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STUDY ON PRACTICES ON REPUTATIONAL RISK MANAGEMENT IN THE BANKING SYSTEM

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Abstract: *This paper explores the definitions surrounding reputational risk in banking with the purpose of identifying the reputational risk factors and the efficient management that can forecast, minimize and evaluate them. Although the concept is not new, only recently has the banking system started to acknowledge the true implications of a negative reputation and has begun to focus on how to find ways to prevent and mitigate this risk. Before the last economic collapse, the banking management had used to have more knowledge about financial risks than about the non-financial ones, the reputational risk had been neglected or even confused with other types of risks. After the crisis it became critical to be aware of hazards that could cause reputation damage in order to develop a framework for managing reputational risk prior to an issue. The banking system has realized that reputation is the most valuable asset and has begun to invest in elaborating a proper risk management strategy.*

Keywords: reputation, reputational risk, bank management, risk management

1. Content analysis of the concept of reputational risk

Reputational risk, although not a new concept, began to be used more often, theoretically and practically, in the mid-1990s. Reputation is very important for any business, but it is much more important for the banking system, as a service provider for a large segment of the population. Generically, in this field, it represents the risk of registering losses or of not achieving the estimated profits, as a result of the deterioration of the public perception on the bank's capacity to properly fulfill its functions. Specifically, reputation risk is created when performance does not match expectations.

For a long time, reputation was underestimated, later people discovering how important it is and how, due to any rumor, gossip, appearance in the media and on social networks, the image of banks can suffer. In connection to this aspect, Warren Buffet (businessman, investor and one of America's richest people, CEO Berkshire Hathaway) stated that "*it takes twenty years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently*"[1].

Subsequently, reputation protection is a major challenge for the banking management and identifying vulnerabilities has become a priority. The awareness of the fact that the emphasis must be on ethics, integrity, trust, competence and qualified personnel has been brought to the attention of practitioners, intensively and extensively, in order to prevent or reduce reputational risks.

In the alternative, the negative effects of an

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affected reputation lead to the impossibility of developing the client portfolio, to the loss of existing ones, create panic among the population (manifested by massive cash withdrawals) and, in some cases, may even affect the entire economy.

2. Approaching the national reputational banking risk — cases, determining factors, implications

In Romania, an example of a reputation severely affected by public opinion is the case of the banks that granted loans in Swiss francs (CHF) during 2007-2008.

With the onset of the financial crisis in late 2007 and early 2008, the exchange rate of the Swiss franc increased significantly, with the borrowers' incomes in this currency considered "exotic" unable to cover the rates that doubled and, in some cases, even tripled.

The first step taken by customers was to ask for help from creditor banks, but they were confronted with their categorical refusal to offer them solutions tailored to their needs. While the vast majority of banks did not even want to have a dialogue with their own customers, some of them came up with impracticable options that, instead of offering them the long-awaited help, indebted them even more.

As a result of these communication failures between customers and banks, of the lack of understanding and of the inability to manage the crisis, the first unfortunate events occurred. Due to the impossibility of paying the instalments, the banks resorted to forced execution and the clients lost their houses for which they had paid the installments for years. There are quite a few cases when some of them resorted to another kind of "rescue", suicide.

The media coverage of these cases seriously affected the image of these banks, but this did not seem to influence their decisions regarding the Swiss franc borrowers. Corroborated with the media attacks, there followed those on social networks. Bank customers formed coalitions, formed groups and they established common strategies for action, they set up non-profit associations and started collective lawsuits against banks. The abusive clauses in the credit agreements, the way of collecting commissions and interest rates, as well as the level of the exchange rate variation were challenged in court. Unfortunately, the legal system in Romania was not on the side of the debtors either, so a series of lawsuits were lost, there being courts where not even one single client won.

Another issue that affected the reputation of the banks was the poor training of the banking staff. At the beginning of lending in Swiss francs, not only did they not inform the borrowers of the risks to which they were exposed, but informed them that the Swiss franc was the most stable currency and urged them to take loans in that currency. Then, assailed by thousands of negotiating requests (the estimated number of creditors in Swiss francs being about 40,000 at the national level), by numerous complaints to the Office of Consumer Protection, by customers who protested by paying installments in coins, they were completely overcome by the situation. Being the interface of the banks, the employees who were poorly trained affected even more the already fragile image of the institutions they represented.

The banks, although with a severely damaged image, went in the same direction, still refusing to negotiate. Their losses were huge, failing to attract new customers, losing much of their portfolio, so most banks that had granted loans in Swiss francs reduced their activity, closed units or were sold or taken over by other banks.

Unfortunately, the history of the banks that granted loans in Swiss francs continues to be written and so is that of the debtors in this currency. They still hope that the National Bank of Romania will come to their aid and will regulate, monitor and sanction the activity of banks operating on the territory of the country (a fact that is included in its own rules of procedure).

