

**Kyiv National University of Trade and Economics**

**Banking Department**

**FINAL QUALIFYING PAPER**

**on the topic:**

# **Reputational risk management of a financial institution**

Student of the 2<sup>nd</sup> year, group 5am,  
specialty 072 “Finance, Banking and  
Insurance”,  
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**Kyiv, 2020**

## Kyiv National University of Trade and Economics

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### **Task for a final qualifying paper**

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1. Topic of a final qualifying paper  
Reputational risk management of a financial institution  
Approved by the Rector's order from November 15 2019, No. 3893.
2. Term of submitting by a student his/her terminated paper (project) to 20.11.2020
3. Initial data of the final qualifying paper (project)  
Purpose of the paper (project) is study is to reveal the theoretical provisions and develop methodological frameworks and practical recommendations for improving the risk management of the reputation of financial institution.  
Object of the research is reputation risk management system of financial institution. Subject of the research is the theoretical and methodological principles of reputation risk management in financial institution.

4. Consultants of the research and titles of subsections which were consulted:

| Section | Consultant (last name and initials) | Date and signature |                    |
|---------|-------------------------------------|--------------------|--------------------|
|         |                                     | The task given     | The task fulfilled |
|         |                                     |                    |                    |
|         |                                     |                    |                    |

5. Contents of a final qualifying paper (list of all the sections and subsections) INTRODUCTION

PART 1. THEORETICAL FOUNDATIONS OF REPUTATIONAL RISK MANAGEMENT

PART 2. ANALYSIS OF REPUTATIONAL RISK IN UKRAINIAN BANKS

2.1 Research of the bank's reputation by various rating agencies

2.2 Analysis of the transparency of the bank's reputation risk management

PART 3. DIRECTIONS FOR IMPROVING THE BANK'S REPUTATIONAL RISK MANAGEMENT

3.1 Improving of methods of assessing bank's reputation risk

3.2 Foreign experience in managing the risk of the bank's reputation

CONCLUSION

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APPENDICES

## 6. Time schedule of the paper

| No. | Stages of a final qualifying paper  | Terms of a final qualifying paper |            |
|-----|---|-----------------------------------|------------|
|     |   | de jure                           | de facto   |
| 1   | 2   | 3                                 | 4          |
| 1.  | Approval of the Task of the FQP (Ukrainian)   | 23.12.2019                        | 23.12.2019 |
|     | Approval of the Task of the FQP (English)   | 03.02.2020                        | 02.02.2020 |
| 2.  | Submission of an <b>article</b> to the Banking department (English), paper and electronic versions                                      | 30.03.2020                        | 28.03.2020 |
| 3.  | Part I. List of sources used (references)   | 27.04.2020                        | 25.04.2020 |
| 4.  | Production (diploma) practice, <b>review</b> (Ukraine)  | 11.05.-<br>19.06.2020             |            |
| 5.  | Part II. List of sources used (references)  | 22.06.2020                        | 20.06.2020 |
| 6.  | Part III, Introduction, Conclusions, References   | 05.10.2020                        | 20.10.2020 |
| 7.  | Submission of the FQP to the Banking department (all Parts, appendices), <b>resume</b> of a scientific adviser                          | 26.10.2020                        |            |
| 8.  | Preliminary FQP' protection at the Banking department, <b>review</b> (KNUTE, Ukraine), <b>review</b> (KNUTE, English)                   | 09.11.2020                        |            |
| 9.  | Submission of completed (intertwined) the FQP to the Banking department, supporting documents (summary, supporting data, three reviews) | 23.11.2020                        |            |
| 10. | Public FQP' protection in the examination commission  |                                   |            |

7. Date of receiving the task \_\_\_\_\_, \_\_\_\_\_, 20\_\_\_\_.

8. Scientific adviser of the final qualifying paper Erkes Olena, PhD,  
Associate Professor of the Department of Banking

9. Head of the project team  
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Associate Professor of the Department of  
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\_\_\_\_\_  
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10. The task received by the student

\_\_\_\_\_  
(last name, initials, signature)



## **11. Resume of a scientific adviser of a final qualifying paper**

The final qualifying paper, completed by the student Zhenzherukha Petro, was performed about the very relevant topic “Reputational risk management of a financial institution”.

While working on research the student used all the knowledge and practical skills which acquired while studying at The Master’s program “Financial intermediation”.

The final qualifying paper contains research of the theoretical bases of reputational risk management in financial institutions, analysis of reputational risk in Ukrainian banks and suggestions the key directions for improving the bank's reputational risk management.

The main achievement of the work is the developed proposals for improving of methods of assessing bank's reputation risk.

The final qualifying paper contains a sufficient number of graphic elements (tables, figures) that demonstrate the results of the study and the relevant substantiated conclusions.

Summing up, the final qualifying paper was structured according to the general requirements for such work and may be recommended for its protection in exam commission, and the student Zhenzherukha Petro deserves the excellent grade.

Scientific adviser of a final qualifying paper Olena Erkes

Note about preliminary paper defense

\_\_\_\_\_  
(last name, initials, signature)

## **12. Resume about a final qualifying paper**

A final qualifying paper of the student Zhenzherukha Petro

can be admitted to defense in the Examination Board.

Head of the project team

(Manager of the educational program) Iryna A. Avanesova

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Head of the Department Nataliia P. Shulha

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\_\_\_\_\_. 2020.

## Reputational risk management of a financial institution

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## INTRODUCTION

**Relevance of research.** Confidence in different financial institutions, especially banks, their shareholders and executives as well as in information they provided in public, has declined significantly after the global financial crisis. The attention of international financial institutions, supervisors and banks to the reputation risk has increased in way to restore it. In particular, the EBA (The European Banking Authority) document on SREP (Supervision and Evaluation Process; EBA / GL / 2014/13) emphasizes the need to consider reputation risk as an essential part of bank risk management.

History has shown many examples of banks' reputational risk associated with a wide range of potential sources that can have serious business consequences. Taking measures to eliminate the consequences of losing your reputation requires enormous effort and resources. Usually, the cost of a damaged reputation is significantly higher than its maintenance, and therefore banks should avoid risk events that will lead to their unfavorable perception by stakeholders. In order to avoid spending a significant amount of money on reputation restoration, banks should take care to establish an effective system for managing this risk.

**The degree of study of the problem in the economic literature.** Theoretical and practical aspects of reputation risk are reflected in the documents of the Basel Committee on Banking Supervision, the EBRD, the IMF, the Bank for International Settlements, the European Banking Organization, central and commercial banks, in the works of foreign and domestic scientists. Research on the nature, assessment and risk management methods of the bank's reputation was carried out by foreign scientists: C. Fombrand, R. Kreutzer, E. Griffin, A. Zaman, J. Larkin, G. Hani, K. Eckert, I. Walter, J. Rainer, and domestic – O. Chorna, B. Filatov, L. Kuznetsova, A. Khristin, A. Buryak, A. Rymar, V. Kovtun and others.

Despite the availability of works on the interpretation and management of reputation risk, this problem still remains unresolved, in particular: the method of determining the risk of reputation of banks needs to be developed; there is a need to



develop a Code of Reputation of the bank, and improve the organizational and information support of the reputation risk management process. This determined the relevance of this research, determined its purpose and objectives.

**The object** of the study is reputation risk management system of financial institution.

**The subject** of the study is the theoretical and methodological principles of reputation risk management in financial institution.

**The purpose** of the study is to reveal the theoretical provisions and develop methodological frameworks and practical recommendations for improving the risk management of the reputation of financial institution.

In accordance with the defined goal and during its achievement there was a need to solve the following **tasks**:

- investigate the economic nature of the reputation risk in financial institution;
- systematize the factors influencing the risk of the financial institution's reputation;
- set out the conceptual provisions of the financial institution's reputation risk management;
- diagnose the reputation of Ukrainian banks by various rating and analytical agencies, identify the features of each methodological approach;
- to study the level of transparency of reputation risk management in foreign and domestic banks;
- develop separate proposals for improving reputation risk management in Ukrainian banks.

**Research methods.** In the process of research the following methods were used: theoretical generalization – to reveal the essence of the definition of "bank reputation risk" and its features; analysis and synthesis – systematization of risk factors influencing the bank's reputation; scientific and systematic approaches – determining



the purpose, objectives and principles of risk management of the bank's reputation, as well as the development of proposals for its improvement.

**Information base of the research.** The study is based on the analysis of publicly available annual reports, risk management notes, corporate governance reports and other information presented on the official websites of foreign and domestic banks, the Basel Committee on Banking Supervision, and international financial institutions.

**The scientific novelty of the study is as follows:**

*improved:*

interpretation of the risk of the bank's reputation as a set of economic, social and ethical relations between the bank and its stakeholders, which may lead to failure to meet their expectations, and thus adversely affect the level of confidence in the bank, resulting in loss of liquidity, capital and solvency. From other points of view, attention is focused on the types of relationships that can hypothetically arise between the bank and stakeholders;

classification of factors influencing the risk of the bank's reputation on the following grounds: by area of origin (external and internal), in turn, internal - by origin (financial, organizational, operational, derivatives); by types of significant risks (credit, liquidity, etc.); external - by source of origin (global and national); spectrum of action (socio-political, economic, legal and legal); the scale of influence (on the banking system in general and a particular bank), which, in contrast to other points of view, is supplemented by signs of the source and the scale of the impact on the bank.

**The practical value of the work.** Based on the results of the study, a Bank Reputation Code has been prepared, which can be implemented in the activities of domestic banks.

**Approbation of research results.** The results of the research became the basis for a report at the II All-Ukrainian Student Scientific Conference "Financial and Credit Systems: Problems of Theory and Practice" (Kyiv, March 16, 2020) on "Systematization of factors influencing the reputation of banks."

**Publication.** Based on the results of the competition, following theses were published: “Peculiarities of the bank's reputation risk” // Information technologies and financial system: current state, efficiency, prospects: a collection of abstracts of scientific papers of participants of the International scientific-practical conference for students, graduate students and young scientists (Kyiv, January 31, 2020). - K. : Analytical Center “New Economy”, 2020. - 136 p. (Pp. 87-89). The volume of theses is 0.15 printed pages.

Based on the results of the competition, following articles were published: “Theoretical foundations of reputational risk management in financial institution”// Business processes in credit and financial institutions” : Coll. Science. Art. stud. full-time and part-time study / resp. ed. N.P. Shulga. - Kyiv: Kyiv. KNUTE, 2020. - 426 p.

“Transparency of banks reputation risk”// Scientific journal “HERALD of Kyiv National University of Trade and Economics” : №5 (133) 2020, - 133 p. (Pp.102-116). The volume of theses is 0,45 printed pages.

**Volume and structure of work.** The report consists of an introduction, three parts, conclusions and recommendations, a list of sources and appendices used. The main content of the work is set out on 42 pages. The report contains 4 tables, 8 figures, 7 appendices, the list of used sources includes 51 names.



## PART 1

### THEORETICAL FOUNDATIONS OF REPUTATIONAL RISK MANAGEMENT

The theoretical and practical aspects of the reputational risk of the financial institution were reflected in the documents of the Basel Committee on Banking Supervision, the IMF, the European Banking Organization, central and commercial banks, in the works of foreign and domestic scientists. Studies of the nature, evaluation and methods of risk management of the reputation of the financial institution were carried out by foreign scientists: E. Griffin, J. Larkin, G. Honey, I. Walter, J. Rayner and domestic – A. Buryak, A. Rimar, V. Kovtun and others. Studying the works of these scientists allows to thoroughly approach the study of the essence of the scientific task, as well as to identify issues that remain unresolved.

Before going into a thorough study of the particularities of reputational risk, one must consider the nature of reputation and why it is important to companies and financial institutions. Overall, reputation is now a very valuable resource that institutions should not neglect. In order to be successful in today's business it is necessary to have a good reputation. According to Oxford English dictionary reputation – is the beliefs or opinions that are generally held about someone or something [1].

There are different approaches of explaining reputation. Each of them have put emphasis on different distinguish feature. For instance, one of the best scientist in question of reputation Garry Honey has developed a very interesting explanation. He uses acronym for REPUTE to define the nature of reputation as “slippery, volatile, amorphous” as:

- relational construct: all stakeholders have a different relationship with your organization and do business based on the reputation they have for your organization;



- exception attributed: reputation of your organization might be because of an exception feature which is different from all other in the industry;
- perception comparison: reputation is the belief about your organization, a perception in the eyes of others;
- unintended 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;
- track record: reputation is built over a period of time based on the work done by the organization;
- emotional appeal: trust on an organization follows from reputation. When trust is tampered reputation is tarnished [2].

He also absolutely correctly insists that good reputation is something that built in years, but can be destroyed immediately due to some bad situation (crisis, incident, operation of one worker etc.). The main idea why financial institutions and companies should manage reputation is in that benefits that it have. There are a lot examples of such benefits, but we want to clarify the most important:

- improving the consumer's perception of the quality of products or services (which allows to charge premium prices): sale increases and positive word-of-mouth;
- improving the capacity of hiring and retaining qualified personnel in corporations;
- raising the morale of employees and therefore productivity;
- protecting the value of the enterprise by diminishing the impact of scrutinizing, crisis and/or competitive attacks;
- preceding and helping international expansion, not only in terms of market penetration but also in preparing the scenery in key communities and facilitating alliances;
- attracting a greater number of investors (good credibility): rise of market value (EBITDA) and diminishing risks for the organization;

- differentiating the company from its competitors and establishing better market positioning;
- allowing access to cheaper capital [3].

Next step of our research is to determine the essence of the reputational risk. There is no clear opinion as to the economic nature of the risk for the financial institution's reputation. Different perspectives on the essence of reputational risk can be combined into several approaches.

The first is to interpret the risk of the financial institution's reputation in terms of the gap between the expectations of the stakeholders and the actual level of service and efficiency of their business activities [2].

The second approach is taken by authors who, in determining the risk of reputation, emphasize the consequences that lead to its occurrence [4; 5].

The third approach is based on the statement that the risk of a financial institution's reputation is associated with a certain probability of negative events of different nature, which ultimately affects the loss of capital, income, customer base, liquidity, deterioration of rating, etc [6; 7].

The fourth approach is proclaimed by authors who believe that reputational risk is a social-economic category, which can serve as a quantification (indicator) of the level of public trust in financial institution and is characterized by an existing or potentially possible risk to income and capital, both internal and external in nature [8].

