BANGKO SENTRAL NG PILIPINAS

OFFICE OF THE GOVERNOR

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Subject : Guidelines on Reputational Risk Management

The Monetary Board, in its Resolution No. 449 dated 08 April 2021, approved the guidelines on reputational risk management for Bangko Sentral Supervised Financial Institutions (BSFIs).

Section 1. Sections 155/151-Q are hereby added to the Manual of Regulations for Banks (MORB)/Manual of Regulations for Non-Bank Financial Institutions (MORNBFI), respectively, to read as follows:

155/151-Q REPUTATIONAL RISK MANAGEMENT

Policy statement. The Bangko Sentral recognizes that building and sustaining a good reputation is a critical element in promoting the safety and soundness of individual supervised financial institutions and the financial system. A good and strong reputation allows Bangko Sentral Supervised Financial Institutions (BSFIs) to strengthen their market position, increase their market value, and enable them to attract and retain employees. This underscores the need for BSFIs to adopt a framework to holistically and actively manage reputational risk.

The guidelines set out the supervisory expectations and the minimum prudential requirements in managing reputational risk. These guidelines are aligned with international standards and recognized practices, to the extent practicable. A BSFI is expected to adopt a reputational risk management framework that is commensurate to its size, nature and complexity of operations, overall risk profile, and systemic importance. The reputational risk management framework shall be embedded in the BSFI's enterprise risk management system.

Definition of reputational risk. *Reputational risk* refers to the risk to earnings, capital, and liquidity arising from negative perception on the BSFI of its customers, shareholders, investors, and employees, market analysts, the media, and other stakeholders such as regulators and other government agencies, that can adversely affect the BSFI's ability to maintain existing business relationships, establish new businesses or partnerships, or continuously access varied sources of funding.

Sources of reputational risk. The BSFI may be affected by perceptions of different stakeholders on its reputation that could be in relation to the areas of corporate and risk governance, personnel/management ethics and integrity, staff competence, organizational culture, business practices, product/service quality, employee and customer relations including the handling of feedback or resolution of complaints, financial soundness/business viability, and legal or regulatory compliance, among others. A clear understanding of the various sources of reputational risk and how these may impact the institution is crucial in determining the appropriate approach to managing reputational risk.

Reputational risk is connected and related to other risk exposures (e.g., credit, market, liquidity, and operational risks) such that it can result from or may be triggered by other types of risks. Exposures to environmental, social and governance (ESG) risk factors, both direct and indirect through its lending and investment decisions, as well as the BSFI impact on ESG factors may likewise have material effect on the BSFI's reputation.

A sound risk management and control environment is critical to mitigating and controlling reputational risk exposures. In this regard, BSFIs are expected to adopt risk management processes following the standards set forth under Chapter E of Part One on *Risk Management, Appendices 69/Q-41* on *Guidelines on Supervision by Risk* and Part X/Part VII on *BSP Regulations on Financial Consumer Protection.*

BSFIs belonging to a conglomerate or group of related entities are susceptible to reputation events[1] affecting the parent bank or holding company, subsidiaries, affiliates and/or other members of the group.[2] For instance, regulatory sanctions imposed on, or concerns on safety and soundness of any member of the group may damage the reputation of the BSFI. In the case of stand-alone BSFIs, the cause of failure of one BSFI may have a crippling or damaging effect for smaller institutions located within the same geographic area or serving the same market as the failed BSFI. The contagion effects on reputation may also arise from business relationships or close association with key customers and counterparties which are engaged in unethical or unlawful acts, or with major service providers that have substandard service quality or lax controls. Other external events, such as unfounded rumors and accusations may likewise have damaging impact on the BSFI's reputation and the level of public confidence. Moreover, social media may accelerate the speed and magnitude of the potential reputational damage.

Sound corporate and risk governance frameworks, and effective internal control system. The establishment of strong corporate and risk governance frameworks, and effective internal control system are the foundation to effectively manage reputational risk. Sound corporate governance fosters a culture where the board of directors/trustees and senior management as well as officers and employees at all levels of the organization, align with the institution's desired values and conduct in pursuing corporate goals and objectives.

