeks to answer the following question:

RQ: How do leading banks of European Union manage reputational risk?

To address the question, the research would cover the following objectives:

1. determine how banks disclose reputational risk management
2. evaluate how risk managers identify, assess, analyse, control and monitor reputational risk.
3. study the management of reputational risk.

The sample chosen for the study is leading banks of European Union based on their total assets and also multilateral banks which are peers to European Investment bank. The banks chosen for the first part of study are given in Table A:

Table A	Rationale	Leading European Union banks for the study
1	Case Study	European Investment Bank
2	Peers	Agence Française de Développement
3		European Bank for Reconstruction and Development
4		International Finance Corporation
5		Kreditanstalt für Wiederaufbau
6	Competition	HSBC Holdings Plc
7		Deutsche Bank AG
8		Barclays
9		Royal Bank of Scotland Group Plc
10		Banco Santander SA
11		Société Générale
12		Lloyds TSB Bank Plc
13		UniCredit SpA
14		ING Bank NV
15		BPCE SA
16		Rabobank Nederland-Rabobank Group
17		Credit Suisse International
18		Danske Bank A/S
19		Standard Chartered PLC

The case study of European Investment Bank (EIB) would cover the response for how risk managers identify and manage reputational risk. This study would give an understanding of management and disclosure of reputational risk by banks. The reason for selecting the sample is that currently reputational risk is managed at EIB by different departments and is not structured, thus bank is looking for an understanding of best practices by peers and competitions to standardize their reputational risk management.

4 DATA COLLECTION AND METHODOLOGY

This study uses the steps outlined by Creswell [2008] on quantitative, qualitative and mixed approaches. This study includes an analysis of publicly available annual reports, risk management report, corporate social responsibility report, sustainability report and disclosure in the official website of the leading banks of European Union in the recent year (2011 and 2012 for those who have published their current report). The qualitative framework using case studies and grounded theory approach is used to analyse the data available. This includes the content analysis that details reputational risk management of the banks. To find the extent of disclosures the observations were divided into 3 attributes namely: Definition, Policies and Management. Details of the attributes evaluated are an extension of ABI's checklist (Larkin [2003]).

Table B	**Reporting/Presentation of Reputational Risk**
Definition	Is there a definition of Reputational Risk in the Annual Report Is there a definition of Reputational Risk in the site Does your company state that it has adequate information for identification and assessment?
Policies	Identified and assessed significant risks and opportunities affecting its short- and long-term value arising from its handling of Reputational Risk matters Are any remuneration incentives relating to the handling of Reputational risks included in risk management systems? Does the company disclose significant short and long term risks and opportunities arising from Reputational issues? If so, how many different risks/opportunities are identified? Are policies for managing Reputational risks to the company's value described? Does the company report on the extent of its compliance with its policies and procedures?
Management	The board takes reputational risk regularly into account Are systems in place to manage Reputational Risk? Does trainings include Reputational Risk Are verification procedures described? Is there any kind of audit in place?

Then a quantitative content analysis was carried to give an extension to the qualitative approach. The coding categories used for the quantitative part of the analysis are shown in Table C.

Table C	**Description**
Quantity	Reputation Reputational/Reputation Risk
Quality	Reputational Risk Policy Reputational Risk Team Reputational Risk Survey Reputational Risk verification Reputational Risk Training Reputational Risk Audit Reputational Risk Management

This study then uses extensive interviews with the risk managers of European Investment bank to analyse their understanding of reputational risk and measures for management of reputational risk. The data obtained was analysed to obtain the procedures used by EIB to manage reputational risk.

The last part of the study deals with the comparison of the procedures and practices with the standards required. These informations were used to analyse the present situation at EIB and map the existing processes to reputational risk management.