A summary of various methodological approaches to determining an explanation of reputational risk is given in Table 1.1. In our opinion, the reputational risk of the financial institution is the totality of economic, social, technical and ethical relationships between the institution and its stakeholders, which may lead to their expectations not being met, and thus have a negative effect on the financial institution's confidence, thereby causing it to lose liquidity, capital and solvency. Unlike other points of view, this definition emphasizes the different types of business relationships.



Table 1.1

**Scientific approaches to definition of reputational risk\***

| <b>Author</b>              | <b>Definition</b>   |
|----------------------------|---|
| Rayner J.<br>[9]           | Reputational risk is any action, event, or circumstance that may adversely or positively affect an organization's reputation  |
| Walter I. [4]              | Reputational risk includes the risk of losing the value of a firm's franchise to a company that goes beyond the accounting losses associated with events and is reflected in a decrease in its portion.   |
| Honey G.<br>[2]            | Reputational risk is the risk that arises from differences in the activities of organizations and stakeholder expectations. Different stakeholder groups have different expectations, so managing reputation risk becomes a crucial, complex and delicate process   |
| Griffin A.<br>[10]         | Reputational risk is a condition that can occur as a result of accidents or other risks that can be a crisis or develop into a crisis.  |
| Shulga N.<br>[11]          | Reputational risk is the likelihood of occurrence of risky events that threaten the reputation of the bank and lead to negative potential consequences. Such consequences may include sanctions from regulatory and supervisory authorities; court decisions on reimbursement to clients and counterparties; inability to maintain an existing customer base and attract new clients, as well as many others, which in turn makes it impossible for the bank to access sources of finance at a reasonable price, or results in loss or loss of income or loss of capital. |
| The Basel Committee<br>[5] | Reputational risk can be defined as risk arising from the negative perception of clients, counterparties, shareholders, investors or regulators, which may adversely affect the bank's ability to maintain existing or establish new business relationships and permanent access to financing sources.  |

\* Systematized by the author based on sources [2, 4, 5, 9, 10, 11]



So, how can we see there are a lot of different definitions and each of them put emphasis on different point. Namely because of such wide range of explanation we decide to formulate a system which represent all main features of reputational risk (Fig. 1.1).

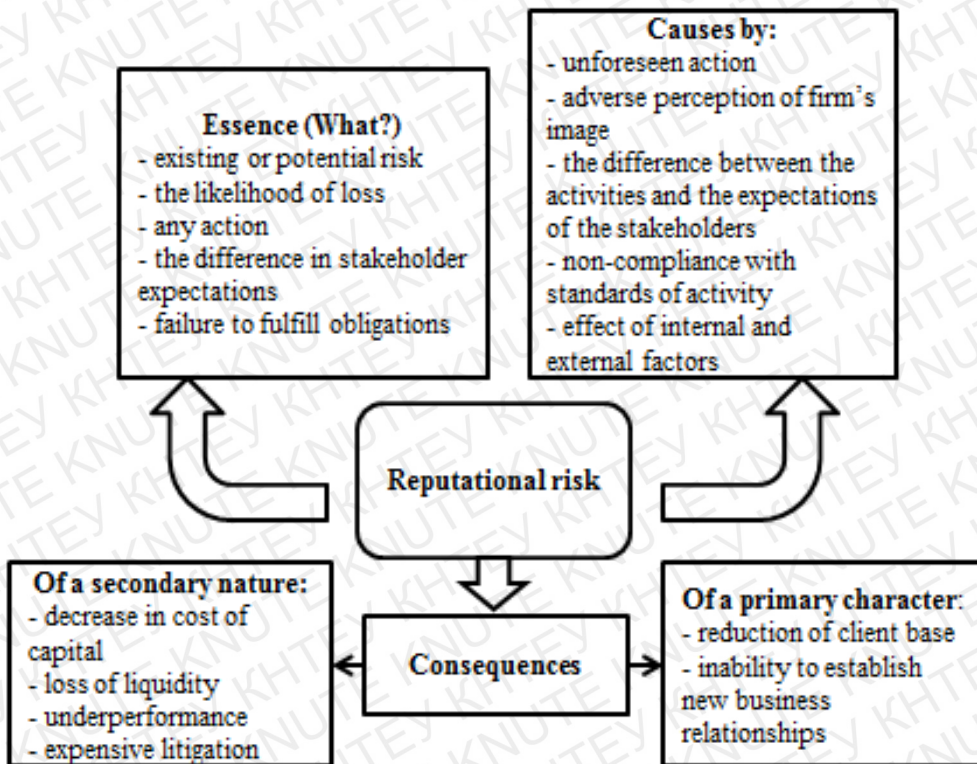


Figure 1.1. In-depth analysis of the economic category “Reputational Risk”

\*Source: Made by author

Moreover it is important to understand that reputational risk have strong connection with other types of risks. There are several methodological approaches to determining the place of reputational risk and its relationship with other types of risks. The first approach is to isolate the risk of reputation as an independent species. The second approach is treating it as a kind of individual risk (such as compliance or operational risks). The essence of the third approach is considered risk of the financial institution’s reputation as a secondary, due to the occurrence of primary risks (credit, market, operational, etc.), that’s mean one or more of them at the same time [11].

Also it is very important to understand sources of reputational risk and the relationship between different risks in organization (Fig. 1.2). In terms of the overall

hierarchy of risks faced by financial institutions, reputational risk is the most intractable, predictable, with very poor data to analyze. In comparison, market risk is usually considered the most tractable, with adequate time-series and cross-sectional data availability, appropriate metrics to assess volatility and correlations, and the ability to apply techniques such as value at risk (VaR) and risk-adjusted return on capital (RAROC). Reputational risk, in large part, arises from the intersection between the financial firm and the competitive environment, on the one hand, and the direct and indirect network of controls and behavioral expectations within which the firm operates on the other. [4]

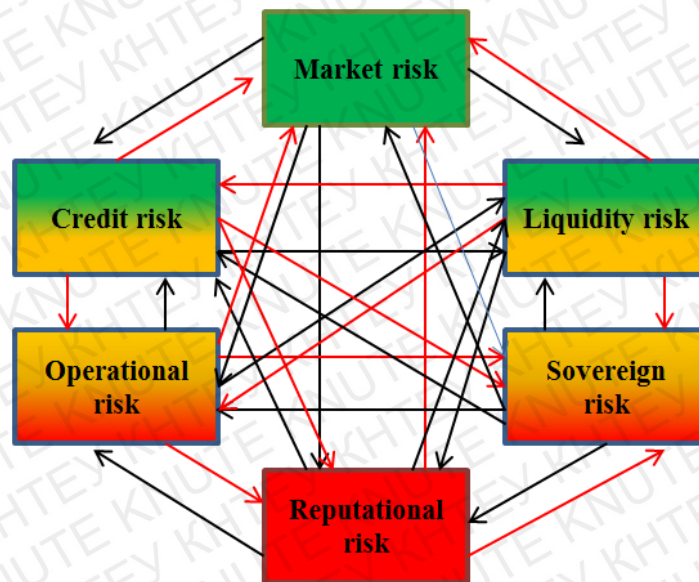


Figure 1.2. A Hierarchy of Risks Confronting Financial Intermediaries

Source: [4]

An in-depth understanding of the nature of a financial institution's reputational risk should be based on an analysis of its impact or risk factors. The conducted researches have allowed to establish that scientists unanimously divide risk factors of reputation of the financial institution into two groups: internal and external. However, within each group, opinions on risk factors differ. Among the internal risk factors of a financial institution's reputation are:

- dynamics of interest expenses, balances on accounts of counterparties and dynamics of liquidity ratio [12];



- instability of the financial condition, unsatisfactory level of financial stability and business activity of the financial institution;
- inefficient operation of financial institution;
- implementation of risky credit, investment, deposit and advertising policies, high level of operational risk;
- fraud inside financial institution and little transparency of transactions;
- conflict of interest with the founders (shareholders), customers and counterparties, as well as other interested parties etc. [8].

External factors include: political instability and social tension in society; underdeveloped infrastructure in the region; decline in the existing economy, a decline in gross domestic product (GDP), a negative balance of payments etc. [12].

Understanding the basic factors that influence reputational risk is very important. So, we have decided to systematize all factors in one big complex picture (Fig. 1.3). Internal factors are more easily identified, subject to control by management of financial institution. The spectrum of internal factors is specific to each bank and is within its sphere of influence. In contrast, external factors are common to financial institutions and they are difficult to predict and are not influenced by them. Among the external factors, it seems appropriate to single out those that affect overall confidence in the banking sector and a particular bank.



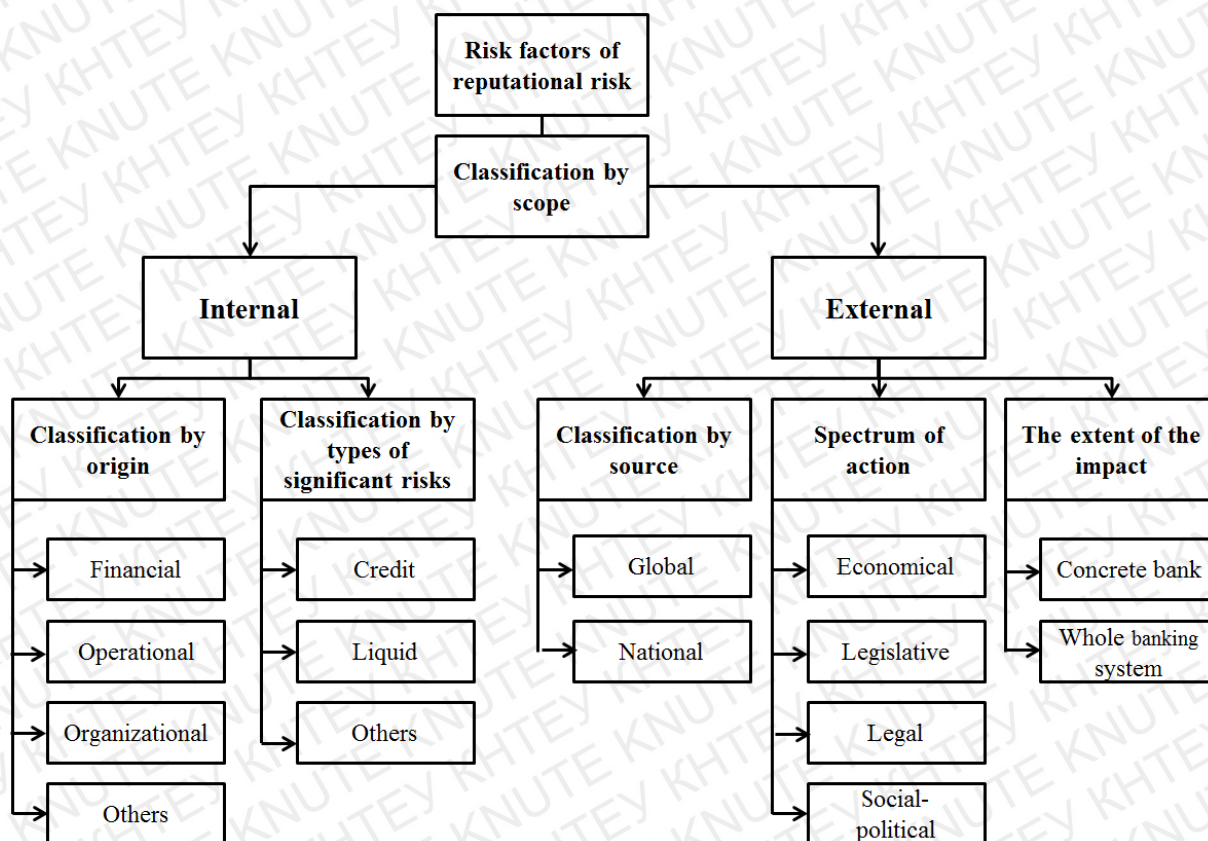


Figure 1.3. Systematizing the risk factors of reputational risk\*

\*Source: Made by author

If reputational risk may occur, it can have a huge impact on all work of financial institutions. For instance it can cause:

- reducing revenue, increasing costs (including litigation and settlement) and liquidity issues;
- reduction of ratings of special agencies and inaccessibility of financing at the expense of investors;
- deterioration of partnerships and relationships with partners;
- inability to attract and retain highly skilled workers.

So, after understanding some basic principles and essence of reputational risk we can move on to reputational risk management system. Before we start it is important to understand that nowadays it is very important to manage reputational risk because of such challenges as:

- overall changes in fundamental principles of business management that dictated by global business environment and big regulator institutions (Basel Committee);
- rising influence of stakeholders opinion (especially in post-crisis period);
- rising level of global communication technologies;
- rising requirements of transparency [13].

According to our research we can highlight some approaches of assessing the reputation of the financial institution, which is based on the attitude of its stakeholders. The first one is based on the evaluation of the financial stability and reliability of the financial institution, the quality of risk management (usually the view of supervisory authorities, rating agencies, shareholders, investors) and the business model of the financial institution. The second approach involves considering the image of the financial institution as a manifestation of its reputation among clients, the media, etc. Therefore, the first approach focuses on the financial design of the bank's stability and reliability, the second one focuses on the image among employers, clients, the media. The third is a combination of the views of many stakeholders, i.e. multilateral. In view of the above, the bank may have different reputation, the basis of which is the stakeholder relationship. It is pertinent to note that the risk of a financial institution reputation is extremely difficult to measure, which is due to its specificity. Usually, the traditional approach, when the risk assessment is carried out in the coordinate system "probability of occurrence and scale of losses" is of little use for measuring the reputational risk.

In general reputational risk management is a process of assessment, monitoring, mitigation and controlling reputational risk. It is important to understand that reputational risk is very specific, so management activities should also be specific. Due to fact that it is highly difficult to calculate this type of risks, there are a lot of different quality methods of such kind of evaluation. So, the most important thing in management is assessment of reputational risk. In general, reputational risk measurement system can be classified into two groups:



- qualitative models, mainly focused on assessing corporate reputation. They are used as preventive measurement tools to minimize the occurrence of reputational risk;
- quantitative models used, especially in the case of banks, to measure the risk and impact of loss of reputation [14].

One of type of assessment is rating agencies. Due to some ratings we can understand some basic principles of organizations reputation. To quality models we can include such special rating as: AMAC Fortune (America's Most Admired Companies), Britain's Most Admired companies by the Management, The Financial Times World's Most Respected Companies. There are also some specific approaches like Reputation quotient or RepTrak model.