In this respect, BSFIs are expected to adhere to the standards set forth under Chapter D of Part One on *Corporate Governance/Corporate Governance Guidelines*, Sec. 142/142-Q on *Risk Governance Framework*, and Sec. 162/162-Q on *Internal Control*

[1] *Reputation event* refers to any incident or circumstance that has the potential to adversely affect the perception of relevant stakeholders of the BSFI. Such critical event, if not responded to quickly and appropriately, may cause damage to the BSFI's reputation and lead to a full-blown crisis.

[2] Part VII of Appendix 71 on *Guidelines on Liquidity Risk Management* requires a bank belonging to a group to assess the possibility of a reputation contagion arising from a liquidity problem in an entity within its group, and to address such inherent vulnerability in its intragroup liquidity risk management system.

Framework. BSFIs shall set out clear objectives and expectations on reputational risk management as well as define the responsibilities of those involved in the risk management process. The reputational risk management framework, and the respective roles and responsibilities of personnel across the organization in terms of implementing such framework shall be disseminated and clearly communicated throughout the institution. BSFIs shall also adopt an effective mechanism to monitor performance and promptly manage reputational risk concerns. BSFIs shall likewise provide adequate training to raise employee awareness and to support them in the proper discharge of their responsibilities relative to the management of reputational risks.

Roles and responsibilities. The responsibility for managing reputational risk rests on the entire organization. Each employee is capable of influencing the stakeholders' perception on the institution through the individual's conduct. Governance and management of reputational risk require clear accountability and engagement across the various organizational functions. In this respect, the roles and responsibilities of the different parties are as follows:

a. *Board of directors/trustees.* The board of directors/trustees shall establish the "tone at the top" and provide adequate oversight on matters relating to the BSFI's strategic direction, key policies, and risk appetite, and overall governance framework. The board of directors/trustees shall ensure that BSFI's reputational risk management is embedded in its enterprise risk management strategy. The board of directors/trustees shall approve the BSFI's reputational risk management framework and ensure that it provides an effective and efficient system for identifying, measuring, monitoring, and controlling reputational risk. The board of directors/trustees shall also ensure that the reputational risk management system is periodically reviewed by an independent and competent party to provide assurance that the controls in place to manage reputational risks are operating as intended.

b. *Senior management.* The senior management shall be responsible for the implementation of the board-approved reputational risk management framework. They shall promote employee awareness of the types of risks or issues that have implications on the BSFI's reputation, the mechanisms in place to report such concerns, as well as the specific reputational risk management tools and processes in place. The senior management shall ensure that the training and communication programs continually emphasize the role of employees in preserving and promoting the BSFI's reputation.

c. *Business units.* As the first line of defense, business line management and personnel shall ensure that all significant risks to the BSFI's reputation in their respective areas are identified and adequately managed. They shall ensure that identified significant risks are reported to senior management in a timely manner. Cognizant that customers are considered as key stakeholders for managing reputational risk, business units shall also ensure that customer perception and expectations are well-managed, and that customer's interest and experience is continuously protected and improved.

d. *Risk management function.* The risk management function/personnel shall be responsible for ensuring the oversight and coordination of reputational risk management efforts across the institution. In particular, it shall provide technical expertise and valuable insights for managing reputational risk allowing the BSFI to appropriately identify and timely respond to uncertainties relating to its business objectives.

e. *Compliance function.* The compliance function shall ensure that a robust compliance system is in place to ascertain that the BSFI conducts business in accordance with relevant laws, rules, regulations and internal policies. It shall identify areas which are likely to lead to incidents or violations that can undermine the institution's reputation.