5 FINDINGS

*Disclosures focusing on Reputational Risk , Qualitative Approach :*Out of the 19 banks under the study, 16 banks mention and disclose details about reputational risk management in some form. The 4 banks which do not disclose any information on reputational risk are: EIB, AFD, IFC and BPCE SA. The references of reputational risk in the reports and site was varied. The information is provided in the sites and published annually in the Annual Report, Risk Management Report, and in some cases along with their Sustainability/ CSR report.

There were 8 banks which mentioned management of reputational risk as part of one of the categories: operational risk, pension risk, insurance risk and compliance risk. These banks do not disclose much information about their reputational risk strategies. 10 banks disclosed to consider reputational risk as a separate risk measure.

Definition of reputational risk was disclosed by 9 banks, details in Table D. The definitions disclosed by the banks can be segregated into the definitions that are related to Basel II Accord (Committee et al. [2009]), ESG strategy and Communications. The reputational risk definitions mainly covers the risk parameters as: 1. Risk arising from environmental , social or governance issues, 2. Risk arising from failure to meet stakeholder expectation and 3. Risk arising from negative publicity due to client relations. This shows that some banks have identified their reputational risk parameters and are working on those. Identification of the risks is foremost in management of reputational risk.

The disclosure of reputational risk focuses mainly on the management of reputational risk. 10 banks disclose that they have a policy in place for management of reputational risk, 12 banks disclose to have a committee formed for managing reputational risk with 9 disclosing to have a person in charge for managing reputational risk. Measures and processes used for identification and assessment of reputational risk have not been disclosed by banks other than Credit Suisse, Barclays (2012 Sustainability report) and UniCredit SpA.

Credit Suisse SpA outlines assessment of Sustainability Risk within the Reputational Risk Process of the group. The CSR report of the group gives details of the transactions that were assessed on the basis of potential environmental and human rights risk. It was reported as 294, out of which 63% approved, 20% approved with conditions and 17% rejected or not pursued.A Case study of each such potential risk factors is published in the site[2].The bank also provides trainings to employees specific on the risks arising in areas of environment.

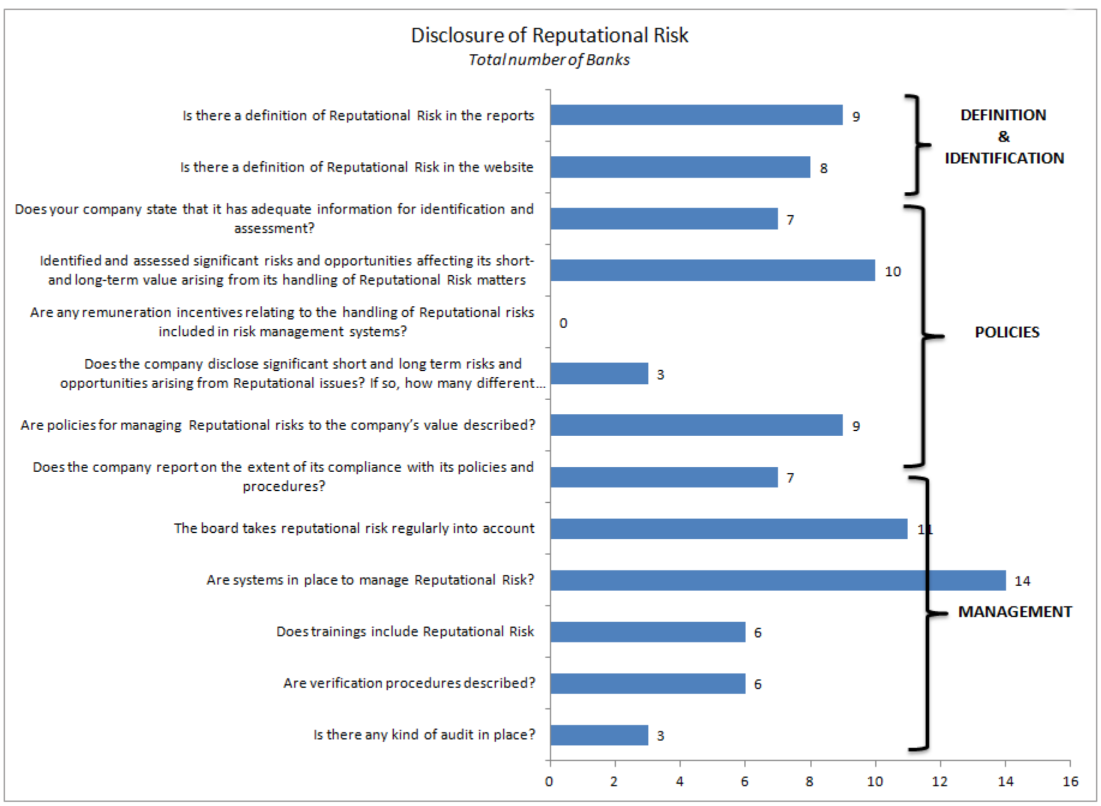
[2](https://www.credit-suisse.com/responsibility/en/infographics/sustainability/index.html)