There are also some quantitate models that evaluate reputational risk. Their main disadvantage is in their complexity. Also some of them mostly concentrate on stock market prices of companies. In this case we can't evaluate a big amount of different banks that are nor listed on stock exchanges. Examples of such methods are: Abnormal returns models, Share price volatility method. They are very similar and the basis of both of them is estimation reputational risk by examining the reaction of the firm's stock prices to the announcement of a major operating loss. Loss percentages are calculated as losses divided by the market capitalization of the firm, and a market model is used to determine market returns for each organization [15].

Nowadays it is very important to understand value of reputation. So all financial institutions should do some actions for efficient management of reputational risk:

- make reputational risk part of strategy and planning;
- control processes;
- understand all actions can affect public perception;
- understand stakeholder expectations;
- focus on a positive image and communication;
- create response and contingency plans;
- develop special reputational codex.



It is important to add that foreign financial institutions are implementing majority of this tips. Most of European banks have separate department of reputational risk management. Also they have some specific frameworks (for example special frameworks of Deutsche bank and Royal bank of Scotland etc.) [16].

## PART 2

### ANALYSIS OF REPUTATIONAL RISK IN UKRAINIAN BANKS

#### 2.1. Research of the bank's reputation by various rating agencies

Analysis of the literature allowed us to identify different approaches to assessing the reputation of the bank, which are based on the relation of stakeholders. The first approach is based on assessing the financial stability and reliability of the bank, the quality of risk management (usually the view of supervisors, rating agencies, shareholders, investors) and the business model of the bank [17;18]. The second approach involves considering the image of the bank as a manifestation of its reputation among customers, the media, etc. [2; 19; 20; 21]. Thus, the first approach focuses on the financial structure of the bank's stability and reliability, the second - the image among employers, customers, the media; the third is a combination of the views of many stakeholders, i.e. it is multilateral. In view of the above, the bank may have a different reputation, the assessment of which is based on the relation of its stakeholders.

It is worth noting that the risk of the bank's reputation is extremely difficult to measure, due to its specifics, which was discussed in the first section. Typically, the traditional approach, where risk assessment is performed in the coordinate system "probability of occurrence and scale of losses" is unsuitable for measuring the risk of the bank's reputation.

Each group of stakeholders has its own specific expectations of the bank's activities, which affects the approach to determining the risk of the bank's reputation. Therefore, a special survey questionnaire should be developed for each of them, based on the results of which the bank would be able to assess the level of fulfillment of stakeholders' expectations. The level of reputational risk depends not only on how large the gap between the bank's performance and stakeholder expectations actually is, but also on the speed with which it can close this gap. Harry Honey, one of the few scholars who has done a great deal of research on reputation risk, provides an

informative table of seven reputation drivers for various stakeholders in his book, *A Short Guide to Reputation Risk* (Appendix A).

With this table, the competent reputation risk department can begin to identify those aspects that are critical to each stakeholder group and that are less important to the bank as a whole. It becomes clear that failure to meet “key categories” is a higher risk to reputation among certain stakeholder groups than others. Red means areas that are critical for business, i.e. "must have" fields, while yellow indicates those aspects that are less critical for the bank, i.e. "nice-to-have".

In Ukraine, the reputation of banks is assessed by various rating and analytical agencies, which include: "IVI - Rating", "Expert - Rating", "Credit - Rating", "Ukrainian Credit Rating Agency", "Standard Rating", National Rating "Reputation ACTIVISTS ". Information on the feedback of consumers of banking services of banks can be found on the website of Ministry of Finance in category "People's Rating" and more. The original method is used by Forbes magazine, which works with market research company Statista. In order to rank the world's best banks, Statista, a marketing company, surveyed more than 40,000 customers around the world about their current and past relationships with them. Banks were evaluated according to the following criteria: trust, conditions, customer service, digital services and financial advice [22].

There are couple disadvantages of domestic rating agencies. First of all it is the fact that different agencies rate different banks and there is no single list of rated banks. Therefore, the representativeness of the analysis is not very high, due to the fact that it is impossible to effectively and uniformly assess one set of banks by different rating agencies. Secondly, there is no national agency which is recognized on the global level. Therefore we can admit that their ratings will cause a lot of questions from international partners.

Each rating agency assesses the reputation of banks according to its own methodology, as a result of which the same bank may find itself on different rating steps. Comparative characteristics of different assessments of the reputation of



Ukrainian banks as rating agencies and existing scientific developments are presented in appendix Table 2.1.

*Table 2.1*

**Comparison of bank ratings by different rating agencies\***

| Banks                       | Credit - rating   | Expert-rating | Standart-rating | Reputation ACTIVISTS | IBI rating |
|-----------------------------|-------------------|---------------|-----------------|----------------------|------------|
| <b>PrivatBank</b>           | No data           | No data       | <b>4 place</b>  | <b>3 place</b>       | No data    |
| <b>Oschadbank</b>           | No data           | No data       | <b>15 place</b> | No data              | No data    |
| <b>Ukrgazbank</b>           | No data           | No data       | <b>9 place</b>  | No data              | <b>5+</b>  |
| <b>Alfa-bank</b>            | No data           | No data       | <b>6 place</b>  | <b>1 place</b>       | No data    |
| <b>Raiffeisen Bank Aval</b> | No data           | No data       | <b>1 place</b>  | <b>4 place</b>       | No data    |
| <b>PUMB</b>                 | <b>5 (rating)</b> | No data       | No data         | <b>8 place</b>       | No data    |
| <b>Ukrsibbank</b>           | No data           | No data       | <b>5 place</b>  | <b>2 place</b>       | No data    |
| <b>Tascombank</b>           | <b>5 (rating)</b> | No data       | <b>3 place</b>  | No data              | No data    |
| <b>Universal Bank</b>       | <b>5 (rating)</b> | No data       | No data         | <b>9 place</b>       | No data    |
| <b>CredoBank</b>            | No data           | No data       | <b>2 place</b>  | <b>7 place</b>       | No data    |

\* Systematized by the author based on sources [23-27].

It should be noted that in this aspect, only the National Rating “Reputational ACTIVISTS” directly assess the reputation of banks and related themes. All other rating agencies assess reputation as derivative value in terms of the study of credit ratings of banks. So, for instance, Credit rating assesses reputation in their rating of bank’s deposits. Expert rating also have the same feature. As for Standart-rating, they have designed special rating of most attractive deposits (their own top-15).

So, to summarize this table and situation at whole, it should be noted that in Ukraine we don’t have good and extensive rating system of bank’s reputation. There are quite a lot different rating systems that only partly investigate reputational case. They have good ratings of quality of banks deposits or other financial stuff, but in

case of reputation our rating system is imperfect. It could be a consequence of low level of understanding of reputational risk in domestic literature.

As we have mentioned, only Reputational ACTIVISTS assess namely reputation. Therefore it is interesting to count components on the basis of which this rating is determined:

- reputational stability;
- CSR image capital;
- media activity;
- innovative approach;
- anti-crisis resilience.

We think that it is important to understand more deeply about some features of estimating process of this rating. So, first of all Reputational Activists look at reputational stability/ This is means presence of a “live” or effective PR service (if we talking about average company) and some special department (if we talking about specific financial institution), the systemic nature of PR work, an objective basis for the formation of a favorable reputation (quality business product, good management, bright and competent speakers, etc.), a positive reaction of target audiences to the company's activity, other positive effect the company's efforts to manage its reputation. Image capital of CSR is next very important part of estimating process. In this special stage takes into account systematic work to inform the public about the CSR projects implemented by the company, the real usefulness of CSR activities for society, the actual degree of the company's social responsibility in relation to personnel, business partners, consumers; positive perception by target audiences of the company's activities in the field of CSR and other positive effects of the efforts made in this area. In the next part of this work we will see that namely this part (CSR projects) is relatively strong point of domestic banks. Nowadays, even banks and financial institutions should be active players on media field. So, this rating also look at openness to communication with representatives of mass media of all types, quality of disseminated information messages, recognition of authorized company speakers by target audiences, positive effect of applied media efforts. An innovative approach

is the next step of this complicated rating. Its count the authority of the company's PR team among target audiences, its own non-standard PR solutions, activity in new media, a positive reaction of target audiences to PR-creativity, a positive effect from the introduced innovations. Anti-crisis resilience is last but also very important step in creation this rating. The company should have an anti-crisis response strategy, the correctness of the tools used, its successful application and the positive reaction of target audiences to such use, the positive effect of the efforts made [24].

The advantage of this rating is its versatility. It could be applied to different companies from different sectors of economy and still be very informative and useful source of information about company's reputation. In other ratings of banks, the element of the reputation component takes place mostly in view of the attractiveness of their deposits to customers.

So, to summarize, there is no special rating about reputation of financial institution. Mostly because of low level of development this problem in literature. We have noticed that some ratings began to take into account such thing as reputation. Moreover there is a special rating Reputational Activists that estimated namely reputational aspects of company's business activity.

## **2.2. Analysis of the transparency of the bank's reputation risk management**

In the process of research, a focus group was formed, which included 14 systemically important banks of Ukraine, which account for 81.47% of assets, 82.73% of liabilities, and the total value of equity is 111.6 billion hryvnias, which is 77, 3% of the total value of the banking system of Ukraine. This is indicates the representativeness of the sample (Appendix B). In addition, foreign banks were selected to the focus group, including those in the top 100 of the world's largest banks according to The Banker's rating (see Appendix C).

Assessment of the level of transparency of reputational risk in focus group banks was carried out in three stages. On the first stage, a list of questions was formed, according to which the transparency of information on the risk of reputation of banks



was studied (Table 2.2). The questions are grouped into three blocks, the first of which involves clarifying the definition of "reputation risk" and its relationship to other risks of the bank; the second block concerns information on the bank's reputation risk management system; the third block - reveals the social, ethical and environmental responsibility of the bank. The need to single out the third set of issues is due to the fact that stakeholders have a growing confidence in those banks that

*Table 2.2*

**List of questions on which the analysis of reputation risk in focus group banks was carried out\***

|  |   |
|--|---|
| <b>Definition issues</b>                                       | Is there an interpretation of the definition of "reputation risk" in the bank's annual report?                  |
|  | Does the bank mention reputational risk as part of other risks?   |
| <b>Reputational risk management issues</b>                     | Does the bank inform about the existence of a reputation risk management policy and / or strategy?              |
|  | Is the bank's reputation risk management system in place?   |
|  | Is there a special committee on reputation risk in the bank?  |
|  | Does the bank consider the level of reputational risk and its factors at meetings of other relevant committees? |
|  | Does the bank provide information on reputation risk measurement tools?   |
|  | Is there any other information related to the risk of the bank's reputation?                                    |
| <b>Corporate, social and environment responsibility issues</b> | Does the bank cover information on social responsibility?   |
|  | Does the bank disclose information on ethical liability?  |
|  | Does the bank provide information on environmental liability?   |

*\*Source: Made by author*

In the second stage of the study, a score scale was formed to assess the transparency of information about the risk of reputation of banks in the following interpretation: 1 - availability of complete information; 0.5 - partial availability of information; 0 - no information. At the third stage, a point assessment of the transparency of reputation risk information in terms of focus group banks was carried out, the results of which are given in Annex D.

According to the results of the study of the level of transparency of the reputation risk of the largest foreign banks and banks of Ukraine, the following trends were revealed.

First of all, the level of transparency of foreign banks is much higher than that of Ukrainian banks, as the latter do not disclose information on any of the issues related to the second block, i.e. those that cover certain elements of the bank's reputation risk management system and infrastructure. Only a few banks in Ukraine have information in their annual financial statements on the issues of the third and first blocks.

Secondly, there are significant differences among focus group foreign banks in scoring the level of transparency of reputational risk. The highest level of transparency on reputation risk was shown by the German Deutsche Bank (12 points), the Scottish Royal Bank of Scotland and the British HSBC with 11 points each (Fig. 2.1).

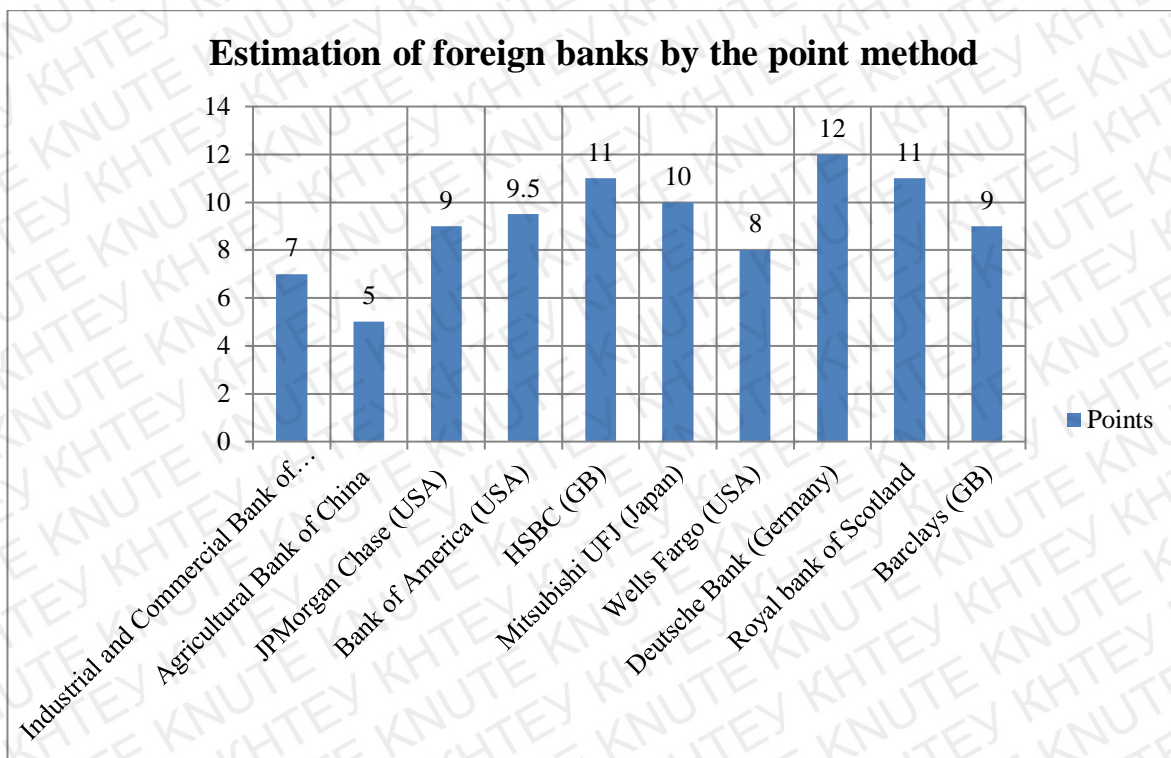


Figure 2.1. Integrated assessment of information transparency about reputation risk in foreign banks of focus group \*

\*Made by the author on the basis of bank websites

Instead, the two Chinese banks Industrial and Commercial Bank of China, Agricultural Bank of China and American Wells Fargo have the lowest level of transparency. These banks provide less public information, limited to the definition and certain aspects of reputation risk management. It is interesting to note that both Chinese banks are state-owned. The low transparency of state-owned Chinese banks is explained by China's general policy, which is strict and rather closed. As for Wells Fargo, it is important to note that in terms of reputation risk research, this bank is very interesting. The fact is that this bank is an ideal example of reputational risk in practice. Employees of Fargo Bank have opened millions of counterfeit accounts, overpaid for mortgage insurance, and recommended unnecessary car and pet insurance to customers. To overcome the consequences of reputational risk, Wells Fargo took the following measures: dismissed the CEO and 5,300 employees; changed the composition of the Board; allocated \$ 185 million to compensate for the shadow operations of its employees; reimbursed \$ 285 million to customers by



paying various fees [30]. This example illustrates how huge the losses can be from the activities of several employees of the bank who were engaged in illegal activities, which led to significant losses.