f. *Internal audit function.* The internal audit function shall provide an independent assessment of the adequacy of the risk management processes and internal control system as well as the effectiveness of actions taken to address material risks affecting the BSFI's reputation. It shall remain abreast of issues affecting the BSFI and its business environment that may impact its reputation (e.g., environmental and social issues), and identify areas that are not being properly managed and, thus, represent threats to reputation. The internal audit function shall also ensure that reputational risks are assessed both at the inherent and the residual levels. It shall timely apprise the board and management of the audit results, including any issues and weaknesses identified, to enable them to take prompt remedial actions, where necessary.

g. *Crisis management team.* The crisis management team (includes the public relations unit or its equivalent) shall be responsible for formulating, implementing, and coordinating the approach to managing a reputation event. It shall determine the appropriate countermeasures depending on the circumstances of the event and actively manage stakeholder communication during a reputational crisis.[3]

Reputational risk management function. The reputational risk management function may be a stand-alone function or integrated with other risk management functions depending on how the BSFI manages its reputational risk exposures considering its size, nature and complexity of operations, overall risk profile, and systemic importance. Notwithstanding the approach adopted, senior management shall ensure that reputational risk within and across the different business lines/functions are properly identified, assessed, monitored, controlled, and reported to the board, as appropriate. Considering that threats to reputation may emanate from various areas, cross-functional teams may be constituted to bring together different perspectives to identify and proactively manage reputational risk across the organization.

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[3] Pursuant to Secs. 149/148-Q on *Business Continuity Management*, members of the crisis management team of BSFIs will convene and activate the crisis management plan to attain control over the crisis and minimize its impact to operations during and immediately after a crisis. For other NBFIs, please refer to Secs. 146-S/143-P/127-N/126-T, as applicable.

In the case of banking groups, the board of the parent bank shall approve the policy defining the reputational risk management framework that shall apply to entities across the group (i.e., established centrally at the parent bank or separately in each of the identified subsidiary). The parent bank shall have overall responsibility with respect to the management of reputational risk exposures of its subsidiaries and affiliates.

Branches of foreign banks may adopt the relevant policies and practices of the head office/regional office that are consistent with applicable provisions in this Section. They are expected to have adequate systems and controls for managing reputational risk and handling local reputation events.

For non-complex or simple banks/finanical institutions[4], the board of directors/trustees and the committee/s in charge of risk management in the organization are expected, at the minimum, to regularly discuss reputational risk concerns as part of the risk universe of the institution. Such discussions, including the decisions/actions taken on matters which may pose reputational risk to the organization, shall be adequately documented in the minutes of meetings.

Reputational risk management framework. A BSFI shall adopt an appropriate reputational risk management framework as part of the enterprise risk management system that is commensurate to its size, nature and complexity of operations, overall risk profile, and systemic importance. The primary objective of sound reputational risk management is to identify potential reputational risks before they materialize or escalate beyond manageable level:

a. *Risk identification and assessment.* Effective risk identification and assessment can disclose significant threats to reputation and identify areas requiring implementation of response plans. Such a process shall aid the board and management in determining whether to implement mitigation.

    (1) BSFIs shall identify the potential sources of reputational risk exposures. These shall include, among others, the business lines, liabilities[5], affiliated operations, off-balance sheet vehicles, and the markets where they operate. Consumer complaints also provide valuable insights into areas representing consumer protection risks and potential regulatory violations which may damage the BSFI's reputation. The established key sources of risk may be categorized according to the type of risk, business activity, and/or the area of operations.

    (2) BSFIs shall adopt tools and mechanisms proportionate to their size, nature and complexity of operations, overall risk profile, and systemic importance to

[4] For this purpose, banks shall refer to Sec. 131 on *Corporate Governance (Policy statement and definition of terms)* on the definition of "Complex banks". Meanwhile, NBFIs shall be classified as "Simple" unless notified by the Bangko Sentral of a higher classification.

[5] This refers to liabilities arising from failure to meet regulatory or legal obligations, such as noncompliance with applicable laws and regulations, gross misconduct of employees or senior management, failure to adequately meet customer expectations, and contractual requirements, among others.

identify and assess significant threats to reputation. The tools may be in the form of interviews, surveys or questionnaires, focus group discussions, self-assessment or other techniques as deemed appropriate to suit the needs of the organization.