The other banks could also learn from the experience of the banks lending in "exotic" currencies. They realized the importance of a

proper risk management, which emphasizes prevention and risk minimization.
Other examples of damaged image of banks in Romania, and not only here, are the internal fraud cases. No company is exempt from the risk of fraud, but the most common internal fraud cases are found in the banking system. Here, both the frequency of the cases and the amounts at stake are often much higher than in other areas. Taking into account that in the banking activity, the institution-client relationship is the most important, the frauds committed by the employees of the banks seriously affect the reputation of the banks. Although most of the time, there is a desire to cover up the internal frauds and the banks' collaboration with state institutions is cumbersome, many of them have reached the front pages of newspapers. The most common modality of internal fraud is the use of inactive customer accounts from which small amounts of money are withdrawn/transferred and deposited in an employee's account. The deposited sums of money are turned into deposits, and from the interests of these deposits the amounts "borrowed" from the clients' accounts are paid back.
Rapid detection of internal banking fraud can be achieved through a rigorous and frequent internal audit. The cases that have been publicized are those discovered by the affected customers. Although the banks try to negotiate directly with the clients, the clients often refuse the offer of the bank and appeal to a court and to the media. In either of the above situations, whether a negotiation is reached or the court is involved, the prejudiced customer always receives his money back, but the bank will not remain with an unaffected image.

3. Risk management — utilized content components

The risk approach, generically analyzing first of all, must have the essential characteristic of the rigor and flexibility necessary for analyzes that allow for further assurance of a minimum level of resilience. Rigor is useful to ensure the usefulness of the assumed methodological framework of analysis and flexibility, for the need to also cover the component of perception, which is subjective, specific to the individual, the group, the organizations, etc. Additionally, we take into consideration the fact that the recovery time of a social system, as approached in Gunderson's view, is determined both by the ability of renewal of the system in a dynamic environment as well as by a person's ability to learn and to change, which, in turn, is partly determined by the institutional context for knowledge sharing, learning and administration, and partly by the social capital of individuals.
Since the financial-banking services market has become more and more sophisticated, and the competition is more and more fierce, an efficient management (as institution and organizational processes), which should manage the banking risk, will make the difference.
In addition to the specific approach of the standards in the field, one of the relevant definitions for risk management is the one given in 2009 by D. Hubbard: "*the risk management consists inidentifying, evaluating and prioritizing risks, followed by the coordinated and economical application of the resources in order to minimize, monitor and control the probability and/or the impact of unfortunate events or to maximize the achievement of opportunities*"[2].
Risk management is an integral part of the strategy of banks. A risk management, in order to be effective, must provide a plan that follows the steps present in figure number 1 [3].

Figure 1: Risk Management cycle

The first stage consists in the management's awareness of the need for the risk management process and the creation of the organizational framework. During this stage, the potential risks and vulnerabilities to which the institution is subjected are identified and the risk profile is elaborated.
Analyzing the probability of risk occurrence and its impact on profitability using the available techniques and tools by each institution, is the next step.
The next step is related to the management's reaction to the possible occurrence of a risk-triggering event and the methods it applies to solve the possible implications of the risk. At this stage, risk approach strategies are established.
Adequate risk management will focus on monitoring and controlling risk factors. These last two stages are achieved through a very good knowledge of the organization, acquired through thorough internal controls and by taking measures the moment vulnerabilities are discovered. The method of concealment, of hiding problems or of trying to minimize them is a fairly common practice in Romanian institutions, which leads to their aggravation and to even greater exposure to risks.
The mandatory steps of risk management must be followed regardless of the type of risk. They apply, or should apply, to reputational risk too. As one can see, risk management should deal primarily with prevention and not with problem solving, thus risk management is a more proactive than reactive process.

4. Conclusions

Reputation is very difficult to gain, it takes time, seriousness, fairness, transparency, integrity. Once the battle is won, it is not over, it must continue. The emphasis of the banking institutions must be placed primarily on the professional training of the employees. A prepared employee will face any challenges, and if organizational culture is instilled in him, he will not be prone to internal fraud.
Communication is very important in any organization, the institution must communicate efficiently and explicitly with both its own employees and with the customers.
In compiling the portfolio of products and services, banks must be transparent, oriented to the real needs of the customers and they should take into account the fact that the institution-customer relationship must be a win-win one.
Prevention is the key to effective risk management and if this has not been done optimally, the banks must have a very short response time, in the order of minutes, in the case of any occurrence of a reputational risk triggering event.
A rigid management, focused mainly on obtaining high profits in a very short time and without taking into account the repercussions, determines, in the long run, significant losses on all levels (financial, image, portfolio, credibility, etc.). The adoption of this management style eventually led to the reduction of activity, to the takeover, sale and even to the bankruptcy of several financial-banking institutions. An integrated risk management in the management of the organization can minimize or even eliminate the disastrous effects of the events that may occur.
Society has evolved, its priorities and values have changed and in order to progress the banks will have to be much more anchored in the existing reality.

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