Table D: ***Definition related to***	***Selected Banks***	***Definition disclosed***
Basel II Accord & Environmental, Social and Governance	HSBC Holdings Plc	*"Reputational risks can arise from environmental, social or governance issues, as a consequence of operational risk events or as a result of employees acting in a manner inconsistent with HSBC's Values."*
	Barclays	*"Reputation risk is the risk of damage to Barclays brand arising from any association, action or inaction which is perceived by stakeholders to be inappropriate or unethical."*
Basel II Accord	Royal Bank of Scotland Group Plc	*"The risk of brand damage arising from financial and nonfinancial events due to failure to meet stakeholders' expectations of the Group's performance and behaviour."*
	Banco Santander SA	*"The reputational risk is that linked to the perception of the Group by its various stakeholders, both internal and external, of its activity, and which could have an adverse impact on results, capital or business development expectations. This risk relates to juridical, economic-financial, ethical, social and environmental aspects, among others."*
	Société Générale	*"risk arising from a negative perception on the part of customers, counterparties, shareholders, investors or regulators that could negatively impact the Group's ability to maintain or engage in business relationaships and to sustain access to source of financing"*
	UniCredit SpA	*"UniCredit Group defines Reputational Risk as the current or future risk of a loss or decline in profits or share value as a result of a negative perception of the bank's image by customers, counterparties, bank shareholders, investors or regulators."*
	Credit Suisse International	*"Reputational risk may arise from a variety of sources, including the nature or purpose of a proposed transaction, the identity or nature of a potential client, the regulatory or political climate in which the business will be transacted or significant public attention surrounding the transaction itself."*
	Standard Chartered PLC	*"Reputational risk is the potential for damage to our franchise, resulting in loss of earnings or adverse impact on market capitalisation as a result of stakeholders taking a negative view of the organisation or its actions."*
Communications	Deutsche Bank AG	*"the risk that publicity concerning a transaction, counterparty or business practice involving a client will negatively impact the public's trust in our organization."*

Unicredit Group outlines the details of reputational risk management strategy in an extensive way giving the steps used for identification, assessment, monitoring and management of the risk. They have formulated special reputational risk policies for their involvement in industries such as weapons, nuclear poer, mining and water infrastructure. The report also outlines the initiatives taken for engagement with stakeholders giving details about the number of interviews conducted, a total of 1,168,880 (Clients/Prospects: 917,053; Employees: 249,897 and Opinion Leaders: 1930). Société Générale discloses that it manages its reputation risk under the compliance department using channels like dashboard etc. for spreading reputational risk awareness.