Considering that reputational risk is inherent in all the risks an institution faces, BSFIs may use existing measures or tools to identify and assess reputational risks relevant to their business and industry. For instance, the identification and assessment of reputational risk can be linked to the tools and instruments used for operational risk but modified accordingly to capture reputational risk issues and concerns. Sample tools which may be considered to identify possible reputation events and to assess/measure their potential impact are provided in Appendix 146/Q-89 (*Annex A of this Circular)*.

BSFIs with simple operations are not expected to adopt sophisticated tools but they should be able to demonstrate that their reputational risk management incorporates the critical elements set out in these guidelines. At the minimum, simple BSFIs should be able to identify which issues or events will effectively undermine their reputation as well as the affected key stakeholders, and gauge the effect or consequence on their overall reputation. These reputation issues or events may be identified from the tools used in identifying and assessing their operational risk exposures: the (i) results of internal/external audit and independent party review, (ii) supervisory issues raised by the Bangko Sentral, or (iii) internal loss data collection and analysis.

(3) BSFIs shall have appropriate policies in place to identify sources of reputational risk when entering new markets, products or lines of activities, or establishing new business relationships including, among others, policies, programs and controls to address fraud or gross misconduct, and manage consumer complaints.

(4) BSFI shall incorporate the identified sources of reputational risk in the risk management processes and appropriately address the same in the internal capital adequacy assessment/capital planning process and liquidity contingency plans.

(5) BSFIs shall have appropriate procedures in place to ensure that the identified reputational risks are regularly reviewed and updated and that no major risk areas affecting reputation are inadvertently excluded.

b. *Risk control and mitigation.* BSFIs shall determine the appropriate measures to control and/or mitigate the impact of identified risks considering the results of risk assessment. In particular, BSFIs shall ascertain which of these risks warrant management attention and require either the crafting of a specific action plan (e.g., need to adopt additional controls or to strengthen existing controls), the development of a contingency plan, or close monitoring.

c. *Risk monitoring and reporting*. BSFIs shall ensure that sufficient mechanisms are in place to monitor reputational risk across the different business lines and functions. Such a process shall enable the board and management to address any significant issues and developments.

To ensure that identified risks are properly controlled, the progress and effectiveness of measures implemented should be periodically monitored. Early warning systems should also be established to detect emerging threats and ensure that corrective actions are carried out in a timely manner. Sample early warning indicators include volume of complaints, number of negative news on the institution, number of violations of laws/regulations/ codes of conduct with material penalties or sanctions for non-compliance. BSFIs may also include reputation concerns in their risk appetite frameworks to facilitate setting of thresholds against relevant indicators.

Results of monitoring activities shall be regularly reported to the board and senior management in a timely manner and in sufficient detail to aid in their decision-making.

BSFIs are expected to promptly notify the Bangko Sentral of any reputation event which may have a significant impact on their business or reputation and/or is likely to lead to a crisis. In this regard, BSFIs shall ensure compliance with the notification/reporting requirements under Secs. 146/146-Q on reportable operational risk events, Secs. 148/147-Q on major cyber-related incident and/or disruption of financial services and operations, and Secs. 145/145-Q *(Supervisory framework for the minimum prudential liquidity requirements)* on liquidity ratios below the minimum.[6]

Apart from above notification requirements, BSFIs are also expected to notify the appropriate supervising department of the Bangko Sentral within five (5) calendar days from the date of determination of any reputation event (e.g., issues arising within the various social media platforms). Upon receipt of notification, the Bangko Sentral may require, if warranted, the BSFI to submit a report detailing the causes and impact of such events and an action plan to address the issue and any other weaknesses identified.

d. *Communications and disclosure*. Effective communications with stakeholders are vital in addressing reputational risk. Communication instruments include, among others, annual reports, website information, press releases, investor briefings, stakeholder forums, annual general meetings, media interviews, and social media platforms.