Third, foreign banks provide comprehensive information on the general features of reputation risk and its definition. We can say that all 10 banks have their own interpretation of the category of reputation risk. Seven banks include reputational risk in other type of risks. Each bank has emphasizes on different risks. For example, the Japanese MUFJ notes the risk of reputation as part of IT risk, and the British HSBC emphasizes that pension risk includes operational and reputational risk of sponsoring pension plans and so on. The Royal Bank of Scotland notes the reputation risk in the particular behavioral risk posed by the financial institution. In turn, two US banks JPMorgan Chase and Bank of America indicate the risk of reputation as part of strategic risk. In general, most banks noted the risk of reputation as part of compliance.

Fourth, the surveyed banks have very different approaches to reputation risk assessment and management. In our list of the 10 banks, only one (Agricultural Bank of China) [31] did not state that it has a reputation risk management system. In 2018, ABC organized a reputational risk study to identify potential reputational risk in departments and related departments, but no separate management system is mentioned in the reports. All other 9 banks have their own developed reputation risk management system.

Fifth, foreign banks are responsible for covering information on environmental, social and ethical responsibility. All 10 surveyed banks have their own reports on social responsibility. 8 out of 10 banks have a clear explanation of their position on environmental responsibility. Their ethical responsibility of banks remains the least revealed. In our list of the 10 surveyed banks, only 6 provide information on their work in the field of ethical responsibility. This information is reflected in the relevant reports of banks, or a separate block on the site, which provides an example of such practices (developed rules and codes of ethics, the results of meetings and courses on ethical responsibility of various committees of the bank), Appendix E. Information on

reputation risk measurement tools turned out to be the least transparent. This information was partially presented only in the reports of Deutsche Bank, Royal Bank of Scotland, HSBC.

As for organizational support, it should be noted that 2 banks state that they have separate teams at reputation risk, 3 banks do not have special departments. According to information published in the Japanese Mitsubishi UFJ annual report, reputation risk management is carried out by the General Risk Department. Reputation risk management committees have been established in 5 banks. It is important to add that the British HSBC has both a team and a reputation risk committee. Another interesting example is the American JP Morgan, which does not have a separate reputation risk department, but at the board level it is stated that each committee or department must independently monitor, analyze and manage the reputation risk in its departments.

There are 8 out of 10 banks state that they manage reputation risk. The exception is the Industrial and Commercial Bank of China, which states that it has a reputation risk management team, but does not disclose their functions and tasks. Instead, the other seven banks clearly describe exactly what measures and actions they use to manage reputation risk. However, no bank provides information on quantifying reputational risk. The only exceptions are Deutsche Bank and Royal Bank of Scotland, which have their own reputational risk measurement tools. An example of such a methodology is the Reputation Risk Framework of Deutsche Bank. Deutsche Bank introduced a revised framework system for reputation risk management in 2015. This system has three lines of banking protection principles. This framework has been developed to manage the process through which active decisions are made on issues that may pose a risk to reputation and thus damage the reputation of Deutsche Bank. The framework requires that units (the term “unit” refers to any Deutsche Bank business unit, infrastructure function or regional office at all levels) establish their own process through which reputational risk issues are first assessed, ensuring accountability and ownership within 1 line of protection. The questions can then be passed to the second line and the third line, respectively [16].



The next step in this research is a similar analysis of domestic banks. For this analysis, we selected 14 systemically important banks in Ukraine. There are 4 state-owned banks, 5 commercial banks with foreign capital and 5 domestic commercial banks. After conducting a detailed analysis in accordance with our chosen methodology, the results are presented in Fig. 2.2 and Appendix F.

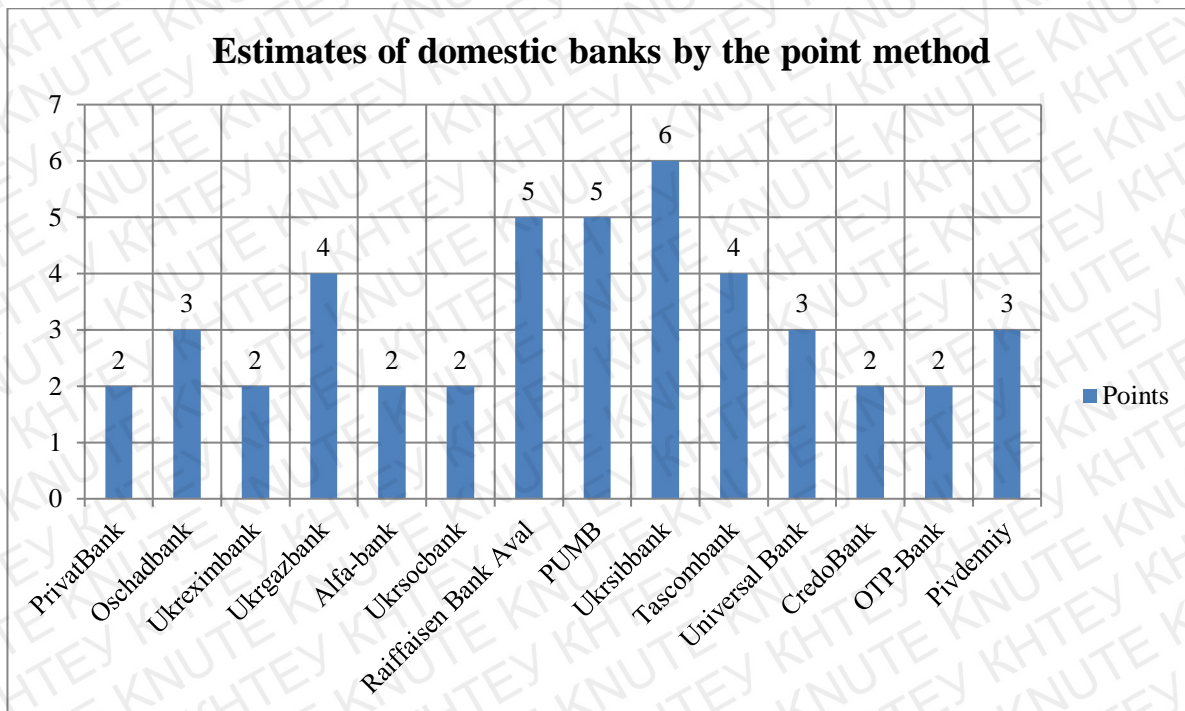


Figure 2.2. Integrated assessment of information transparency about reputation risk in domestic banks of focus group \*

\* Made by the author on the basis of bank websites

According to the results, PUMB, Ukrsibbank and Raiffeisen Bank Aval are the most transparent banks in terms of disclosure of reputational risk information. A characteristic feature is that two of the top three banks are banks with foreign capital. Therefore, as an intermediate conclusion, we can note that it is the availability of foreign capital, and as a result, foreign management has led to increased attention to the phenomenon of reputation risk. While most banks with public or private capital cover very limited information. However, it is interesting to note that in our study, the worst banks were OTP Bank, Kredobank and Alfa-Bank, which have foreign capital or are managed through foreign firms (Alfa-Bank). In general, the results are unsatisfactory, compared to foreign banks. The level of attention to the phenomenon



of reputation risk is relatively minimal. However, it should be noted that positive trend also exist, as almost all banks are aware of the importance of reputation and somehow mention it in their reports, internal documents, on the website and so on. However, only a few of them actually disclose minimal information about reputation risk. Only 3 banks provide their own definition of reputation risk. Another 10 banks mention reputation risk either as part of their own risk classification or as part of compliance risk. No bank has a reputation strategy or policy for reputation risk management. Only 2 banks mentioned reputation in their overall banking risk management strategy and that it has some impact on the bank's operations, but without any explanations or examples to support this assertion. No bank has a separate team, committee or department that deals with reputational risk. Only one bank, namely PUMB, provides information that the Communication Service and the Marketing Department are working with the bank's reputation. It is emphasized that among the functions of these divisions is the formation, preservation and protection of PUMB's reputation. The result of these units is to maintain a high level of reputation of the bank. In addition, the bank assesses the level of compliance risk and reputation risk based on the construction of models of the most unfavorable situation for the Bank (maximum possible fines, losses, negative impact on operations in the short, medium and long term). According to the results of the assessment, high, medium and low risks are identified. No other bank has such information. A relatively strong point of domestic banks was the availability of special reports on corporate, ethical, social, environmental responsibility. Partially or completely, but almost every bank has similar reports. Annex G provides similar information provided on foreign banks above on the degree of disclosure on each issue.

According to the results obtained, we can see that the most widely available is information on social, ethical and corporate responsibility. In full (in the form of a report) or in part (information on the site), but banks provide the necessary information about activities in this area. Instead, reputational risk and derivative disclosure issues are very concise. If we analyze the information in more detail, we can see that only 5 banks disclose certain information about reputational risk. Most of

this information is covered in information security policy documents. However, this information is general and vague, and therefore does not carry much value in terms of analysis of reputation risk. Directly, regarding reputation risk, only 3 banks provided their own definition in internal documents. Another 4 banks say that the high business reputation of their partners is important to them. Only 1 of the surveyed banks (PUMB) has a separate special report on the bank's banking risk management policy, which is provided separately from the annual report.

Most domestic banks at this stage of development focus on compliance risk. In part or in full, but 10 banks provided information on compliance risk. From these 10 banks, only 7 mentioned reputation within compliance risk. And only 2 banks mentioned the reputation risk as part of compliance risk. It is important to note that out of 14 banks, only Ukrsibbank singles out reputational risk as a separate type of risk. All 14 banks state that they have a negative attitude towards any illegal transactions and pursue a strict policy to minimize their participation in such transactions with the participation of their partners. Each bank gives its own examples of such activities, but in general they are the same for everyone. Among them should be noted: fraud, corruption, opening fictitious accounts, etc. Banks see this as a threat to their reputation, and therefore prefer to avoid such practices.

In summary, the risk of reputation is insufficiently represented by domestic banks. It can be concluded that despite the understanding of the importance of reputation, banks do not sufficiently develop the direction of reputation risk. After all, management, monitoring, reputation risk assessment are very important aspects of the bank's activity, especially in modern conditions, when any negative information can spread in a few days on social networks, media, etc. and cause irreparable damage to the bank. This is the main relevance of the study of reputation risk, namely the representation of foreign practices and the accumulation of best practices for the domestic banking sector.

## **PART 3**

### **DIRECTIONS FOR IMPROVING THE BANK'S REPUTATIONAL RISK MANAGEMENT**

#### **3.1. Improving of methods of assessing bank's reputation risk**

Nowadays, there are a lot of different approaches and methods of assessing classical types of risks (operational, liquidity etc.). Moreover, different approaches of assessing operational risk have been successfully quantified in the last decade. But reputational risk isn't the typical type of risk, so standard approaches are not suited for its. What gets measured gets managed, but quantification of reputation risk is extremely difficult as there is no universally accepted methodology and the concept is broad [32].

Reputation risk management in Ukrainian banks is carried out by different divisions, and, as a rule, is not structured, and therefore requires research to develop a standardized format.

The risk of the bank's reputation should be regulated by a separate division, which reflects the approaches to the detection, evaluation and organization of its management. The regulations should be periodically reviewed and updated in accordance with changes in the conditions of banking regulation and international best practice.

In order to avoid conflicts of interest, it is necessary to clearly delineate the responsibilities and responsibilities between the subjects of the management system that carry out the identification, assessment, control of reputation risk.

According to our analysis of foreign banks, we can say that each bank has individually chosen approaches of understanding the phenomenon of reputation risk, especially in the context of management. Thus, foreign banks have different structural units responsible for reputation risk management. However, despite the difference in direct functions and tasks, they are all united by a common goal, namely the identification of potential sources and determinants of reputational risk and their



effective management. In general, after analyzing a number of banks, we can group their functions as follows:

- development of general policy, as well as internal documents with recommendations for maintaining the high reputation of the bank
- development of internal documents on ethical, social and environmental responsibility;
- initial supervision of reputation risk;
- conducting trainings for employees, as well as persons influencing public opinion;
- implementation of external communication strategies to reduce risk;
- informing key stakeholders about potential reputational risks;
- consideration of issues arising in connection with work with customers, transactions and third parties that pose a serious potential risk to the bank's reputation;
- forming risk appetite and principles of reputation risk management;
- establishing policies and standards for reputation risk management at the general level;
- management of the management infrastructure and processes that support the consistent identification, management and monitoring of reputational risk issues throughout the bank;
- ensuring control over the risk departments of the LOB ("RRO") over certain situations that may damage the bank's reputation.

In general, it should be noted that at this stage, domestic banks are faced with the task of implementing the basic principles and functions related to reputation risk management, and only then move to more specific or even begin to develop their own methodology. There is no justified reason and no infrastructure facilities to implement complicated practices of foreign banks. For this stage of development implementation of basic principles will be good enough.