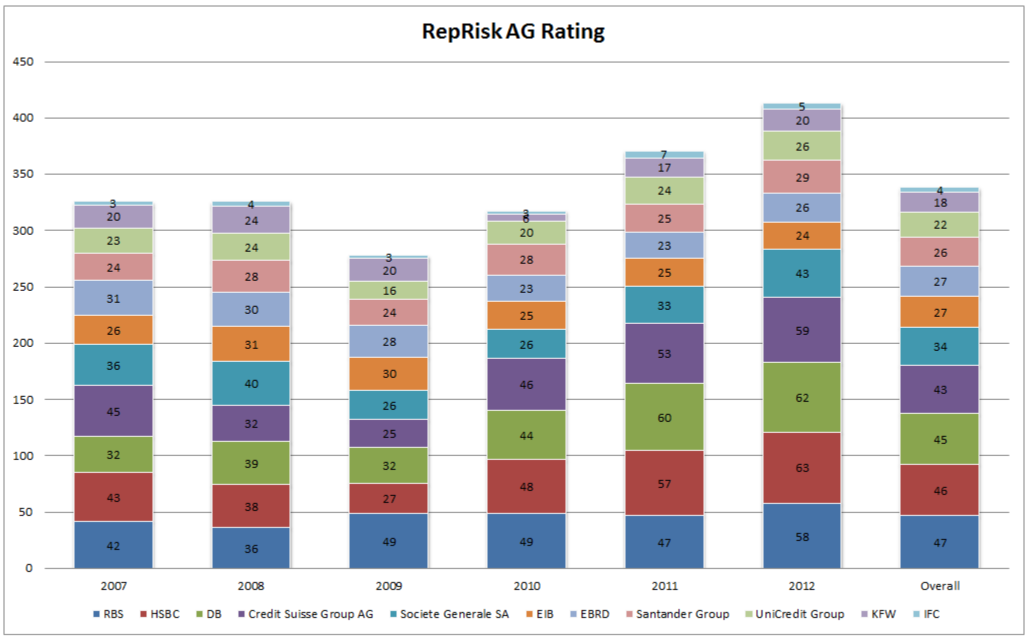
To find the extent to which banks disclose reputational risk, the Chart A below gives the number of banks in each category. The categories are an extension to ABI's checklist and gives details of disclosure in 3 attributes of reputational risk management: Definition and Identification, Policies and Management.

Chart A: Disclosure of reputational risk on various categories.



Some banks disclosed management of reputational risk extensively while others presented the definition of reputational risk in their context. So, we tried to study the reputation risk that the banks are for the banks under study. Our aim was to find the reputational risk rating of the bank. We used the monthly data of "Current RRI value[3]" for the year 2007-2012 provided by RepRisk AG[4]. We included only those banks for which the team captured data for the whole period. The Chart B gives the graph of current RRI ratings of the banks. It was interesting to note, that the banks disclosing more reputational risk management initiatives are the ones with a higher high RRI rating with an exception of UniCredit Group. It also showed that there has been an increasing trend in the RRI rating from the year 2009 onwards, indicating the importance of management of the risks arising from these issues[5].

Chart B: Current RRI Rating for the year 2007-2012



Disclosures focusing on Reputational Risk , Quantitative Approach : We used the methodology used by Hogan and Lodhia [2011]and formulated a coding for measuring reputational risk management by banks. The results of the analysis is shown in the Table E and Chart B[6]. We analysed the number of indicators per page, the indicators of quantity is higher than quality. This indicates the lack of disclosures about the management strategies by banks.The number of indicators per page in case of other reports(Sustainability Report, CSR Report,

[3]The RRI calculation is based on influences of news, as well as news content. The current RRI value indicates the current level of criticism about a company or a project. 0-25: low exposure, 25-50: medium exposure, 50-75: high exposure and 75-100 very high exposure.

[4]http://www.reprisk.com/

[5]RepRisk AG monitor 27 issues that fall under ESG headings.