[6] For other NBFIs, please refer to Secs. 125-T/125-N on reportable operational risk events, and to Secs. 142-P/145-S/126-N on major cyber-related incident and/or disruption of financial services and operations, as applicable.

BSFIs shall ensure the reliability, integrity and transparency of publicly reported information by maintaining effective internal control over financial reporting and information disclosures. Disclosure documents containing misleading or inaccurate statements, whether intentionally or inadvertently, may cause serious damage to reputation. Thus, there shall be adequate policies and procedures in place to ensure that all disclosures to stakeholders are clear, accurate, consistent, relevant and timely.

With the significantly increasing influence of social media, BSFIs are expected to immediately and effectively address issues and complaints consistent with their social media crisis management plan and escalation procedures as required under Sec. 150/149-Q on *Social Media Risk Management*.

Crisis preparedness and resolution. The manner by which BSFIs handle a reputation-damaging incident or crisis determines the magnitude and duration of the impact. Poor or delayed response to a crisis can increase reputational damage than the event itself, and possibly lead to a liquidity crisis and/or major disruptions to operations. Meanwhile, effective and timely crisis management arrangements, including stakeholders and media communications, could quickly allay stakeholder fears, regain their trust, and even enhance reputation.

A well-documented crisis management plan shall be approved by the board of directors/trustees and subjected to periodic review and updating to ensure that it remains relevant. Post-crisis measures to restore stakeholders' confidence shall depend, among others, on the underlying cause of the incident, the extent of reputational damage, and the BSFI's direction and business objectives. In this regard, BSFIs shall take into account relevant guidance set out under Secs. 149/148-Q[7] on *Business Continuity Management,* and consider how the expectations under this Section may be integrated with their existing business continuity and contingency plans.

Supervisory enforcement actions. Consistent with Secs. 002/002-Q[8], the Bangko Sentral reserves the right to deploy its range of enforcement actions to promote adherence with the requirements set forth in this Section and bring about timely corrective actions. The Bangko Sentral may issue directives to improve the reputational risk management system or impose sanctions on the BSFI and/or its directors, officers and/or employees.

Section 2. Sections 148-S/145-P/128-T/129-N are hereby added to the MORNBFI to read, as follows:

148-S/145-P/128-T/129-N REPUTATIONAL RISK MANAGEMENT

The guidelines on reputational risk management for QBs under Sec. 151-Q shall govern the reputational risk management of BSFIs to the extent applicable.

[7] For other NBFIs, please refer to Secs. 143-P/146-S/126-T/127-N, as applicable.
[8] For other NBFIs, please refer to Secs. 002-P/002-S/002-T/001-N, as applicable.

The guidelines set out the supervisory expectations and the minimum prudential requirements in managing reputational risk. A BSFI is expected to adopt a reputational risk management framework that is commensurate to its size, nature and complexity of operations, overall risk profile, and systemic importance.

Section 3. Transitory Provision. The following is to be incorporated as a footnote to Sections 155/151-Q of the MORB/MORNBFI on *Reputational Risk Management.*

BSFIs shall comply with the foregoing standards on reputational risk management within a period of one (1) year from the effectivity of this issuance. In this regard, a BSFI should be able to show, upon request of the Bangko Sentral, its plan of actions with specific timelines, as well as the status of initiatives being undertaken to fully comply with the provisions of this Section.

Section 4. This Circular shall take effect fifteen (15) calendar days following its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:

BENJAMIN E. DIOKNO
Governor

16 April 2021

REPUTATIONAL RISK MANAGEMENT TOOLS FOR IDENTIFICATION AND ASSESSMENT

(Appendix to Secs. 155/151-Q on Reputational Risk Management)

The Bangko Sentral Supervised Financial Institutions (BSFIs) may employ any or a combination of the following tools in identifying and assessing reputational risk:

1. *Internal expert judgments* – Self-assessments or in-depth interviews with the institution's area experts (e.g. C-suite or senior executives) provide an inside-out view of the major enterprise strategies and risks, vulnerability points, as well as threats and opportunities including competitive positioning and industry pressures.