So, we can consider two fundamental ways of improving assessment process and management at whole. First block of advices is based on internal conclusions of this research. Second block is based on clear examples of dealing with problem of reputational risk in foreign banks. So, if we talking about our proposals of improving methods of assessing reputational risk we want to emphasis our conclusion on the next statements:

- introduce reputation risk management systems, which will provide development of a categorical apparatus, the formation of risk position and determination of risk appetite, as well as the development of regulations on risk management of the bank's reputation;
- develop regulations on reputation risk management, which should formulate the basic terms and concepts, purpose, objectives, functions, principles;
- identify participants in the risk management process, as well as areas of interaction between them;
- provide information support of risk management, namely the list of forms of the administrative reporting and responsible divisions for their formation. For example it could be list of methods, rules and procedures relating to this risk, etc.;
- establish a close relationship between all participants in the reputation risk management process: the board, the board, profile committees, risk management and compliance units, business units and support units;
- initiate the establishment of a Reputation Risk Management Committee for large systemic banks at the bank's board. This profile committee should consider issues related to the bank's reputation. Its meeting must be attended not only by board members, but also by heads of risk management and compliance services, as well as public relations and communications. The Bank should develop regulations on the Reputation Risk Management Committee. For other banks, it is necessary to

determine at which committee the issues concerning reputation risk will be considered (in the absence of a special committee).

It is important to add that for Ukrainian banks it will be really tough work, because our domestic bank has to create a very difficult system almost from a zero-point. But without these actions our banks will be not ready for nowadays trend in international banking system.

### **3.2. Foreign experience in managing the risk of the bank's reputation**

So, as we have mentioned previously, Ukrainian banks have not recognize reputational risk and have absolutely no experience in its management. As a result, it is critical important for us to learn cases of foreign banks. Because some of European and American banks have been working with reputational risk for more than 5-10 years. As a result we have a perfect guide map of some process of establishing so complicated system in domestic banks.

There is a very interesting case of Commerzbank, which has formed a reputation risk management department, whose key tasks are to identify and assess the potential environmental, social and ethical risks of the bank arising from the provision of banking services and business relationships with customers and other stakeholders. It is appropriate to periodically review the Regulations on the primary risk of the bank's reputation. In the event that the risk to the bank's reputation is significant, it should be considered at a meeting of the Profile Committee for Risk Management.

Foreign banks also have specially developed codes that clearly define the role of each employee, as well as his tasks and principles of work in the context of ethical responsibility. In general, the principles of these codes are similar for different banks. We decided to summarize the best practices of each such code and formulate our own Bank Reputation Code, which can be of great practical importance for domestic banks. It should be noted that foreign banks have a Code of Conduct, the essence of which is similar to the Bank's Reputation Code, but is still narrower in nature, and therefore covers the issue of reputation only in part. To a greater extent, such codes



focus on the formation of basic principles of the work process for staff, as well as tips on how a good employee should behave. But it is very important to understand a difference between code of conduct and reputational code. Main differences are provided in Table 3.1.

*Table 3.1*

**Comparison of Code of Conduct and Reputation code\***

| <b>Code of Conduct</b>   | <b>Reputation Code</b>                                     |
|--|--|
| Broad and non-specific   | Narrow profile and specific                                |
| Forms a common set of values   | Complements and clarifies certain aspects of set of values |
| Has a description of recommended actions and the possibility of independent evaluation | Creates a clear system for assessing the situation         |

\*Source: Made by author

However, only some issues of Code of Conduct are directly related to reputation. It should be noted that at the initial stage, such a code would be enough for Ukrainian banks. Having already passed the main stages of implementation of the reputation risk management system in their activities, domestic banks could create a more effective and in-depth Code of Reputation Code of the bank on the basis of the Code of Conduct. Nevertheless, such codes are based on the general principles and values of the bank. It is the separation of such values is an important task when writing a Behavioral or Reputation Code of the bank. Therefore, the priority is to focus on the values of the bank. (Fig. 3.1.)

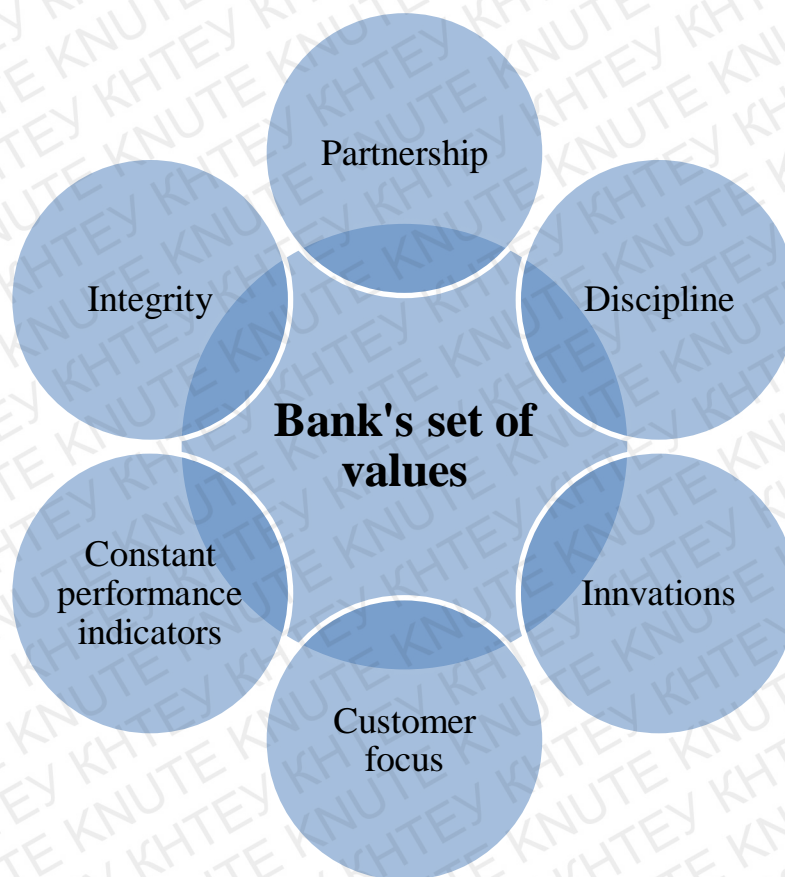


Figure 3.1. Example of bank values \*

\* Made by the author

Based on the above functions, we can say that the bank has a good basis for the implementation of a special Code of Conduct or Code of Reputation of the bank. The purpose of such a code is to summarize the basic principles of ethical and social responsibility for employees within the company. Potentially, such Code could minimize a number of reputational risks that may adversely affect the bank's operations. It is also important to periodically update the code, as well as follow all current trends that pose reputational threats. We believe that the current Code of Reputation of the bank should contain the following fundamental postulates:

- within the framework of its activities, each employee must monitor potential risks that threaten of the bank's reputation;
- bank supports social corporate responsibility programs;
- bank has set high standards for conducting its own business and promotes the development of its customers' business (favorable attitude to customers, timely consideration of complaints, etc.);

- bank creates favorable working conditions for its employees;
- active and constant cooperation of the bank with social media;
- careful attitude of the bank to the preservation of personal data of customers and counterparties;
- the employee must act honestly, decisions must be ethically motivated. The employee must take personal responsibility for the actions performed;
- prevention and detection of financial crimes (anti-financial crimes, anti-money laundering / terrorist financing);
- all actions of employees must comply with applicable government laws, regulations of state and local authorities and other relevant regulatory authorities;
- all employees should never, directly or indirectly, take any action to coerce, manipulate, mislead or fraudulently influence the firm's independent auditors during their audit or review of the firm's financial statements;
- all employees should assist in creating full, fair, accurate, timely and clear disclosure of reports and documents submitted by the bank to the Securities and Exchange Commission and other regulatory bodies, as well as in other public communications made by the bank.

This list could be continued at the discretion of supervisory board according to individual business practices. Every bank should create such code of conduct that will manage their special kind of questions that occur namely in their field of work.

Deutsche Bank “Decision Tree” is another perfect example of mechanism of managing reputational risk. In general “Decision Tree” helps employees to adequately understand the situation that has arisen, as well as to avoid actions that could have reputational consequences for the bank. On the Fig. 3.2 we can see this "Decision Tree".



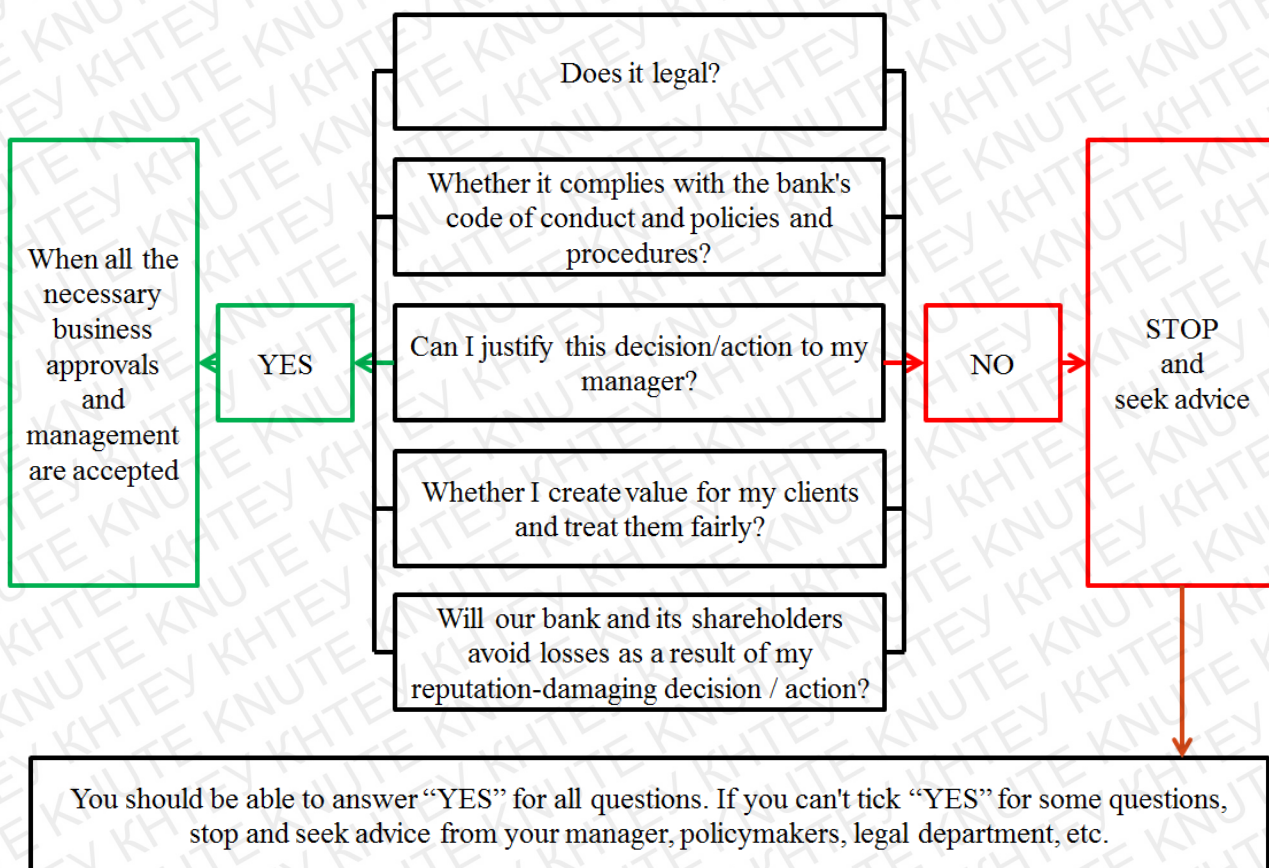


Figure 3.2. Decision Tree of Deutsche Bank

Source: [6].

It should be noted that almost all foreign banks as part of their own Code of Conduct have a similar scheme, which may differ in form, but the essence remains the same.

The data in Fig. 3.2 show that the German bank has developed a successful methodology that can level the onset of reputational risk factors at an early stage. In our opinion, such a decision tree should be introduced in domestic banks, which will help reduce the likelihood of reputational risk.

Moreover this powerful german bank has some additional mechanisms of managing reputational risk. The core of "Decision Tree" is employee and his actions. But Deutsche Bank has also special designed Deutsche Bank's Reputational Risk Framework, which covers all big structure of this international bank. Deutsche Bank introduced a revised Framework to manage reputational risk in 2015 which embodies the Bank's 3 Lines of Defence principles. The Framework is in place to manage the process through which active decisions are taken on matters which may pose a

reputational risk and in doing so to prevent damage to Deutsche Bank’s reputation wherever possible [6]. On the Figure 3.3 you can see simplified scheme of this framework.

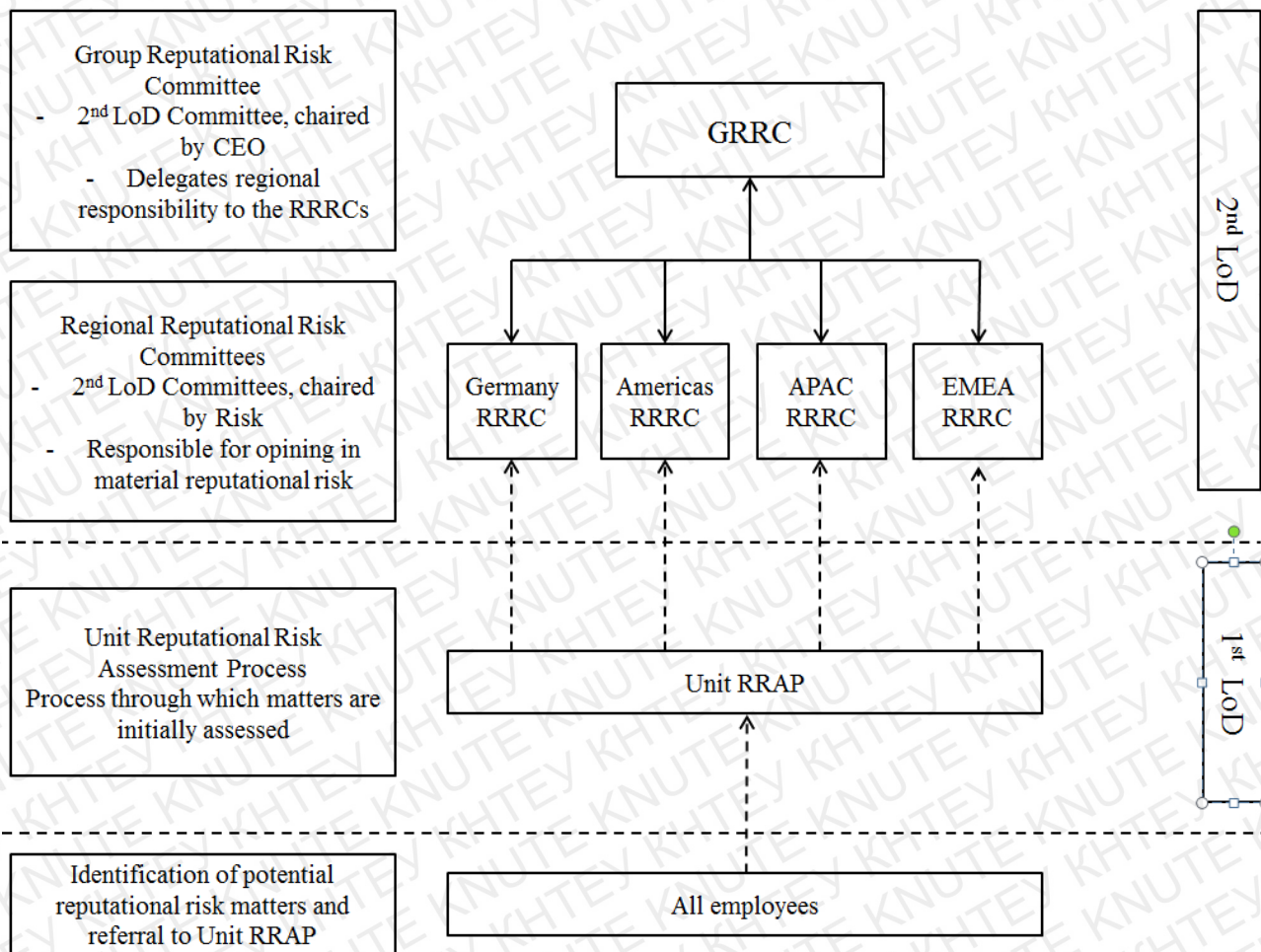


Figure 3.3. Deutsche Bank’s Reputational Risk Framework

Source: [6]

According to this figure we can see that Deutsche Bank has very branched and complicated framework. This perfectly depicts how important to understand reputational risk phenomena. Such schemes and frameworks should be considered by our domestic banks and implemented in future. But it will be possible only after implementation of fundamental principles of reputational risk management.