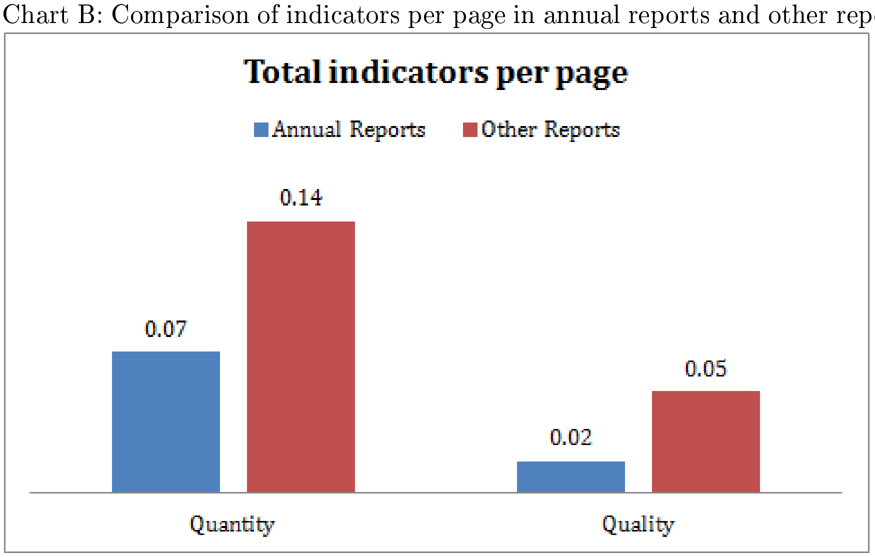
[6]Appendix gives detailed results.

Risk Management Report) is higher than the indicators used in Annual report. This finding is consistent with the results of Hogan and Lodhia [2011]. It was also observed that only few banks have audit and verification of the policies, standards and practices. These findings illustrate that the disclosures by banks is not consistent in the industry. We shall use the banks that disclose extensively to benchmark the process within EIB and thus, formulate a standardise process.

Table E: Consolidated Result

Indicator of	Reports Total	Annual Reports	Other Reports	Total	Website
	No. of pages	5067	1624	6691	20
Quantity	Reputation	0.03	0.06	0.04	608
	Reputation/al Risk	0.04	0.08	0.05	238
	Total/page	0.07	0.14	0.09	847
Quality	Reputation/al Risk Policy	0.00	0.01	0.01	9
	Reputation/al Risk Team	0.01	0.02	0.01	13
	Reputation/al Risk Survey	0.00	0.00	0.00	3
	Reputation/al Risk verication	0.00	0.00	0.00	0
	Reputation/al Risk Training	0.00	0.00	0.00	3
	Reputation/al Risk Audit	0.00	0.00	0.00	6
	Reputation/al Risk Management	0.00	0.01	0.01	15
	Total/page	0.02	0.05	0.02	50

Chart B: Comparison of indicators per page in annual reports and other reports



6 CONCLUSION

This research could help in understanding of the concepts surrounding reputational risk management and its reporting. The current study analysed the reputational risk management by leading European Union banks through qualitative and quantitative approach. The publicly available reports: annual report, sustainability report, risk management report and the official website was used for the qualitative and quantitative analysis. This research gives an extension to the concept of reputational risk management by banks.

The findings of this research would assist risk managers with an understanding of disclosures and reporting trends. Other reports like sustainability, risk management and CSR report appear to provide more information about reputational risk management. The variations in the process of treatment of reputational risk indicates need of stricter regulations and standardised process.[7]