2. *Stakeholder analysis* – Stakeholders' perceptions and expectations are considered leading drivers of reputation. Stakeholder analysis involves the identification of key stakeholders in terms of their influence and impact on the institution's business and reputation. These critical stakeholders provide an outside-in perspective of their demands and expectations, and allow the institution to gauge the likely impact of the stakeholders' adverse reaction should these concerns not be met. The report may also flag interconnected threats across the various stakeholder groups, which individually may seem insignificant, but when viewed together require action. As stakeholders' concerns and expectations are evolving, regular monitoring should be conducted to account for emerging issues or threats.

3. *Reputational risk and control assessment* – This tool can be used to identify, categorize and rank the potential threats based on the likelihood that the reputational risk will materialize and the estimated impact. Such an assessment tool looks into the root causes of the risk, the controls in place to mitigate such risks, the effectiveness of such controls, and any resulting residual risk exposure. The past experience of similar institutions and the changes within the institution (e.g. personnel, system, or structural changes) as well as in the external environment should be taken into account in assessing the likelihood and impact of identified reputational threats. The determination of whether the controls are effective shall consider the internal and external audit reports, compliance reports, and management exception reports, among others.

   The outcome of the reputational risk and control assessment may be documented using the following:

   a. *Risk register* – A risk register provides a comprehensive view of the status and materiality of the identified risks which may impact the organization's reputation as well as the response actions taken. This aids in risk prioritization and allows for an in-depth understanding of the drivers, impacts, and vulnerabilities. At the minimum, details for each identified risk include the following:

i. risk category to group similar risks;
ii. risk description;
iii. root causes of the risk or the core issue(s) involved;
iv. existing controls to manage the risk and their effectiveness;
v. risk assessment on the likelihood and impact on the institution's reputation;
vi. designated risk owner; and
vii. response plan and agreed actions.

b. *Risk heat map* – A risk heat map or matrix is used to visualize and communicate the outcome of a risk assessment process. In particular, this tool aids in contrasting and prioritizing risks by categorizing the likelihood and impact of identified risks.

4. *Stress-testing* – The impact of stress scenarios to all material risk factors, including reputational risk, should be taken into account. Reputational risk scenarios should be included in the stress testing procedures to obtain a firm understanding of the effect of reputational risk in terms of other risk types (e.g. credit, liquidity, market or operational risk), and the possible second round effects. BSFIs should measure the reputational risk impact, including the amount of implicit support of securitizations or losses that might be sustained under adverse market conditions. In assessing the potential amount of the impact, both the on- and off-balance sheet exposures shall be considered. In this regard, banks, including material NBFIs are expected to adhere to the standards set forth under Sec. 151 on the *Guidelines on the Conduct of Stress Testing Exercises*. Similarly, NBFIs may refer to such guidelines in their conduct of stress testing taking into account the nature, size and complexity of their operations. The results of the stress testing shall feed into the internal capital adequacy assessment/capital planning process of BSFIs.

5. *Risk sensing* – This can be embedded into an organization's risk governance program to allow continuous identification of emerging threats as well as to complement crisis management response. Such a program may require human- and technology-enabled functions to facilitate data analysis and interpretation as inputs to business decisions.

   Listening posts is a form of risk sensing program which uses advanced technology to gather the opinion of stakeholders as well as detect and track trends by selectively scanning the internet and social media for risk indicators, emerging risks and potential risk events. These include blogs, interviews, industry fora, academic papers, media commentaries and other social media and news sources. Listening posts can also be used to monitor changes in the customers and employees' sentiments and regulatory expectations. In this respect, BSFIs are expected to comply with the standards under Secs. 150/149-Q[1] on *Social Media Risk Management*.

[1] For other NBFIs, please refer to Secs. 144-P/147-S/127-T/128-N, as applicable.