Summing up the research, we can say that the question of reputation in foreign banks has received a lot of attention. That is why we have developed a number of recommendations for Ukrainian banks aimed at improving reputation risk management based on foreign practices. Such recommendations include:



- develop a methodology for quantitative and qualitative risk assessment of the bank's reputation. This methodology must be tested for its adequacy and only then approved by the profile committee. The methodology should be periodically reviewed by the bank, and the changes made should also be approved by the profile committee;
- depending on the scale of activities, the level of risk appetite, the branching of the regional network and other factors, banks may establish special units or designate a person responsible for reputation risk management. This unit will be responsible for analyzing and monitoring all events related to reputational risk, as well as developing a special Bank Reputation Code;
- introduce a Bank Reputation Code, which should reflect a set of rules that would regulate the effective work of employees, create favorable working conditions, and oblige employees to monitor potential reputational risks. In addition, this Code would state a number of positions of the bank on the inadmissibility of fraud, security of personal data of customers, a high level of service, ethical, corporate and social responsibility, etc.

These recommendations for Ukrainian banks are based on the results of a study of the practices of foreign banks, which can be very useful for managing the risk of their reputation. Thus, the following recommendations can be given: the use of ratings of behavior and performance of all employees, which directly affects the results of their remuneration; positive salary adjustments for persons who have shown exemplary behavior; reduction of wages when there are cases of inappropriate individual behavior.

However, the positive fact is that we can take the example of foreign banks that have undergone a long process of formation and implementation of reputation risk management, and therefore domestic banks are faced with the task of using existing knowledge and advice.



## CONCLUSIONS AND RECOMENDATIONS

1. Summing up the research, it should be noted that reputational risk is a very complex economic phenomenon, which is relatively new to science and therefore requires special attention from scientists. A bank's reputational risk is a combination of economic, social and ethical relations between a bank and its stakeholders, which may lead to a failure to meet their expectations and thus adversely affect the level of confidence in the bank, resulting in loss of liquidity, capital and solvency.

2. The risk of the bank's reputation is influenced by numerous factors, which are classified by the following characteristics: by area of origin (external and internal), in turn, internal - by origin (financial, organizational, operational, derivatives); by types of significant risks (credit, liquidity, etc.); external - by source of origin (global and national); spectrum of action (socio-political, economic, legal and legal); the scale of influence (on the banking system in general and a particular bank), which, in contrast to other points of view, is supplemented by signs of the source and the scale of the impact on the bank.

3. The need to manage the risk of the bank's reputation is due to the following challenges: in the post-crisis period, the influence of stakeholders on the bank's activities, and accordingly on its reputation; there were changes in business management, which necessitated taking into account the risk of reputation in the process of stress testing of the bank; increased level of communication due to the active spread of the Internet, which accelerated the flow of both positive and negative information from one part of the world to another; the importance of intangible assets in the activities of banks has increased and the requirements for their transparency have increased; the scale and complexity of monitoring the money laundering process has increased.

4. Reputation risk management system is a systematic process of identifying, measuring, monitoring, controlling, reporting and mitigating reputation risk at all organizational levels of a financial institution. The purpose of the bank's reputation risk management is to build its reputation, maintain its reputation and protect its

reputation, as well as provide adequate information support for the effective implementation of management decisions. The main tasks of reputation management of the bank's reputation include: formation of appetite for risk and principles of reputation risk management; implementation of external communication strategies to reduce the risk of the bank's reputation; informing key stakeholders about potential reputational risks, etc.

5. The most transparent among foreign focus group banks were the German Deutsche Bank, Royal Bank of Scotland, HSBC. These banks have a reputational risk management system in place. Most of these banks are characterized by the coverage of complete and comprehensive information regarding the definition of reputation risk, as well as its management. There is also clear and understandable information on current measures regarding reputation risk management. Independent reputation risk management committees have been formed. Individual methods of reputation risk assessment are provided and own methodologies for reputation risk management and assessment are developed. The least transparent among foreign focus banks are the reputational risk management positions of the two Chinese state-owned banks Industrial and Commercial Bank of China, Agricultural Bank of China, and American Wells Fargo. Chinese banks have a limited amount of information presented on the website and in internal documents, which is limited to the definition of reputation risk and certain references to the bank's reputation in general. In the situation with Wells Fargo, there is a loud reputation scandal due to which the bank lost profits and also had to pay hundreds of millions of US dollars to offset the negative consequences.

6. The study found that domestic banks pay very little attention to reputational risk compared to foreign ones, namely the complete absence of the above methodologies and practices for reputation risk management and assessment. Only 3 Ukrainian banks have their own definition of reputation risk in their internal documents (Raiffeisen Bank Aval, Ukrsibbank, Universal Bank). Lack of a common reputation risk management system and infrastructure. Absence of separate divisions, departments, divisions on management of risk of reputation. Contrary to a number of

negative factors, it should be noted that the relatively strong side of Ukrainian banks is the coverage of social and environmental responsibility.

7. In order to improve the management of reputation risk in the banks of Ukraine it is proposed:

7.1. Develop provisions for the management of this risk, which should be formulated basic terms and concepts, purpose, objectives, functions, principles; identified participants in the risk management process, as well as areas of interaction between them; information support of risk management, namely the list of forms of the administrative reporting and responsible divisions for their formation; list of methods, rules and procedures related to this risk, etc.

7.2. Establish a close relationship between all participants in the reputation risk management process: the board, board, profile committees, risk management and compliance departments, business units and support units.

7.3. Initiate the establishment of a Reputation Risk Management Committee for large systemic banks at the bank's board. This profile committee should consider issues related to the bank's reputation. Its meeting must be attended not only by board members, but also by heads of risk management and compliance services, as well as public relations and communications. The Bank should develop regulations on the Reputation Risk Management Committee. For other banks, it is necessary to determine at which committee the issues concerning reputation risk will be considered (in the absence of a special committee).

7.4. Develop a methodology for quantitative and qualitative risk assessment of the bank's reputation. This methodology must be tested for its adequacy and only then approved by the profile committee. The methodology should be periodically reviewed by the bank, and the changes made should also be approved by the profile committee.

7.5. Depending on the scale of activities, the level of risk appetite, the ramifications of the regional network and other factors, banks may establish special units or designate a person responsible for reputation risk management. This unit will



be responsible for analyzing and monitoring all events related to reputation risk, as well as developing a special Bank Reputation Code.

7.6. Introduce a Bank Reputation Code, which should reflect a set of rules that would regulate the effective work of employees, create favorable working conditions, and would oblige employees to monitor potential reputational risks. In addition, this Code would state a number of positions of the bank on the inadmissibility of fraud, security of personal data of customers, a high level of service, ethical, corporate and social responsibility etc.

In addition, it is appropriate to use the special practices of leading foreign banks, in particular the special "Decision Tree" of the German Deutsche Bank, which helps employees to act lawfully and not damage the reputation of the bank. Also it is very important to learn all knowledge and experience of foreign banks in order to develop good and effective system of reputational risk management. It will be also very useful to use special Deutsche Bank's Reputational Risk Framework in future. This framework is too complicated for our banks today but in future such mechanisms of defense should be implemented obligatory.

Thus, the establishment of an effective reputation risk management system is a key prerequisite for ensuring the financial stability and reliability of banks, as well as their long-term operation in the market.

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## APPENDICES

### Appendix A

#### The seven key drivers of reputation according to study of G. Honey

| Key drivers                       | Investors | Customers | Suppliers | Employees |
|-----------------------------------|-----------|-----------|-----------|-----------|
| Financial performance             |           |           |           |           |
| Delivery of products and services |           |           |           |           |
| Vision and leadership             |           |           |           |           |
| Corporate responsibility          |           |           |           |           |
| Workplace environment             |           |           |           |           |
| Knowledge and skills              |           |           |           |           |
| Emotional appeal                  |           |           |           |           |

*Source: [2].*

## Appendix B

**The value of assets, liabilities and equity of 14 systemically important banks of  
Ukraine, as of August 1, 2020**

| <b>Bank</b>                     | <b>Assets,<br/>billions of<br/>hryvnas</b> | <b>ratio to the total<br/>value in<br/>Ukraine, %</b> | <b>Liabilities,<br/>billions of<br/>hryvnas</b> | <b>ratio to the total<br/>value in<br/>Ukraine, %</b> | <b>Capital,<br/>billions of<br/>hryvnas</b> |
|---------------------------------|--|---|---|---|---|
| <b>PrivatBank</b>               | 278,048                                    | 20,43   | 246,584   | 20,46   | 31,464                                      |
| <b>Oschadbank</b>               | 217,786                                    | 16,00   | 199,224   | 16,53   | 18,561                                      |
| <b>Ukreximban<br/>k</b>         | 161,643                                    | 11,88   | 153,192   | 12,71   | 8,450                                       |
| <b>Ukrgazbank</b>               | 82,224                                     | 6,04  | 76,468  | 6,35  | 5,756                                       |
| <b>Alfa-bank</b>                | 60,287                                     | 4,43  | 55,246  | 4,58  | 5,041                                       |
| <b>Ukrsochbank</b>              | 15,664                                     | 1,15  | 12,59   | 1,04  | 3,073                                       |
| <b>Raiffaisen<br/>Bank Aval</b> | 73,8                                       | 5,42  | 62,109  | 5,15  | 11,691                                      |
| <b>PUMB</b>                     | 51,16                                      | 3,76  | 44,457  | 3,69  | 6,702                                       |
| <b>Ukrsibbank</b>               | 52,043                                     | 3,82  | 45,273  | 3,76  | 6,769                                       |
| <b>Tascombank</b>               | 17,709                                     | 1,30  | 15,588  | 1,29  | 2,121                                       |
| <b>Universal<br/>Bank</b>       | 8,378                                      | 0,62  | 7,501   | 0,62  | 0,876                                       |
| <b>CredoBank</b>                | 16,796                                     | 1,23  | 15,002  | 1,24  | 1,793                                       |
| <b>OTP-Bank</b>                 | 38,686                                     | 2,84  | 32,946  | 2,73  | 5,704                                       |
| <b>Pivdenniy</b>                | 34,44                                      | 2,53  | 30,841  | 2,56  | 3,598                                       |

Source: [28]

**TOP-100 banks in the world according to The Banker**

| No<br>(Place) | Bank                              | Country       | Assets,<br>millions of<br>USD | 1 tier<br>Capital,<br>millions of<br>USD |
|---------------|-----------------------------------|---------------|-------------------------------|--|
| 1             | ICBC                              | China         | 4,043,728.47                  | 337,539.12                               |
| 2             | China Construction<br>Bank        | China         | 3,390,174.16                  | 287,461.31                               |
| 3             | Agricultural Bank of<br>China     | China         | 3,300,652.70                  | 242,895.33                               |
| 4             | Bank of China                     | China         | 3,104,711.68                  | 229,969.78                               |
| 5             | JP Morgan Chase & Co              | USA           | 2,622,532.00                  | 209,093.00                               |
| 6             | Bank of America                   | USA           | 2,354,980.00                  | 189,038.00                               |
| 7             | Wells Fargo & Co                  | USA           | 1,895,883.00                  | 167,866.00                               |
| 8             | Citigroup                         | USA           | 1,917,383.00                  | 158,122.00                               |
| 9             | HSBC Holdings                     | Great Britain | 2,558,124.00                  | 147,142.00                               |
| 10            | Mitsubishi UFJ<br>Financial Group | Japan         | 2,805,074.86                  | 146,739.09                               |
| 25            | Barclays                          | Great Britain | 1,434,535.44                  | 67,086.08                                |
| 27            | Deutsche Bank                     | Germany       | 1,549,582.76                  | 63,322.99                                |
| 41            | RBS                               | Scotland      | 878,778.48                    | 45,851.90                                |

Source: [29]