[7] Work in Progress

APPENDIX

Table F: Indicators in Annual report

Indicator of	Annual Reports	European Investment Bank	Agence Française de Développement	European Bank for Reconstruction and Development	International Finance Corporation	Kreditanstalt für Wiederaufbau	HSBC Holdings Plc	Deutsche Bank AG	Barclays	Royal Bank of Scotland Group Plc	Banco Santander SA
	No. of pages	300	63	94	123	71	440	528	286	490	258
Quantity	Reputation	0	0	0	3	1	27	8	15	20	1
	Reputation/al Risk	0	0	1	2	4	22	22	2	15	23
	Total/page	0.00	0.00	0.01	0.04	0.07	0.11	0.06	0.06	0.07	0.09
Quality	Reputation/al Risk Policy	0	0	0	0	1	1	1	0	1	5
	Reputation/al Risk Team	0	0	0	0	0	3	2	1	1	4
	Reputation/al Risk Survey	0	0	0	0	1	0	0	0	1	0
	Reputation/al Risk verication	0	0	0	0	0	0	0	0	0	1
	Reputation/al Risk Training	0	0	0	0	0	0	0	0	0	0
	Reputation/al Risk Audit	0	0	0	0	0	0	1	0	0	1
	Reputation/al Risk Management	0	0	0	1	1	1	1	1	2	2
	Total/page	0.00	0.00	0.00	0.01	0.04	0.01	0.01	0.01	0.01	0.05

Indicator of	Annual Reports	Société Générale	Lloyds TSB Bank Plc	UniCredit SpA	ING Bank NV	BPCE SA	Rabobank Nederland-Rabobank Group	Credit Suisse International	Danske Bank A/S	Standard Chartered PLC	Total
	No. of pages	456	371	312	332	8	23	149	55	268	5067
Quantity	Reputation	15	24	1	17	0	1	1	0	6	0.03
	Reputation/al Risk	14	2	15	6	0	0	10	0	34	0.04
	Total/page	0.06	0.07	0.05	0.07	0.00	0.04	0.07	0.00	0.15	0.07
Quality	Reputation/al Risk Policy	3	1	1	1	0	0	1	0	1	0.00
	Reputation/al Risk Team	3	0	4	1	0	0	1	0	8	0.01
	Reputation/al Risk Survey	0	0	0	0	0	0	0	0	0	0.00
	Reputation/al Risk verication	1	0	2	0	0	0	1	0	2	0.00
	Reputation/al Risk Training	0	0	0	0	0	0	0	0	1	0.00
	Reputation/al Risk Audit	0	0	0	0	0	0	0	0	0	0.00
	Reputation/al Risk Management	1	0	1	0	0	0	3	0	5	0.00
	Total/page	0.02	0.00	0.03	0.01	0.00	0.00	0.04	0.00	0.06	0.02

Table G: Indicators in Other reports

Indicator of	Other Reports	(EIB) European Investment Bank	(AFD) Agence Française de Développement	(EBRD) European Bank for Reconstruction and Development	(IFC) International Finance Corporation	(KFW) Kreditanstalt für Wiederaufbau	HSBC Holdings Plc	Deutsche Bank AG	Barclays	Royal Bank of Scotland Group Plc (The)	Banco Santander SA
	Total no. of pages	52	132	100	84	87	27	112	356	44	72
Quantity	Reputation	1	0	4	0	0	2	3	46	3	1
	Reputation/al Risk	0	0	1	2	2	0	15	56	2	12
	Total/page	0.02	0.00	0.05	0.02	0.02	0.07	0.16	0.29	0.11	0.18
Quality	Reputation/al Risk Policy	0	0	0	1	0	0	2	6	0	1
	Reputation/al Risk Team	0	0	0	1	0	0	4	15	0	2
	Reputation/al Risk Survey	0	0	0	0	0	0	0	0	0	0
	Reputation/al Risk verication	0	0	0	0	0	0	0	2	0	1
	Reputation/al Risk Training	0	0	0	0	0	0	0	0	0	0
	Reputation/al Risk Audit	0	0	0	0	0	0	0	1	0	0
	Reputation/al Risk Management	0	0	0	0	2	0	6	6	1	3
	Total/page	0.00	0.00	0.00	0.02	0.02	0.00	0.11	0.08	0.02	0.10