## Appendix D

## Score of transparency of reputation risk information by foreign banks \*

| Questions / Banks   | Commercial Bank of China | Industrial and Agricultural Bank of China | JPMorgan Chase | Bank of America | HSBC | Wells Fargo | Deutsche Bank | Royal bank of scotland | Barclays | Mitsubishi UFJ |
|---|--------------------------|---|----------------|-----------------|------|-------------|---------------|------------------------|----------|----------------|
| Is there an interpretation of the definition of “reputation risk” in the bank's annual report?                  | 1                        | 1   | 1              | 1               | 1    | 1           | 1             | 1                      | 1        | 1              |
| Does the bank mention reputational risk as part of other risks?   | 0                        | 0   | 1              | 1               | 1    | 1           | 1             | 1                      | 1        | 1              |
| Does the bank inform about the existence of a reputation risk management policy and / or strategy?              | 1                        | 0,5                                       | 1              | 1               | 1    | 0,5         | 1             | 1                      | 1        | 1              |
| Is the bank's reputation risk management system in place?   | 0,5                      | 0,5                                       | 0              | 1               | 1    | 0           | 1             | 1                      | 1        | 0              |
| Does the bank consider the level of reputational risk and its factors at meetings of other relevant committees? | 1                        | 0   | 1              | 1               | 1    | 1           | 1             | 0,5                    | 1        | 1              |
| Does the bank cover information on social responsibility?   | 1                        | 0,5                                       | 1              | 1               | 1    | 1           | 1             | 1                      | 1        | 1              |
| Does the bank disclose information on ethical liability?  | 0                        | 0   | 1              | 0,5             | 0,5  | 0           | 1             | 1                      | 0        | 1              |
| Does the bank provide information on environmental liability?   | 0                        | 0,5                                       | 1              | 1               | 1    | 1           | 1             | 1                      | 0        | 1              |
| Is there any other information related to the risk of the bank's reputation?                                    | 1                        | 1   | 1              | 1               | 1    | 1           | 1             | 1                      | 1        | 1              |
| Is there a special committee on reputation risk in the bank?  | 0,5                      | 0   | 0              | 0,5             | 1    | 0           | 1             | 1                      | 1        | 1              |
| Does the bank provide information   | 0                        | 0   | 0              | 0               | 0,5  | 0           | 1             | 0,5                    | 0        | 0              |

|  |          |          |          |           |           |            |           |           |          |           |
|--|----------|----------|----------|-----------|-----------|------------|-----------|-----------|----------|-----------|
| on reputation risk measurement tools?                          |          |          |          |           | 5         |            |           |           |          |           |
| Does bank have any systems of management of reputational risk? | 1        | 0        | 1        | 1         | 1         | 1          | 1         | 1         | 1        | 1         |
| <b>Summary (points)</b>  | <b>7</b> | <b>4</b> | <b>9</b> | <b>10</b> | <b>11</b> | <b>7,5</b> | <b>12</b> | <b>11</b> | <b>9</b> | <b>10</b> |

*\* Made by the author on the basis of bank websites*



## Appendix E

## Analysis of coverage of each type of issues by foreign banks \*

| Questions   | Number of banks |
|---|-----------------|
| Is there an interpretation of the definition of “reputation risk” in the bank's annual report?                  | 10              |
| Does the bank mention reputational risk as part of other risks?   | 9               |
| Does the bank inform about the existence of a reputation risk management policy and / or strategy?              | 10              |
| Is the bank's reputation risk management system in place?   | 7               |
| Does the bank consider the level of reputational risk and its factors at meetings of other relevant committees? | 9               |
| Does the bank cover information on social responsibility?   | 9               |
| Does the bank disclose information on ethical liability?  | 6               |
| Does the bank provide information on environmental liability?   | 10              |
| Is there any other information related to the risk of the bank's reputation?                                    | 8               |
| Is there a special committee on reputation risk in the bank?  | 9               |
| Does the bank provide information on reputation risk measurement tools?   | 3               |
| Does bank have any systems of management of reputational risk?  | 10              |

\* Made by the author on the basis of bank websites





|  |          |          |          |          |          |          |          |          |          |          |          |          |          |          |
|--|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| Does the bank provide information on environmental liability?                | 0        | 0        | 0        | 1        | 0        | 0        | 0        | 1        | 1        | 0        | 0        | 0        | 0        | 0        |
| Is there any other information related to the risk of the bank's reputation? | 0        | 0        | 0        | 0        | 0        | 0        | 1        | 1        | 1        | 1        | 1        | 0        | 0        | 0        |
| Is there a special committee on reputation risk in the bank?                 | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        |
| Does the bank provide information on reputation risk measurement tools?      | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        |
| Does bank have any systems of management of reputational risk?               | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        | 0        |
| <b>Summary (points)</b>  | <b>2</b> | <b>3</b> | <b>2</b> | <b>4</b> | <b>2</b> | <b>2</b> | <b>5</b> | <b>5</b> | <b>6</b> | <b>4</b> | <b>3</b> | <b>2</b> | <b>2</b> | <b>3</b> |

*\* Made by the author on the basis of bank websites*



## Appendix G

## Analysis of coverage of each type of issues by domestic banks \*

| Questions   | Number of banks |
|---|-----------------|
| Is there an interpretation of the definition of “reputation risk” in the bank's annual report?                  | 3               |
| Does the bank mention reputational risk as part of other risks?   | 0               |
| Does the bank inform about the existence of a reputation risk management policy and / or strategy?              | 0               |
| Is the bank's reputation risk management system in place?   | 0               |
| Does the bank consider the level of reputational risk and its factors at meetings of other relevant committees? | 0               |
| Does the bank cover information on social responsibility?   | 14              |
| Does the bank disclose information on ethical liability?  | 12              |
| Does the bank provide information on environmental liability?   | 3               |
| Is there any other information related to the risk of the bank's reputation?                                    | 5               |
| Is there a special committee on reputation risk in the bank?  | 0               |
| Does the bank provide information on reputation risk measurement tools?   | 0               |
| Does bank have any systems of management of reputational risk?  | 0               |

\* Made by the author on the basis of bank websites



KYIV NATIONAL UNIVERSITY OF TRADE AND ECONOMICS  
BANKING DEPARTMENT

PRESENTATION TO THE FINAL QUALIFICATION WORK ON THE TOPIC

**REPUTATIONAL RISK MANAGEMENT OF A  
FINANCIAL  
INSTITUTION**

Student of the 2<sup>nd</sup> year, group 5am,  
specialty 072 "Finance, Banking and  
Insurance",  
specialization "Financial Intermediation"

Zhenzherukha Petro

Scientific adviser, PhD in Economics,  
Docent

Erfkas O.

Fig. F.1.1 Presentation for the defense, Slide №1

## Relevance of research

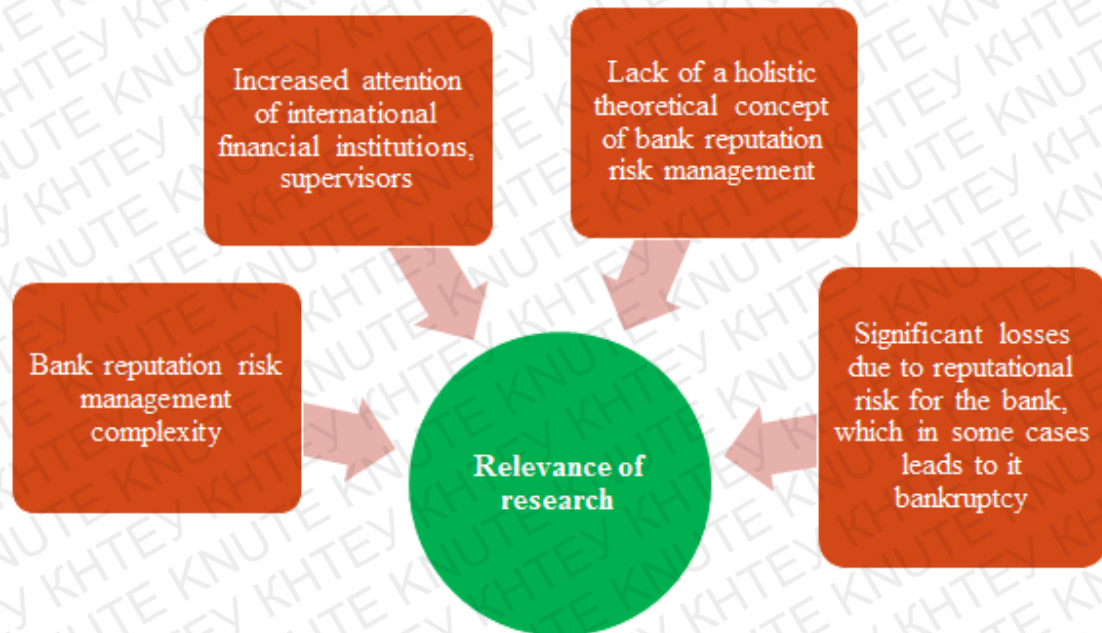


Fig. F.1.2 Presentation for the defense, Slide №2

## Object, subject, purpose of the study

- **The object** of the study is reputation risk management system of financial institution.
- **The subject** of the study is the theoretical and methodological principles of reputation risk management in financial institution.
- **The purpose** of the study is to reveal the theoretical provisions and develop methodological frameworks and practical recommendations for improving the risk management of the reputation of financial institution.

Fig. F.1.3 Presentation for the defense, Slide №3

## What is reputational risk?

Reputational risk – is a combination of economic, social, technical and ethical relations between a bank and its stakeholders, which may lead to a failure to meet their expectations and thus adversely affect the level of confidence in the bank, resulting in loss of liquidity, capital and solvency..



Fig. F.1.4 Presentation for the defense, Slide №4



## Systematizing the risk factors of reputational risk

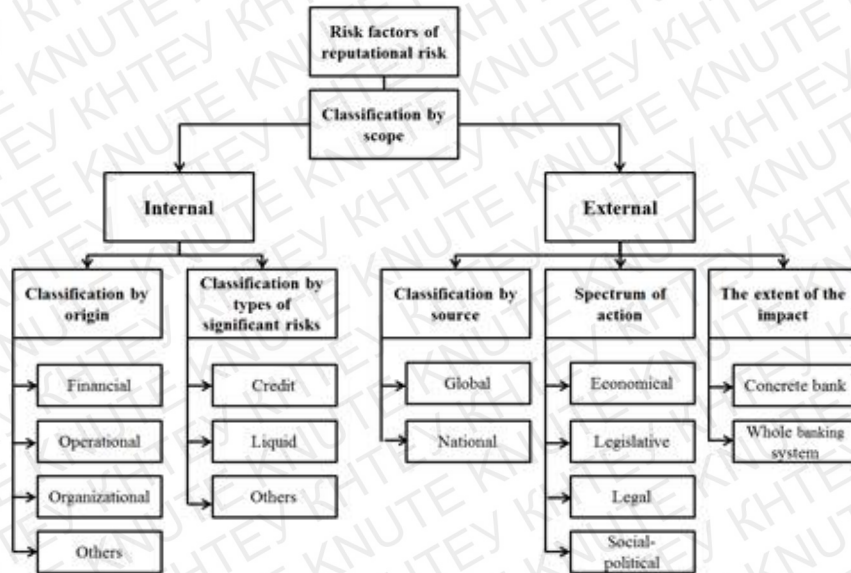


Fig. F.1.5 Presentation for the defense, Slide №5

Why is it necessary to manage the risk  
the bank's reputation?

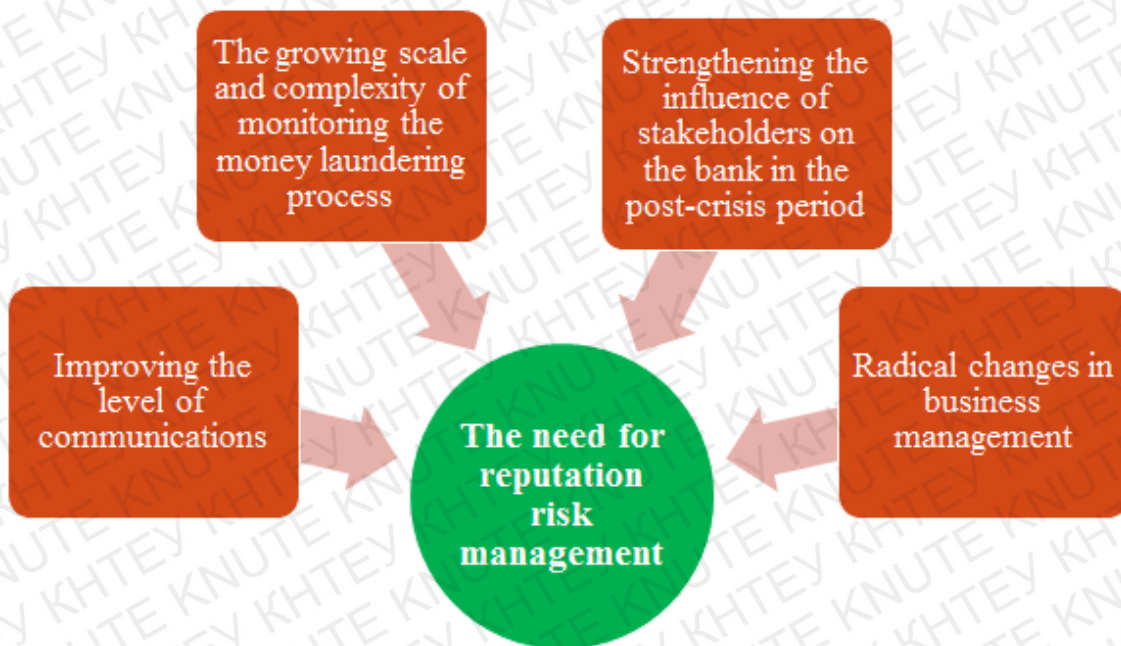


Fig. F.1.6 Presentation for the defense, Slide №6



### Assessing the level of transparency of the bank's reputation risk management

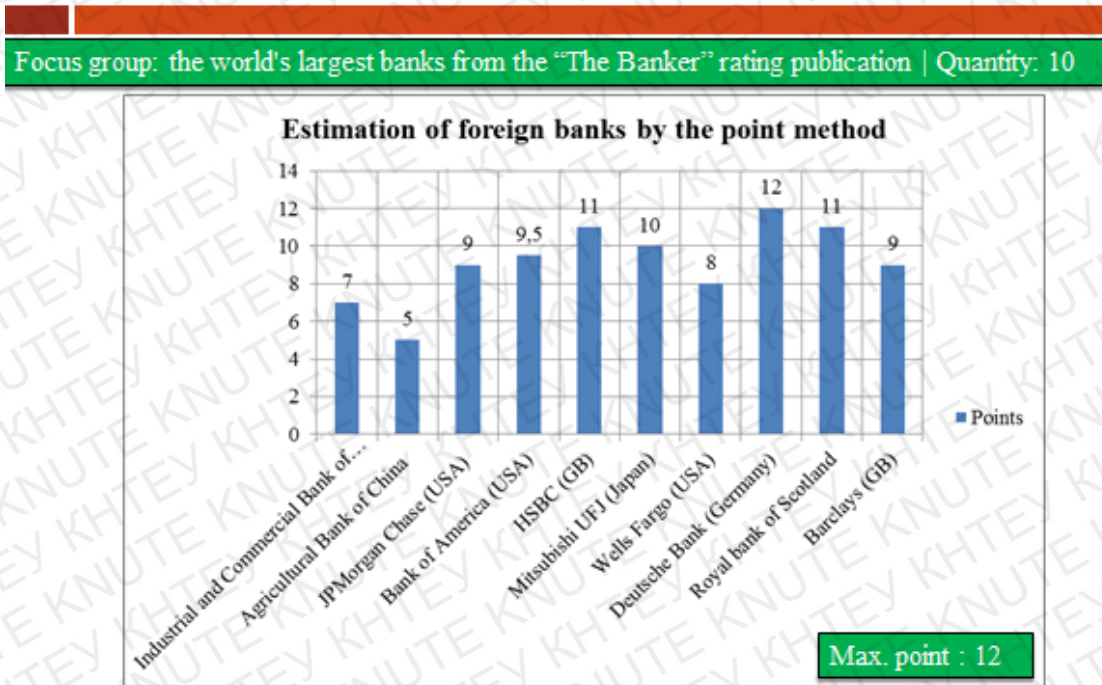


Fig. F.1.7 Presentation for the defense, Slide №7

### Assessing the level of transparency of reputational risk management of Ukrainian banks

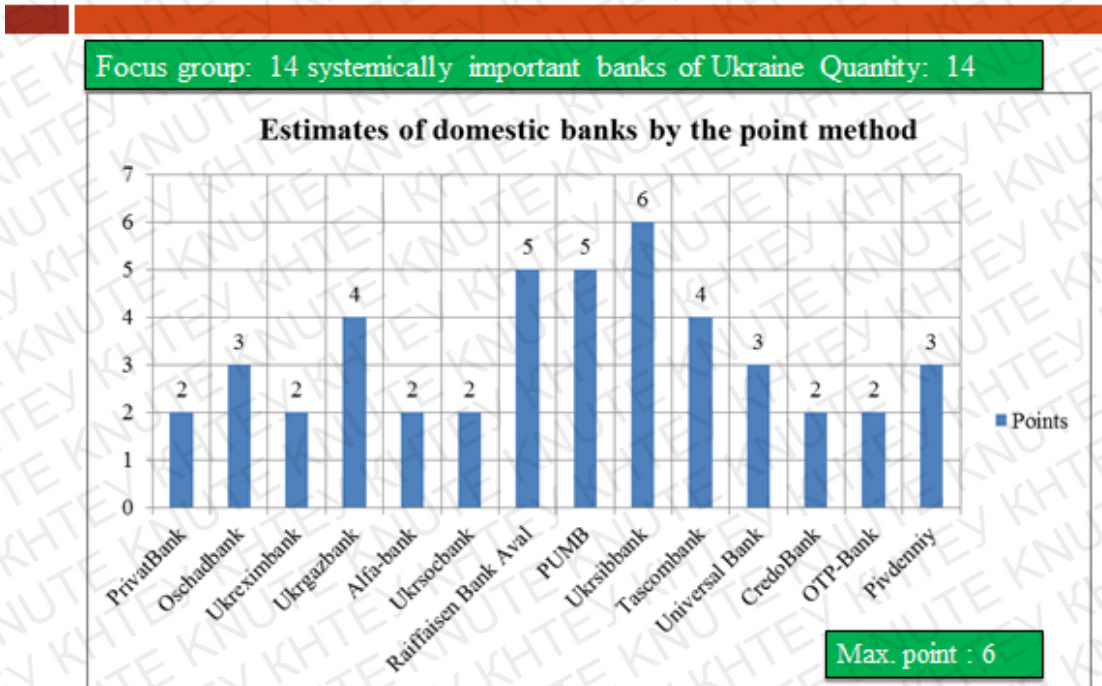


Fig. F.1.8 Presentation for the defense, Slide №8

## Features of transparency of domestic and foreign banks

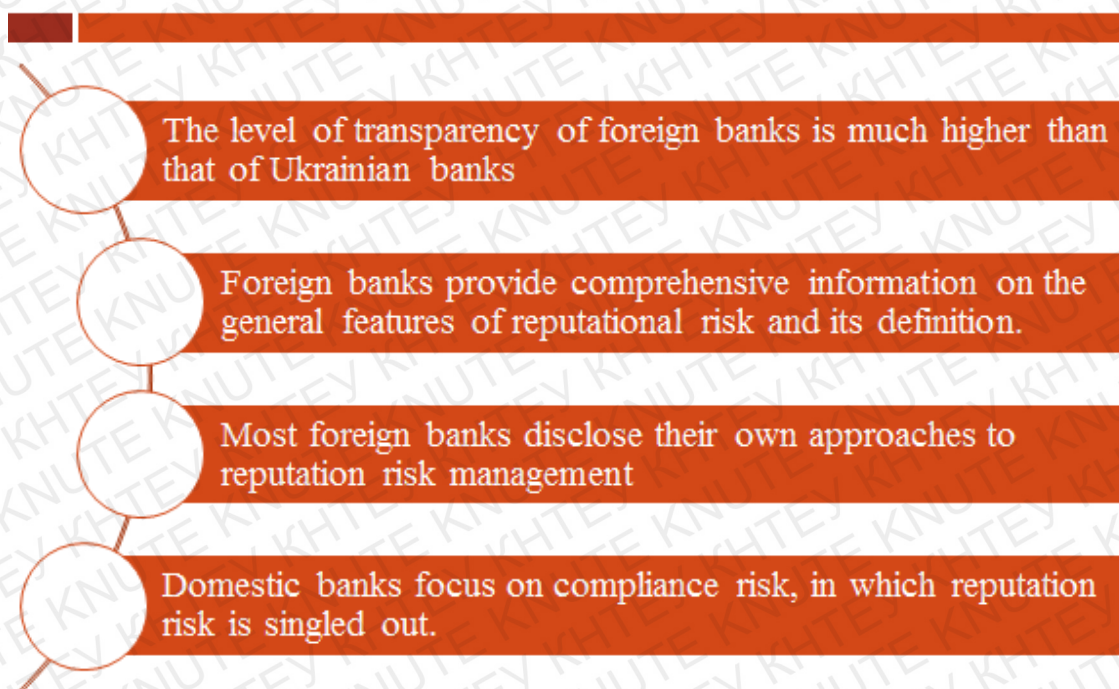


Fig. F.1.9 Presentation for the defense, Slide №9

## Proposals for improving reputation risk management for Ukrainian banks:

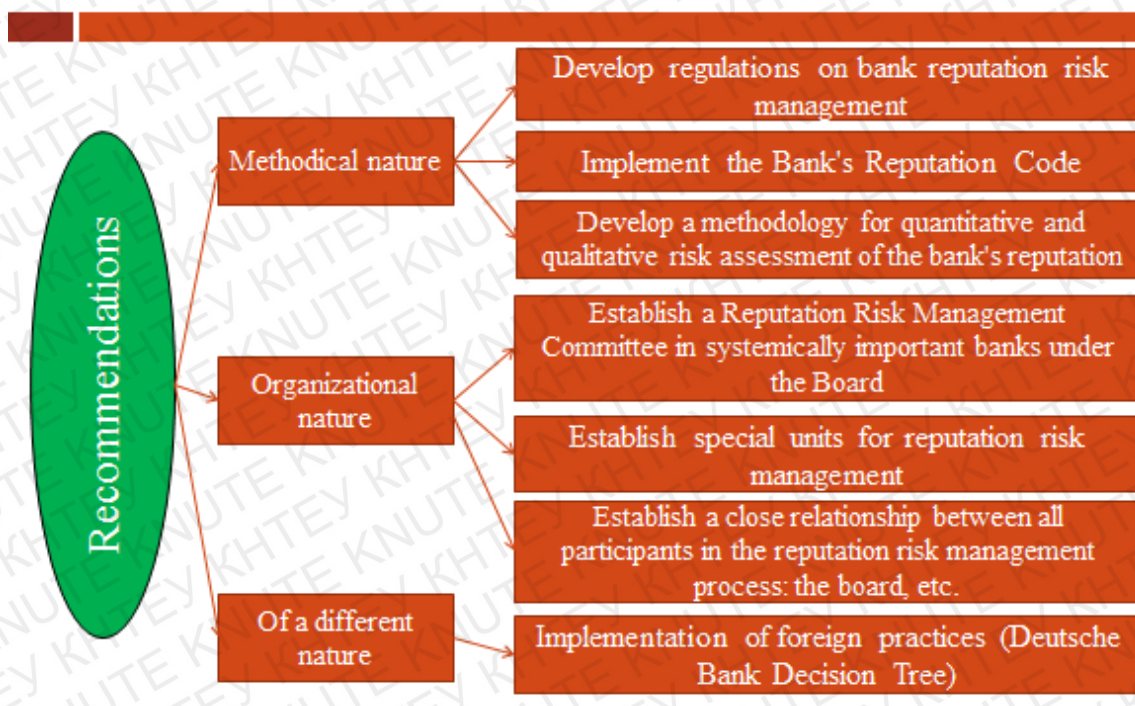


Fig. F.1.10 Presentation for the defense, Slide №10



### An example of a decision tree of the German Deutsche Bank

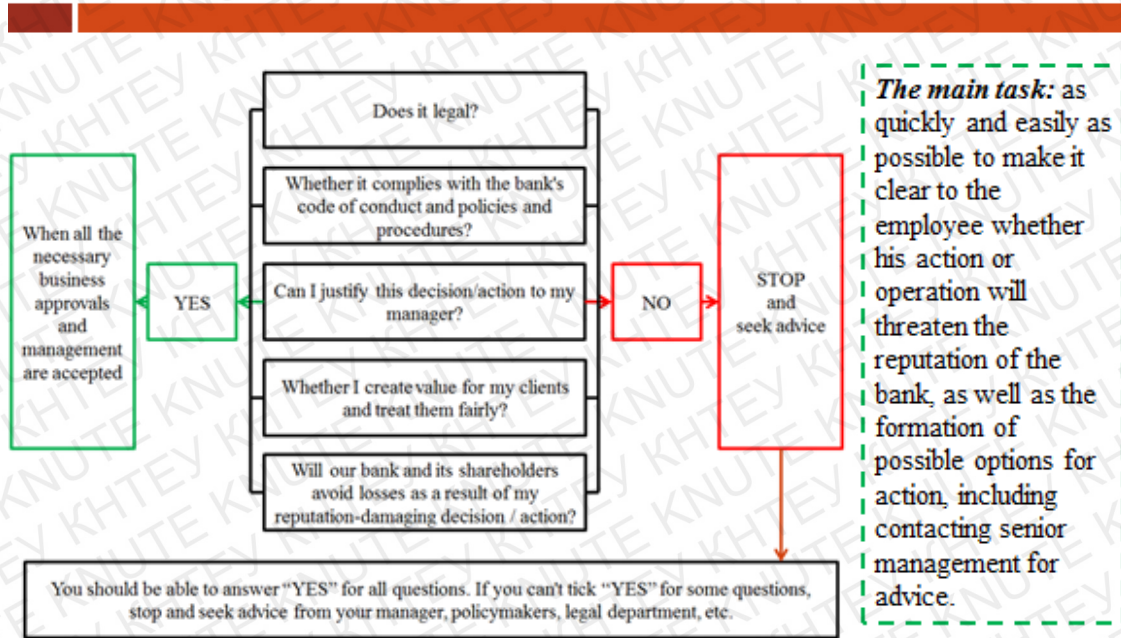


Fig. F.1.11 Presentation for the defense, Slide №11

### Implementation of the Code of Conduct and the Bank's Reputation Code

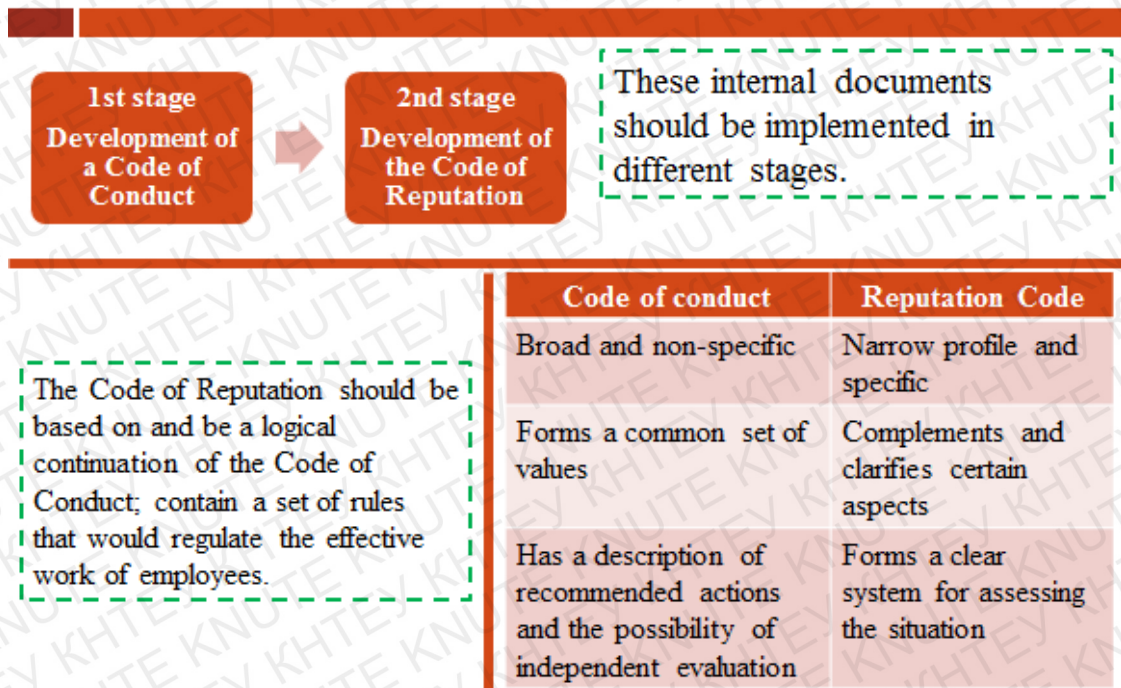


Fig. F.1.12 Presentation for the defense, Slide №12



# THANK YOU FOR ATTENTION!

Fig. F.1.13 Presentation for the defense, Slide №13