Indicator of	Other Reports	Société Générale	Lloyds TSB Bank Plc	UniCredit SpA	ING Bank NV	BPCE SA	Rabobank Nederland-Rabobank Group	Credit Suisse International	Danske Bank A/S	Standard Chartered PLC	Total
	Total no. of pages			144	112	1	77	78	119		1624
Quantity	Reputation			14	6	0	0	5	3		0.06
	Reputation/al Risk			30	0	1	1	10	1		0.08
	Total/page			0.31	0.05	1.00	0.01	0.19	0.03		0.14
Quality	Reputation/al Risk Policy			11	0	0	0	1	0		0.01
	Reputation/al Risk Team			5	0	0	0	2	0		0.02
	Reputation/al Risk Survey			1	0	0	0	0	0		0.00
	Reputation/al Risk verication			1	0	0	0	1	0		0.00
	Reputation/al Risk Training			1	0	0	0	0	0		0.00
	Reputation/al Risk Audit			0	0	0	0	0	0		0.00
	Reputation/al Risk Management			5	0	0	0	1	0		0.01
	Total/page			0.17	0.00	0.00	0.00	0.06	0.00		0.05

Table H: Indicators in Website

Indicator of	Website	(EIB) European Investment Bank	(AFD) Agence Française de Développement	(EBRD) European Bank for Reconstruction and Development	(IFC) International Finance Corporation	(KFW) Kreditanstalt für Wiederaufbau	HSBC Holdings Plc	Deutsche Bank AG	Barclays	Royal Bank of Scotland Group Plc (The)	Banco Santander SA
	Total no. of pages	1	1	1	1	1	1	1	1	1	1
Quantity	Reputation	137	43	57	1030	204	29	391	108	6670	2092
	Reputation/al Risk	0	40	19	49	60	1	106	14	4160	0
	Total/page	137.00	83.00	76.00	1079.00	264.00	30.00	497.00	122.00	10830.00	2092.00
Quality	Reputation/al Risk Policy	0	0	0	1	1	0	3	1	28	0
	Reputation/al Risk Team	0	0	0	1	0	0	72	2	2	0
	Reputation/al Risk Survey	0	0	0	0	0	0	0	0	0	0
	Reputation/al Risk verication	0	0	0	1	0	0	0	1	0	0
	Reputation/al Risk Training	0	0	0	0	0	0	0	1	0	0
	Reputation/al Risk Audit	0	0	0	1	0	0	0	1	0	0
	Reputation/al Risk Management	0	0	8	1	1	1	55	5	1	0
	Total/page	0.00	0.00	8.00	5.00	2.00	1.00	130.00	11.00	31.00	0.00

Indicator of	Website	Société Générale	Lloyds TSB Bank Plc	UniCredit SpA	ING Bank NV	BPCE SA	Rabobank Nederland-Rabobank Group	Credit Suisse International	Danske Bank A/S	Standard Chartered PLC	Total
	Total no. of pages	1	1	1	1	1	1	1	1	1	20
Quantity	Reputation	9	0	16	182	1	25	932	12	200	608.35
	Reputation/al Risk	0	0	1	5	0	4	132	1	171	238.20
	Total/page	9.00	0.00	17.00	187.00	1.00	29.00	1064.00	13.00	371.00	846.55
Quality	Reputation/al Risk Policy	0	0	1	0	0	1	5	0	138	8.95
	Reputation/al Risk Team	0	0	1	0	0	0	30	0	152	13.00
	Reputation/al Risk Survey	0	0	1	0	0	0	15	0	37	2.65
	Reputation/al Risk verication	0	0	1	0	0	0	4	0	1	0.40
	Reputation/al Risk Training	0	0	1	0	0	0	3	0	58	3.15
	Reputation/al Risk Audit	0	0	0	0	0	0	0	0	125	6.35
	Reputation/al Risk Management	0	0	1	0	0	1	61	0	170	15.30
	Total/page	0.00	0.00	6.00	0.00	0.00	2.00	118.00	0.00	681.00	49.80

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